FINANCIAL RESPONSIBILITY IN EUROPEAN INTERNATIONAL INVESTMENT POLICY

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Abstract EU Financial responsibility resulting from investor-state arbitration is a politically sensitive topic that is currently shaping the emerging European international investment policy. What level of protection can foreign investors be granted in future EU investment treaties without compromising EU 'policy space'? How much review of its regulatory powers by arbitral tribunals, rather than by the CJEU, is the EU willing to accept? Taking the Commission's recent draft Regulation on managing financial responsibility as the starting point, this article analyses the implications that future EU investment agreements may have for the existing safeguards balancing private and public interests in EU law. It discusses the different policy choices in the light of fears that investment treaties may affect the EU policy space. A more scientific and sustainable approach is then suggested for ensuring that future EU agreements provide sufficient clarity regarding the outer bounds of financial responsibility and criteria for liability with the aim of maximizing legal certainty for both investors and host states.

Keywords: investment treaties, state liability, EU law, comparative public law, EU law, investment arbitration, investment treaties, state liability.

I. INTRODUCTION

In June 2012, the European Commission presented its proposal for an EU Regulation 'establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is a party'.[1] This is a further step in defining the emerging European international investment policy, clearing the path for the upcoming—and partially already ongoing—replacement of EU

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[1] Proposal for a Regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is a party (21 June 2012), COM(2012) 335 final, 2012/0163 (COD).

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Member States' bilateral investment treaties (BITs) with EU agreements with non-EU countries on the protection of foreign investments.

This article analyses the broader implications of financial responsibility under future EU international investment agreements, beyond the mere technical allocation of liabilities and competences as among the EU and its Member States. The financial responsibility in question concerns awards that might be rendered by arbitral tribunals against the EU or its Member States. It results from arbitrators affirming liability based on an assessment that the regulatory treatment afforded to a non-EU investor was in some way unlawful. Whether the treatment was lawful under EU law, which is itself designed to remove undue public interference with private cross-market transaction (including investments) is not decisive. Such financial responsibility is for treatment which is unlawful under EU investment treaties that confer special jurisdictional and substantive rights to foreign investors.

This article first sketches the background and the context of the debate, highlighting the potential interference of investment treaty law with EU law aimed at ensuring the effective operation of the Internal Market (Section II). The article then turns to the assumptions underlying the emerging European investment policy, which are by no means unproblematic since they potentially open the door to significant changes to the principles of EU liability as elaborated by the Court of Justice of the EU (CJEU) (Section III). It becomes clear that the European institutions cannot avoid making fundamental policy choices concerning the extent to which they are willing to see future investment agreements deviate from existing standards under EU law (Section IV). The simple transposition of the conventional vague standards of investor protection in the existing BITs of the Member States is not an option if investment treaty law is to be taken seriously by the EU, as shown by the most recent shift in the European Parliament. The insertion of investor-state arbitration in EU investment agreements should not be undertaken automatically but consciously determined in the light of the circumstances of each negotiation. Future EU investment treaties should not allow the circumvention of the safeguards established by the CJEU for shielding the Union's legislative powers to regulate economic activity in the Internal Market. They should be framed carefully so as not to upset the general balance of private and public interests struck by EU law when guaranteeing investment-related freedoms in Europe to domestic and foreign investors. The article concludes by summarizing the findings and making a case for a slower and more sophisticated approach to the elaboration of future EU investment treaties (Section V). Rather than approaching the risks of uncontrolled adjudication of disputes by arbitral tribunals only through unilateralist attempts to impose EU law standards as a cap to future EU international investment obligations, it would be more coherent and sustainable to elaborate detailed principles of investor protection. These may be formed by synthesizing the comparative public law experience of the countries with the highest level of investment protection and the proper

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balancing of private and public interests. It is argued that this is the only means for taking seriously what is the ultimate justification of investment treaty law: legal certainty.

II. BACKGROUND AND RELEVANCE

A. The Emerging EU International Investment Policy and Its Current Implementation

The Commission's 2010 communication 'Towards a uniform European international investment policy' initiated the institutional discussion in this new field of EU law,[2] laying out its position regarding the new regime of international investment rules. This became necessary as the Union had newly obtained the exclusive competence for foreign direct investments as part of the common commercial policy as redefined by the Treaty of Lisbon, which entered into force in 2009.[3] Together with its communication, the Commission submitted a proposal for a Regulation on transitional arrangements for existing bilateral investment agreements between Member States and third countries.[4] This led to extensive and heated discussions and negotiations within, and between, the European institutions before the considerably amended regulation finally came into force in December 2012.[5]

Parallel to these internal negotiations, the Commission sought and obtained a mandate from the Council to start negotiations of investment chapters in the context of free trade agreements with Canada, India and Singapore.[6] The negotiations with Canada over a Comprehensive Economic and Trade Agreement (CETA) have now led to a political agreement, although details still remain to be determined.[7] The main focus of attention, however, is on the even more ambitious project of negotiating a Transatlantic Trade and Investment Partnership (TTIP) with the United States of America.[8] Negotiations of a bilateral investment treaty (BIT) with China are also imminent.[9]

[2] COM(2010) 343 final.

[3] Art 3(1)(e), 206, 207(1) TFEU.

[4] COM(2010) 344 final.

[5] Regulation (EU) 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, [2012] OJ L 351/40 (12 December 2012).

[6] See the leaked mandates approved by the Council at its 3109th meeting, 12 September 2011: <http://www.s2bnetwork.org/themes/eu-investment-policy/eu-documents/text-of-the-mandates.html>.

[7] 'EU and Canada Strike Free Trade Deal', European Commission press release (18 October 2013) <http://trade.ec.europa.eu/doclib/press/index.cfm?id=973>.

[8] 'Statement from United States President Barack Obama, European Council President Herman Van Rompuy and European Commission President José Manuel Barroso', European Commission memo (13 February 2013) <http://europa.eu/rapid/press-release_MEMO-13-94_en.htm>; see also (nn 13 and 14).

[9] 'Commission Proposes to Open Negotiations for an Investment Agreement with China', European Commission press release (23 May 2013) <http://trade.ec.europa.eu/doclib/press/index.cfm?id=900>.

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In the internal negotiations over the first international investment Regulation, the Member States obtained—and the Commission ultimately accepted—a significant reduction of the Commission's power as compared to the original proposal, in particular concerning the scrutiny of the Member States' existing investment treaties. During the negotiations in the Parliament, a mechanism for ensuring the compatibility of existing treaties with European policies on investments has already been taken out of the Regulation's text.[10] The final text of the Regulation, which assures the continuation in force of all existing investment treaties of the Member States until they are superseded by new agreements negotiated by the Union with third countries, provides that these future EU agreements shall provide 'for high standards of investment protection'.[11]

In its mandate given to the Commission for negotiating free trade agreement (FTA) investment chapters with Canada, India and Singapore, the Council insisted that such agreements 'shall provide for the highest possible level of legal protection and certainty for European investors' and stipulated that 'its respective provisions shall be built upon the Member States' experience and best practices regarding their bilateral investment agreements'.[12] The same language can be found in the latest Commission's draft mandate for negotiating the TTIP.[13] The final report of the EU-US High Level Working Group that initiated the TTIP process went as far as recommending 'that a comprehensive U.S.-EU trade agreement should include investment ... protection provisions based on the ... highest standards of protection that both sides have negotiated to date'.[14]

B. The Impact of Investment Treaty Law on the Internal Market

Before entering into the merits and the implications of such escalating statements about how future investment agreements of the EU should look, it is worth considering the impact that investment treaties can have on European

[10] For more detail see J Kleinheisterkamp, 'European Policy Space in International Investment Law' (2013) 27(2) ICSID Review 416–31.

[11] Recital 6 of Regulation (EU) No 1219/2012 (n 10); on the background of this recital see Kleinheisterkamp (n 10) 427–8.

[12] Art 3A of the negotiating mandate given by the Council to the Commission (n 6). See also 'Facts and Figures of the EU-Canada Free Trade deal', European Commission press release (18 October 2013), <http://trade.ec.europa.eu/doclib/press/index.cfm?id=974>, affirming that the investment protection provisions in CETA will be 'in line with EU Member States best practices in their existing [BITs]' but also that 'at the same time, [they] fully preserve the right of the parties to regulate and implement their public policy objectives'.

[13] See the leaked 'Recommendation for a Council Decision authorising the opening of negotiations on a comprehensive trade and investment agreement, called the Transatlantic Trade and Investment Partnership, between the European Union and the United States of America' COM (2013) 136, 12 March 2013, <http://www.s2bnetwork.org/fileadmin/dateien/downloads/EU_Draft_Mandate_-_Inside_US_Trade.pdf> (Annex section 15).

[14] Final Report of High Level Working Group on Jobs and Growth, 11 February 2013, <http://trade.ec.europa.eu/doclib/docs/2013/february/tradoc_150519.pdf>.

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law and especially on the functioning of the Internal Market. The *prise de conscience* of the potential for conflict dates back to 2003, when the European Commission had to negotiate safeguards for the new Central and Eastern countries with the US and Canada. These countries were about to accede to the (then) European Community and its complex Internal Market rules, the *acquis communautaire*. In order to attract foreign investments after the implosion of Communism, they had all previously entered into BITs with important economies such as Canada, the US, and the old European Member States (which, with accession, became the highly problematic intra-EU BITs). It had become clear—and subsequently became even clearer—that the new Member State's obligations and their resulting liability under the BITs could clash with their obligations under the EU Treaties in numerous ways:[15] unqualified capital transfer guarantees in BITs are incompatible with the regulatory powers and the policy space that the EU Treaties reserved to the Council of the EU;[16] national treatment and most-favoured-nation (MFN) treatment may collide with EU and Member State restrictions on market freedoms for the purposes of public policy, security or health;[17] the prohibition of performance requirements in BITs conflict with agricultural policies and cultural exceptions (excluded from the TTIP negotiations at the insistence of France[18]);[19] the continuation in force of Member States' BITs alongside EU trade agreements with the same country would undermine the balance struck in those trade agreements and create discrimination among EU nationals investing abroad;[20] the fair and equitable treatment (FET) standard in BITs also could potentially clash with EU state aid law and rules on market liberalization.

The impact of investor rights on the functioning of the Internal Market can best be illustrated by a case decided by the CJEU itself rather than by arbitral tribunals. In the *ATEL* case,[21] the Commission had brought infringement proceedings against Slovakia for violations of its obligations under Directive 2003/54/EC concerning common rules for the internal market in electricity. Slovakia had refused to force its national power utility to terminate a contract

[15] See in more detail A Radu, 'Foreign Investors in the EU – Which ''Best Treatment''? Interaction between Bilateral Investment Treaties and EU Law', (2008) 14 ELJ 237; also J Kleinheisterkamp, 'Investment Protection and EU Law: The Intra- and Extra-EU Dimension of the Energy Charter Treaty' (2012) 15(1) Journal of International Economic Law 85, 87–8, 89–95.

[16] See especially ECJ Cases C-205/06 *Commission v Austria* [2009] ECR I-1301; C-249/06 *Commission v Sweden* [2009] ECR I-1335; C-118/07 *Commission v Finland* [2009] ECR I-10889.

[17] See in more detail Kleinheisterkamp (n 10); see also art 65(1)(b) and (2) TFEU.

[18] 'European Commissioner for Trade Karel De Gucht on the Transatlantic Trade and Investment Agreement: The cultural exception is not up for negotiation!', European Commission press release (22 April 2013) <http://trade.ec.europa.eu/doclib/press/index.cfm?id=890>.

[19] For a more detailed discussion of EU legislation denying of national treatment to investors from third countries, see R Torrent, 'The Contradictory Overlapping of National, EU, Bilateral and Multilateral Rules on Foreign Direct Investments: Who Is Responsible for the Mess?' (2011) 34 Fordham International Law Journal 1377, 1378–83.

[20] Kleinheisterkamp (n 15) 94–5.

[21] Case C-264/09 *European Commission v Slovak Republic, ATEL* [2011] ECR I-8065.

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with ATEL, a Swiss investor, who had been granted priority transmission rights for 16 years on a power line from Poland in return for building it and financing 50 per cent of the costs. Slovakia argued that this was not a contract for preferential access but an investment contract, with the consequence that it was bound by its obligations under the Energy Charter Treaty (ECT) and under the Slovak–Swiss BIT to respect the Swiss investor's right to fair and equitable treatment and protection against expropriation. The Commission argued that there was no incompatibility between the ECT or BIT provisions and EU law and that EU law in fact provided a precise legal justification for enforcing the termination of the agreement without breaching investor rights. Slovakia insisted that what the Commission requested was an interference with a private contract and would violate the investor's right under international law.

It is interesting to note that Advocate General Jääskinnen merely considered that 'EU energy law cannot be considered as failing to achieve the standards required by the ECT' and that 'the general level of protection of fundamental rights provided by EU law affords protection to investors which fulfils the obligations resulting from the ECT'.[22] He then merely focused on the BIT, as did the Court with the somewhat surprising justification that 'since the Swiss BIT relates directly to investment protection'.[23] More crucially, both the AG and the Court came to the conclusion that Slovakia would breach both the FET and the expropriation provisions of the Swiss BIT if it were to comply with the Commission's demands to obtain the termination of the contract, which did not contain a termination clause. On this basis, the Court dismissed the Commission's action because (what is now) Article 351(1) TFEU clarifies that Slovakia's obligations under international law assumed prior to its accession to the EU 'shall not be affected by the provisions of the Treaties'.[24]

The Court's conclusion seems straightforward.[25] But it is difficult not to hesitate before reaching it—as did AG Jääskinnen: 'Even though the application of Article [351 TFEU] justifies such an outcome, it seems to sit at odds … with the idea of market liberalisation that Directive 2003/54 aims to promote.'[26] The AG overcame his hesitations by trying to reassure himself that the outcome would not be incompatible with the derogation provisions of the Directive and that 'the present case does not pose a threat to market liberalisation since ATEL is a third country company, not an incumbent monopoly, with a right that was acquired prior to Slovakia's accession, fixed in time and not renewable'.[27] The Court preferred to remain silent on these points and with good reason: the first reassurance can hardly be squared with the clear case law —affirmed also by the AG—that, in the absence of a derogation granted by the Commission, privileged access always constitutes discrimination against other

[22] Opinion AG Jääskinnen, [2011] ECR I-8067, para 63.

[23] *ATEL* (n 21) para 30.

[24] ibid, paras 50–51.

[25] But see the criticism by A Boute, Case C- 264/09, *Commission v Slovakia*, with annotation (2012) CMLRev 1179, 1184–96.

[26] Opinion AG Jääskinnen (n 22) para 109.

[27] ibid, paras 109–110.

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market operators and is thus prohibited;[28] the second reassurance is highly questionable in light of the 16-year duration of the priority access and, moreover, because the regulatory emphasis is not on the privilege to the investor but on the resulting discrimination against the (EU) competitors.

This remaining unease reflects the realization of the radical consequences that the applicability of the investment treaty has for the EU regime liberalizing the electricity market—and that investment treaties in general potentially have for the Internal Market altogether. As questionable as the AG's and the Court's justifications may be, this case shows that the applicability of the investment treaty (under Article 351(1) TFEU) justifies reaching an outcome that, in the Court's eyes, is clearly incompatible with EU law. The mere fact that an economic actor comes from outside the EU and is therefore entitled to invoke the rights of a treaty concluded between a Member State and its home country may entitle it to keep a substantial benefit that constitutes discrimination as regards its EU competitors and is therefore prohibited under the applicable EU legislation designed precisely to eliminate discrimination and establish a level playing field. This outcome is nothing short of extraordinary if one remembers the very essence of EU law orthodoxy as laid down emphatically in *Costa v ENEL*:

> The executive force of Community law cannot vary from one state to another in deference to subsequent domestic law, without jeopardizing the attainment of the objectives of the Treaty ... and give rise to the discrimination prohibited [by the Treaty]... [T]he law stemming from the Treaty, an independent source of law, could not, because of its special and original nature, be overridden by domestic legal provisions, however framed, *without being deprived of its character as Community law and without the legal basis of the Community itself being called into question*.[29]

Of course, in the *ATEL* case, the application of EU law was not overridden by domestic legal provisions but by the Treaty itself in Article 351(1) TFEU. In principle, it should not make any difference at all whether the problematic legal provisions of the Member State are of domestic or international origin; but whereas conflicts of application between domestic provisions and EU law necessarily have to be resolved in favour of the latter, the primacy of EU law is suspended when a Member States' pre-existing obligations under international law conflict with EU law. This, however, cannot mean that the principle of the primacy of EU law is compromised by this exception. Article 351(2) TFEU clarifies the merely temporary nature of the suspension of the primacy of EU law: 'To the extent that such [pre-accession] agreements are not compatible with the [EU] Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established.'

[28] See Case C-17/03 *VEMW* [2005] ECR I-4983, paras 63, 71; see also Case C-439/06 *Citiworks AG v Flughafen Leipzig/Halle GmbH* [2008] ECR I-3913, para 55.
[29] Case 6/64 *Costa v ENEL* [1964] ECR 585 (emphasis added).

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Again, *ATEL* is an excellent illustration of the concretization of the general duty of sincere cooperation in Article 4(3) TEU.[30] The Court specifically stated that the application of the rules of the internal market in electricity was incompatible with the Swiss–Slovak BIT. This can only mean that Slovakia has a duty to renegotiate this BIT so as to accommodate the full effect of the Directive in question in order to ensure that such a situation would not arise again. But this means that Slovakia would have to renegotiate *all* its BITs so as to ensure full effect of the Directive—and, moreover, to ensure full effect of *all* EU internal market rules. Taking this logic to an extreme, would not *all* Member States have to renegotiate all their BITs so as to ensure full effect of all of EU Law?

One starts to sense that the first BIT judgments of the CJEU against Austria, Sweden and Finland in 2009 were not just a lonely polar bear on a melting floe but the tip of a rather huge iceberg.[31] These cases clearly showed that the Commission can successfully bring infringement proceedings under Article 258 TFEU against Member States that refuse or fail to renegotiate their BITs in compliance with Article 351(2) TFEU. But it is also worth noting that the Commission has a legal *duty* under Article 17(1) TEU to ensure 'the application of the Treaties, and of measures adopted by the institutions pursuant to them'.[32] This means that the Commission's failure to act against Slovakia or any Member State in this situation would entitle the European Parliament to bring an action—or entitle even a natural or legal person to bring a complaint—against the Commission before the Court of Justice by virtue of Article 265 TFEU.

The solution to the problem of eliminating incompatibilities between BITs and EU law is simple, at least in theory. As a consequence of Article 351(2) TFEU, it is necessary to include broad Regional Economic Integration Organisation (REIO) clauses so as to exempt all government action related to the implementation or application of EU law from the scope of the BITs. These would be similar to—but more sweeping than—the carve-outs negotiated by the Commission for the new Member States with the US and Canada

[30] Art 5(3) TEU: 'Pursuant to the principle of sincere cooperation, the Union and the Member States shall, in full mutual respect, assist each other in carrying out tasks which flow from the Treaties.

The Member States shall take any appropriate measure, general or particular, to ensure fulfilment of the obligations arising out of the Treaties or resulting from the acts of the institutions of the Union.

The Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives.'

[31] See (n 16).

[32] For the irrelevance of the elimination of incompatibility of BITs with EU policy as a ground for the Commission to revoke authorization of existing BITs from the Regulation 1912/2010 (n 5) see Kleinheisterkamp (n 1) 424–7. In these terms, the *ATEL* case is not technically about conflict between a BIT and EU *law* because art 351(1) TFEU resolves the substantive conflict in favour of the former, but about the incompatibility with EU *policy* (as spelled out in the Electricity Directive) and thus the Member State's obligation to eliminate the incompatibility.

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in 2003.[33] The result is that EU Member States cannot be held liable in investment arbitration for implementing EU policies. Investors who want to challenge such EU policies affecting their investments directly are, whether EU or non-EU, restricted to using the remedies offered by EU law itself against illegitimate state interference with cross-border economic activity in the Internal Market. In other words, EU law alone determines the procedural and substantive protection of investors. Arguably, this protection is one of the highest in the world—that is, outside the investment treaties system. Given the high degree of economic and political integration in the EU, it is one of the most advanced and sophisticated regimes of protection of cross-border private economic activity with elaborate rules on how best to strike the complicated balance between private and public interests in this field.[34]

But how does the situation change now that the EU is itself taking up its powers to negotiate investment agreements or chapters in FTAs? What are the implications for the definition of EU policies on international investment protection when EU instruments themselves will be granting non-EU investors special rights (in the investment agreement provisions) and special jurisdiction (of international arbitral tribunals) for their investments in the Internal Market? Put differently, how will—or rather, how should—the EU create exceptions to its own rules of market regulations without undermining them? What is clear is that the Commission is determined to achieve this hat-trick in its current negotiations. But it is much less clear how this would be possible by building 'upon the Member States' experience and best practices regarding their bilateral investment agreements' and even less clear if the aim is 'to include investment ... protection provisions based on the ... highest standards of protection that both sides have negotiated to date'.[35] All—including the very basis of EU law, if the reasoning in *Costa v ENEL* is correct—stands and falls with the safeguards for the application of EU law that will be included in future agreements.

III. FINANCIAL RESPONSIBILITY AND STATE LIABILITY

After sketching the impact of investment treaty law on EU law and highlighting the need for taking this impact properly into account when negotiating the future EU investment agreement, it is necessary to gauge the consequences of such agreements, not only on the regulatory framework of the Internal Market, but also on the existing system of liability under EU law. It has become clear that 'managing financial responsibility' resulting from potential claims before arbitral tribunals established by EU investment treaties is a complicated matter. Indeed, the European Commission has proposed to establish a framework for the management of such financial responsibility in its draft second international investment Regulation of 2012.[36] This offers a current and

[33] See (n 15).

[34] See in detail Kleinheisterkamp (n 15) 98–9.

[35] (n 12–14).

[36] See (n 1).

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relevant entry point for the analysis of how the EU law of state liability is affected.

The main focus of the proposed rules on managing financial responsibility is on internal arrangements for the apportionment of financial responsibility. These internal arrangements are tied together with the question as to who (the EU or the concerned Member State) shall be liable externally as a potential award debtor and, act as the respondent in arbitral proceedings brought by investors from third countries as a result of treatment suffered in the European Union. By including rules on the conduct of investor-state dispute settlement procedures, the proposal thus anticipates and indirectly frames the rights that the future EU investment agreements can grant non-EU investors. Foreign investors will have to accept that they cannot choose against whom to bring their claim—a choice that, according to the proposal, should largely be at the Commission's discretion. Finally, the proposal includes rules on the practically important questions of settling investor claims and the payment of arbitral awards.

On the face of it, the issues tackled in this second Regulation are merely technical and seem to be of little relevance for the broader question of how to define the general principles of the emerging international investment policy of the Union—a question the Commission clearly aimed to avoid at this point. However, a closer look at the underlying assumptions on which the proposed solutions are based and which will thus set the agenda for the future, reveals that the same fundamental policy choices are at stake as already discussed in Part II. As will be seen, the future investment agreements of the EU have the potential to alter fundamentally the current status of existing European law concerning state liability and equally to interfere with the EU's regulatory powers concerning the functioning of the internal market.

As seen previously, the necessity of safeguarding EU law from interference by investment treaties signed by the Member States ultimately requires restricting their scope so as to carve out all implementation and application of EU law: the Member States' liability cannot be triggered if the treatment afforded to the investor is mandated by EU law. In addition to the protection under the host state's administrative and constitutional law, the foreign investor is left 'only' with the remedies that EU law provides against state interference with cross-border economy activity.

This logic of exempting the Member State from liability can also be found in the draft Regulation on financial responsibility—albeit with the key difference that EU investment agreements *will* create a special regime of liability for the EU. In contrast to the external responsibility (for acting as respondent, negotiating a settlement or assuming the role of the award debtor), the question of apportionment of financial responsibility from an EU internal perspective is not linked to the Union's external competences. Article 3 of the draft Regulation links financial responsibility to the question of who—the EU or a Member State—actually undertook the treatment giving rise to the foreign

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investor's claim.[37] To the degree that either the Member State concerned or the Union respects the limits of their respective powers as defined by the Treaties, the internal apportionment of financial responsibility can thus be said to follow the internal competences within the EU.

Put differently, financial responsibility should fall internally on the entity responsible for defining the content of the treatment afforded to the foreign investor. Accordingly, Article 3(1)(b) of the draft Regulation exempts Member States from financial responsibility for claims brought by foreign investors where the Member State's treatment that triggered the claim was required by EU law. This *prima facie* sensible solution, however, raises two fundamental issues that are part of a much broader question.

A. Liability for Treatment That Is Illegal under EU Law

Article 3(1) of the draft Regulation merely focuses on which entity *did* afford the treatment that gives rise to the foreign investor's claim as opposed to whether the entity had the competence for taking such measure according to the allocation of internal competences under the Treaties. It thereby implicitly accepts that investment treaties concluded by the Union will allow arbitral tribunals to impose damages on the entity that afforded treatment in breach of its powers under EU law. This may seem like an obvious case for accepting liability—and hence financial responsibility—under an EU investment agreement, since a Member State acting in breach of EU law would also be liable under EU law in line with the case law of the CJEU originating with the *Francovich* decision,[38] just as the Union is liable for breaches of EU law according to Article 340(2) TFEU.[39] The key issue, however, is that by accepting that future EU agreements will create a special regime of liability outside the existing internal market rules, one also has to accept that such EU agreements will fundamentally alter the existing rules of liability in EU law—at least if they follow the standards of existing BITs.

[37] COM(2012) 335 final art 3: 'Apportionment criteria – 1. Financial responsibility arising from a dispute under an agreement shall be apportioned according to the following criteria:

(a) the Union shall bear the financial responsibility arising from treatment afforded by the institutions, bodies or agencies of the Union;
(b) the Member State concerned shall bear the financial responsibility arising from treatment afforded by that Member State, except where such treatment was required by the law of the Union.

Notwithstanding point (b) of the first subparagraph, where the Member State concerned is required to act pursuant to the law of the Union in order to remedy the inconsistency with the law of the Union of a prior act, that Member State shall be financially responsible unless the adoption of such prior act was required by the law of the Union.'

[38] Joined Cases C-9/90 *Francovich* [1991] ECR I-5373, para 35: 'It is a principle of Community law that the Member States are obliged to make good losses and damage caused to individuals by breaches of Community law for which they can be held responsible.'

[39] Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame* [1996] ECR I-1029, paras 28–29; for art 340(2) TFEU see below at n 47.

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The CJEU has clearly recognized that 'it is a general principle common to the legal systems of the Member States that the injured party must show reasonable diligence in limiting the extent of the loss or damage, or risk having to bear the loss or damage himself'.[40] The rule is therefore that a European investor is under an obligation first to attempt to obtain the annulment of the illegal Member State or Union act that affects its investment before being able to recover the losses suffered.[41] The CJEU has recognized that the obligation only exists insofar as it is reasonable to pursue annulment.[42] This exception, however, merely confirms the rule that EU law—in line with most national laws of the Member States[43]—does not allow private actors merely to 'endure and cash in'. Indeed, national judges of Member States are obliged to ensure the primacy of EU law over a conflicting national act, and where an act of a Member State is based on secondary EU law that might in itself be in violation of the Treaties the judge must request a preliminary ruling from the CJEU.[44]

Most existing BITs, in contrast, do not require investors to exhaust local remedies and allow them directly to bring a claim for all damages before an international arbitral tribunal.[45] Investment treaties concluded by the Union on such a basis, as indirectly accepted by the Commission's proposal, would *de facto* change the existing balance of judicial recourses established by the Treaties for the determination of whether EU law has been breached and relegate the primary remedy of judicial challenge to the same rank as the secondary remedy of damages. Foreign investors could short-cut the existing mechanisms by relying exclusively on the protection standards found in the investment agreement and seek damages directly.

Whether and how to establish such new liability rules for the EU by accepting investment treaty rules along the lines of existing BITs of the Member States is ultimately a policy choice. And, indeed, this draft Regulation was probably one of the last chances for the European Parliament to substantively shape the fundamental policy choices relating to the emerging EU

[40] Case C-446/06 *Danske Slagterier* [2009] ECR I-2119, para 61, referring to Joined Cases C-104/89 and C-37/90 *Mulder and Others v Council and Commission* [1992] ECR I-3061, para 33, and *Brasserie du Pêcheur and Factortame* (n 39), para 85.

[41] The finding of illegality of a measure of the EU 'has the legal effect of requiring the competent Community institutions to take the necessary measures to remedy that illegality', Order of 8 November 2007 in Case C-421/06 *Fratelli Martini and Cargill* [2007] ECR I-152, para 52.

[42] ECJ, Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, paras 104–106.

[43] See eg in Germany Bundesverfassungsgericht 1 BvL 77/78 (*Naßauskiesung)*, decision of 15 July 1981, BVerfGE 58 (1981) 300, 322–4.

[44] Art 267 TFEU.

[45] See in detail A von Aaken, 'Primary and Secondary Remedies in International Investment Law and National State Liability: A Functional and Comparative View' in S Schill, *International Investment Law and Comparative Public Law* (OUP 2010) 721, 730–1. The logic of dispensing foreign investors from exhausting national remedies emerged as a solution to the low effectiveness of the rule of law in many developing countries and at a time where the directions of investment streams where unidirectional and the 'bilateral' reciprocity of the investment treaties was 'rather a matter of prestige … than reality'; FA Mann, 'British Treaties for the Promotion and Protection of Investments' (1981) British Yearbook of International Law 241.

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international investment policy. This meant that by agreeing to the text as proposed by the Commission without any qualification, the Parliament would have opened the way for future negotiating mandates given by the Council to the Commission to result in changes to the existing legal system of Member State and EU liability— and the reverse discrimination of EU investors in Europe that this entails.

B. Liability for Treatment that Is Legal under EU Law

The second issue arises from the exception in Article 3(1)(b) of the draft Regulation, which exempts a Member State from financial responsibility 'where such treatment [afforded by that Member State] was required by the law of the Union'. While this solution again may appear to be self-evident,[46] the underlying assumption on which it rests is not unproblematic. The formulation suggested by the Commission implies that investment tribunals can decide on the legality of legislative acts of the Union in the light of the protection standards of the investment agreements. This means that a legislative act of the Union may be perfectly legal according to the Treaties but may nevertheless give rise to the Union's liability if an arbitral tribunal finds that the treatment is not in conformity with the investment treaty's provisions, such as its interpretation of fair and equitable treatment.

Whereas the liability of Member States or of the Union for legislative acts that violate EU law is clearly recognized by the CJEU[47] (albeit in other terms than the liability that current BITs establish, as shown above), the situation is different regarding the Union's liability for legislative acts that are legal under EU law. The liability of the EU for damages caused to investors is laid down in Article 340(2) TFEU, which provides:

> In the case of non-contractual liability, the Union shall, in accordance with the general principles common to the laws of the Member States, make good any damage caused by its institutions or by its servants in the performance of their duties.

It is therefore ultimately for the CJEU to determine the exact extent of the Union's liability on the basis of a comparative analysis of the Member States' national laws of state liability. In the *FIAMM and Fedon* case,[48] the CJEU had to address, on this basis, the question of whether the Union can be liable for legislative acts that cause loss to an investor but which are in full conformity with the Treaties.

[46] See also Case C-511/03 *Ten Kate* [2008] ECR I-8979, para 32: 'Community law does not impose any obligation on a Member State to bring an action for annulment or failure to act for the benefit of one of its citizens'; see also *Electrabel SA v Hungary*, ICSID Case No Arb/07/19, Decision on Jurisdiction, Applicable Law and Liability, para 4.169.

[47] Joined Cases C-120/06 and C-121/06 *FIAMM and Fedon*, paras 170 and 175.

[48] ibid.

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This question of 'objective liability' arose when European companies sued the Union for losses suffered as a consequence of retaliation measures that the US imposed on the EU following its being condemned by a WTO panel for being in breach of WTO law. In line with previous case law,[49] the CJEU confirmed that WTO rules 'are not in principle, given their nature and structure,[50] among the rules in the light of which the Community courts review the legality of action by the Community institutions'.[51] Consequently, companies affected by EU measures that breach WTO law cannot invoke this breach of the 'external' obligations of the EU (under international law) for the purpose of establishing that the EU measure would be illegal 'internally' and thus give rise to liability under EU law.

The remaining question is then whether the Union can be liable under EU law for measures that are perfectly legal from the 'internal' perspective of EU law, ie, whether there is some 'objective liability' without the traditional requirement of fault. The Grand Chamber of the CJEU explicitly and in detail rejected the affirmative view of AG Poiares Maduro and reversed the judgement of the Court of First Instance. It affirmed that a comparative analysis of the laws of the Member States did *not* allow affirming 'the possible existence of a principle of liability in the case of a lawful act or omission of the public authorities, in particular where it is of a legislative nature'.[52] The CJEU concluded that:

> as Community law currently stands, no liability regime exists under which the Community can incur liability for conduct falling within the sphere of its legislative competence in a situation where any failure of such conduct to comply with the WTO agreements cannot be relied upon before the Community courts.[53]

The CJEU's position can be understood in the light of its previous case law, which firmly stated as early as 1978 that:

> the legislative authority, even where the validity of its measures is subject to judicial review, *cannot always be hindered in making its decisions by the prospect of applications for the damages* whenever it has occasion to adopt legislative measures in the public interest which may adversely affect the interest of individuals… Although [the] principles [in the legal systems of the Member

[49] Case C-149/96 *Portugal v Council* [1999] ECR I-8395, para 47; Case C-93/02 *P Biret International v Council* [2003] ECR I-10497, para 52; Case C-377/02 *Van Parys* [2005] ECR I-1465, para 39.

[50] The reasons given by the CJEU are that WTO law, even where a breach has been established, still allows the parties to find a solution by negotiations, which would be compromised if EU courts could impose certain behaviour following the claim of affected individuals; and that 'by undertaking [specifically] to comply with the WTO rules … the Community did not intend to assume a particular obligation in the context of the WTO, capable of justifying an exception to the principle that WTO rules cannot be relied upon before the Community courts and enabling the Community courts to review the legality'; *Van Parys* (n 49), paras 41 and 52.

[51] *FIAMM* (n 477), para 111; for the same conclusion see already W Weiß, 'Zur Haftung der EG für die Verletzung des WTO Rechts' [2005] Europarecht 277, 297–300.

[52] *FIAMM* (n 477), para 175.

[53] ibid, para 176.

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> States governing the liability of public authorities for damage caused to individuals by legislative measures] vary considerably from one Member State to another, it is however possible to state that the public authorities can *only exceptionally and in special circumstances* incur liability for legislative measures which are the result of choices of economic policy . . . .[54]

The CJEU affirmed this strict approach towards the liability of the Community in the exercise of its legislative activities in its landmark decision in *Brasserie du Pêcheur and Factortame* in 1996:

> First, even where the legality of measures is subject to judicial review, *exercise of the legislative function must not be hindered by the prospect of actions for damages whenever the general interest of the Community requires legislative measures to be adopted which may adversely affect individual interests*. Second, in a legislative context characterized by the *exercise of a wide discretion, which is essential for implementing a Community policy*, the Community cannot incur liability unless the institution concerned has manifestly and gravely disregarded the limits on the exercise of its powers.[55]

The current restrictive liability of the Union for its legislative acts would be widened significantly, however, if future investment treaties of the EU were to be based on the principles of the existing BITs of the Member States, as currently required by the Council in the mandate for the negotiations with Canada, India and Singapore.[56] The EU may well be obliged under WTO law to find (and negotiate) a way of adapting its legislation to conform with the interpretation affirmed by the WTO panel, but the Grand Chamber of the CJEU made clear in *FIAMM* that the EU is not obliged to pay compensation to merchants affected by this legislation. Whereas WTO law, whose rules apply only between third countries and the Union, does not confer any directly applicable and thus actionable rights to individuals, investment agreements do. This means that if future EU investment agreements are negotiated in the same spirit as the existing BITs—which Article 3(1)(b) of the current proposal seems to implicitly accept—the restrictions on state liability, accepted by the laws of the majority of Member States and elaborated on that basis by the CJEU for the Union, will no longer apply if future investment agreements do not contain safeguards in this respect.

Put differently, the EU would expose itself to financial responsibility for its legislative acts that are perfectly legal under EU law but which could be considered by some arbitral tribunal to be in breach of standards of an investment treaty. This is, again, not surprising from the perspective of existing BITs. What is required, however, is a policy choice by the EU, which is not yet bound by any investment treaties. This choice must be made with the full

[54] Joined Cases 83/76, 94/76, 4/77, 15/77 and 40/77 *Bayerische HNL Vermehrungsbetriebe and Others v Council and Commission* [1978] ECR 1209, para 5 (emphasis added).
[55] *Brasserie du pêcheur and Factortame* (n 39), para 45 (emphasis added).
[56] See (n 6).

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awareness that an unqualified acceptance of the Commission's proposed rule on apportionment of financial responsibility also means accepting the underlying assumption and its implications: negotiation mandates—future and present—given by the Council can result in allowing foreign investors to circumvent the existing safeguards that currently shield the Union from financial responsibility for its regulatory decisions on economic policies in the exercise of its legislative powers. Again, this can entail the reverse discrimination of EU investors in Europe.

C. The Source of the Problem

It is interesting to note a fundamental concern raised against the Commission's approach in the draft Regulation by a study commissioned by the European Parliament's Committee for International Trade (INTA). The essence of the criticism is that, in trying to allocate financial responsibilities internally and competences of representation externally on the basis of different criteria, the Regulation would open the door to the Union trespassing upon the competences of Member States in contravention of the explicit prohibition in Article 207(6) TFEU. The study gives the following example:[57] a foreign investor in the education service sector brings a claim against a national legislative measure that affects the profitability of the sector; the Commission then decides on the basis of the Regulation that the EU should assume respondent status; the arbitral tribunal rules that the Member State's legislation violates the 'Fair and Equitable Treatment' standard of the EU investment agreement[58] and not only awards damages, but orders the Member State to bring its legislation in compliance with the 'Fair and Equitable Treatment' standard as interpreted by the arbitral tribunal. This, according to the study, would be a situation in which the EU would then be obliged to force the Member State to change its legislation and thus interfere with the competences explicitly reserved to the Member States. The legislation of the Member States

[57] C Tietje, E Sipiorski, G Töpfer, 'Responsibility in Investor-State-Arbitration in the EU—Managing Financial Responsibility Linked to Investor-State Dispute Settlement Tribunals Established by EU's International Investment Agreements' (December 2012) EXPO/B/INTA/FWC/2009-01/Lot 7/31, <http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=79450> 15–17.

[58] For the inclusion of the 'Fair and Equitable Treatment' standard as providing the 'highest possible level of legal protection and certainty for European investors' in accordance with 'the Member States' experience and best practices regarding their bilateral investment agreements', i.e. *a priori* without any restraining qualifications, see the mandate given by the Council to the Commission for the FTA negotiations with Canada, India and Singapore, above (n 6). Contrast this with the clarification in art 5(2) of the 2004 Canadian Model Foreign Investment Protection Agreement (FIPA), which coincides with art 5(2) 2012 US Model BIT and is based on the ruling of the NAFTA Free Trade Commission: '2. The concepts of ''fair and equitable treatment'' and ''full protection and security'' in paragraph 1 do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.'

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would, *de facto*, be harmonized via the investment agreement concluded by the EU—in violation of Articles 165(4) and 207(6) TFEU.

While the issues raised by this example are not wholly realistic,[59] the example illustrates that the problem is not so much the allocation of financial responsibility but the underlying grounds for liability. Why is it necessary to have to worry about arbitral tribunals condemning the policy choices of the Union or Member States for not complying with vague standards such as 'Fair and Equitable Treatment'? Why is there a need to discuss the possibility of an arbitral tribunal requiring that the Union or Member States revoke measures or legislation implementing policies decided in conformity with the rules established by the EU Treaties? The answer can hardly be that the EU does not possess a sufficiently sophisticated and elaborate (and balanced) legal framework for protecting economic actors in the Internal Market.[60] On the contrary, the problem arises if future EU investment treaties that 'shall provide for the highest possible level of legal protection for European investors' abroad are 'built upon the Member States' experience and best practices regarding their bilateral investment agreements':[61] such investment treaties would be as indeterminate as the existing BITs of the Member States.[62]

The real problem is not the interference of EU external competences with the internal allocation of competences for policy making and regulatory powers. The core of the problem for the Internal Market is the high degree of legal uncertainty resulting from the vagueness of the investor protection standards and the large spectrum of possible interpretations which might be given to them in the decentralized system of investment arbitration.[63] This uncertainty

[59] Consider the safeguards in art 207(4) TFEU; the difficulty of the Commission invoking art 8 (2) of the draft Regulation in the light of its art 3(1)(b) and more generally arts 6(e) and 165(4) TFEU; as well as the limited—if any—powers of arbitral tribunals to order a state to take specific action, see *Antoine Goetz et al v Republic of Burundi*, ICSID Case No ARB/95/3, paras 132–136 (giving Burundi the choice either to restitute certain licenses to the investor or to compensate for the resulting damages); but see the US Federal District Court for the Western District of Texas in *Sky Petroleum v Albania*, Case No A-12-CA-023-SS, Order and Preliminary Injunction (20 January 2012) (enjoining the Government of Albania from awarding, transferring or otherwise disposing of petroleum exploration and exploitation rights purportedly held by the claimant investor until an investment tribunal could be constituted and decide the matter), also von Aaken (n 45) 733–5.

[60] See Kleinheisterkamp (n 15) 98–9.

[61] See text accompanying (nn 10–14).

[62] But see the senior trade policy advisor of the Dutch government, N Lavranos, 'In Defence of Member States' BITs Gold Standard: The Regulation 1219/2012 Establishing a Transitional Regime for Existing Extra-EU BITs – A Member State's Perspective' (2013) 10(2) Transnational Dispute Settlement 1, 12 and 14, available also at <http://ssrn.com/abstract=2226979>, announcing that the Council would 'fiercely' oppose the second international investment Regulation and emphasizing the passage in the Council's 'Conclusions on a comprehensive European international investment policy' (25 October 2010), <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/117328.pdf>, that 'the creation of a common EU international investment policy should increase the current level of protection and legal security for the European investor abroad'.

[63] Boute (n 25) 1194–5, pointing also at Opinion AG Sharpston, Case C-118/07 (n 16), paras 27 and 34–35 ('the application of Article 307 EC is not adequately safeguarded by the uncertain interpretation of clauses in an international agreement'; '[t]he mere possibility that an international

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—both for states and investors—is what ultimately puts the effectiveness of EU regulation of the Internal Market into question.

IV. Adapting the Grounds for Liability to EU Law

The discussion of the different issues arising under the draft Regulation shows that financial responsibility is intimately linked with the substantive and procedural rules of investment protection agreements. One may well question whether it is altogether possible to establish a 'framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party' without also addressing the grounds for liability that give rise to potential financial responsibility. Without an assessment of the latter it is hardly possible to evaluate the actual impact of the former. It is difficult to conceive how the attribution of responsibility can be regulated in the abstract without having clear parameters concerning how liability will be established. This is especially flagrant in times where even old Member States are currently facing multi-billion Euro claims by foreign (but even intra-EU) investors in arbitration, such as Germany being sued by Vattenfall over its decision to abandon the use of nuclear energy,[64] Belgium being sued by Ping An over its decision to sell Fortis bank in an effort to avoid its collapse in the early phase of the financial crisis,[65] and Spain and other countries being sued by investors for having cut benefits for photovoltaic electricity production because of the need for

court or an arbitral tribunal might interpret the contested clause in that way does not suffice to discharge Finland's obligations'); Opinion AG Poiares Maduro, Cases C-205/06 and 249/06 (n 16), para 62; for the problem of vagueness of investment treaties in general see *Suez, Sociedad General de Aguas de Barcelona SA and InterAguas Servicios Integrales del Agua SA v Argentine Republic*, ICSID Case No ARB/03/17, Decision on Liability of 30 July 2010, para 196 ('an especially difficult challenge'); *Saluka Investments BV v Czech Republic* (UNCITRAL), Partial Award of 17 March 2006, para 297 ('The "ordinary meaning" of the "fair and equitable treatment" standard can only be defined by terms of almost equal vagueness'); *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No ARB/01/8, Award of 12 May 2005, para 273 ('Argentina's concern about [the Fair and Equitable Treatment standard] being somewhat vague is not entirely without merit'); see also O Chung, 'The Lopsided International Investment Law Regime and its Effect on the Future of Investor-State Arbitration' (2007) 47 VaJIntlL 953, 961; Z Douglas, *The International Law of Investment Claims* (CUP 2009) para 150; A von Aaken, 'International Investment Law between Commitment and Flexibility' (2009) 12(2) JIEL 507, 514 and 527–31; S Schill, 'Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach' (2011) 52 VaJIntlL 57, 66–7.

[64] *Vattenfall AB and others v Federal Republic of Germany*, ICSID Case ARB/12/12, registered 31 May 2012; cf L Peterson, 'Germany is Sued at ICSID by Swedish Energy Company in Bid for Compensation for Losses Arising out of Nuclear Phase-Out', IAReporter, 1 June 2012, <http://www.iareporter.com/articles/20120601_1>.

[65] *Ping An Life Insurance Company of China, Limited and Ping An Insurance (Group) Company of China, Limited v Kingdom of Belgium*, ICSID Case ARB/12/29, registered 19 September 2012; cf L Peterson, 'Chinese Insurer Files ICSID Arbitration against Belgium; Ping An Lost $2.3 Billion When Fortis Bank Crumbled', IAReporter, 22 September 2012, <http://www.iareporter.com/articles/20120922_1/>.

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financial austerity.[66] This is not to speak of potential investor claims resulting from a default of Member States in the Euro zone.

If the policy choice of the European Union is to afford European investors the 'highest possible level of legal protection', a consequent policy choice to be made is whether this economic benefit granted to European investors should be cross-subsidized by exposing European taxpayers by non-EU investor's claims which are not currently recognized by the rules of liability of the Union and the Member States. If the EU wants to set a general framework that depends on the content to be negotiated in future *bilateral* investment agreements, the EU institutions also have to meet the challenge of setting general parameters that reconcile the goals of maximizing the protection of its own investors abroad with the need to minimize the exposure of its own taxpayers to claims by foreign investors.

A. Approaches to Capping Financial Responsibility in the United States

It is worth noting that two approaches to keeping financial responsibility within politically acceptable bounds have been adopted by the United States. These result from its exposure in the context of NAFTA to foreign investors challenging public policy decisions taken at the state or federal level and the resulting political pressure. Firstly, public indignation over Canadian investors challenging Californian environmental legislation in the *Methanex* case resulted in Congress making the fast-track authority first granted in 2002 for the negotiation of trade agreements conditional on the requirement that such agreement must 'ensur[e] that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States'.[67] Accordingly, the FTAs concluded by the United States with Panama, Peru, Colombia and South Korea explicitly include this in their Preambles.[68]

[66] cf L Peterson, 'New Arbitration Threat Looms for Spain as Legislature Debates New Measures Affecting Solar-Thermal Energy', IAReporter, 12 November 2012, <http://www.iareporter.com/articles/20121112_2>; L Peterson , 'Solar Investors File Arbitration Against Czech Republic; Intra-EU BITs and Energy Charter Treaty at Center of Dispute', IAReporter, 15 May 2013, <http://www.iareporter.com/articles/20130515_1>.

[67] Section 2102(b)(3) of the Trade Act 2002, 19 USC 3802, Public Law 107–210, reiterated in, and in force under, the Bipartisan Agreement on Trade Policy between Congressional leaders of 10 May 2007, <http://www.ustr.gov/sites/default/files/uploads/factsheets/2007/asset_upload_file127_11319.pdf>.

[68] US–Peru FTA, signed 12 April 2006, <http://www.ustr.gov/trade-agreements/free-trade-agreements/peru-tpa/final-text>; US–Colombia FTA, signed 22 November 2006, <http://www.ustr.gov/trade-agreements/free-trade-agreements/colombia-fta/final-text>; U.S.–Panama FTA, signed 28 June 2007, <http://www.ustr.gov/trade-agreements/free-trade-agreements/panama-tpa/final-text>; US–South Korea FTA, signed 30 June 2007, <http://www.ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text>, Preamble paragraph 5: '<u>Agreeing</u> that foreign investors are not hereby accorded greater substantive rights with respect to investment protections than domestic investors under domestic law where, as in the United States, protections of investor rights under domestic law equal or exceed those set forth in this Agreement' (original emphasis).

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Secondly, the consequent revision of the US BIT programme led to the elaboration of the 2004 US Model BIT, followed by the 2004 Canadian Model FIPA. These revisions sought to limit the interpretative powers of arbitral tribunals by spelling out the investor protection standards in much greater detail. Notably, the US Model BIT (the 2012 version of which remains unchanged in this regard following a new review) reflects US case law on state liability ensuring that US internal standards of protection and international standards in investment treaties concluded by the US coincide to a large degree,[69] as well as providing clarifications of the NAFTA Free Trade Commission that sensitively limit the scope of the 'Fair and Equitable Treatment Standard'.[70] It is also worth noting that the US, when negotiating its FTA with Australia, did not insist on including any direct investor-state dispute settlement mechanism because of 'the fact that both countries have robust, developed legal systems for resolving disputes between foreign investors and government'.[71] This shows that also the decision as to whether to grant investors direct access to international arbitration is carefully decided on an individual basis.

B. Current Reactions in the EU

It could be imagined that the EU would also follow one or both of these two approaches—or even a more sophisticated one. One option would be to make the framework for managing financial responsibility subject to the interpretative safeguard that future EU investment agreements cannot provide more protection to foreign investors than European investors are granted under current EU law. This would not be quite consistent with the logic of reciprocity of investment agreements, but it is a politically attractive solution that would eliminate, albeit simplistically, many of the problems addressed earlier in this article. Notably, it would allow for at least some assessment of the future impact of the rules on financial responsibility because it provides for a straightforward cap on the exposure of the EU and the Member States in investment arbitrations.

A systematically more coherent solution could be to make the rules for managing financial responsibility conditional upon the assurance that future EU investment treaties will contain much more elaborate and detailed rules on the exact scope and conditions of the protection granted to investors than contained in Member States' existing BITs. It could be a requirement that

[69] See eg Annex B of the 2012 US.Model BIT, incorporating under 4(a) the *Penn Central* test of the U.S. Supreme Court for regulatory takings, *Penn Central Transportation Co v City of New York* 438 US.104 (1978); see also the clarification in (b) that '[e]xcept in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations'.

[70] See (n 58).

[71] See Australian Government Department of Foreign Affairs and Trade, 'Australia-United States Free Trade Agreement: Fact Sheets – Investment', <http://www.dfat.gov.au/fta/ausfta/outcomes/09_investment.html>; see art 11.16 US–Australia FTA 2004.

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future EU investment treaties incorporate the rules of EU law that protect investors in the Internal Market against the interference by public administrations, and especially the existing case law of the CJEU on Article 340(2) TFEU —which is itself based on the general principles common to the law of the Member States.[72] This would be an efficient way of ensuring the 'highest possible level of protection and legal certainty for European investors abroad' since European investors abroad cannot legitimately hope for better investment protection than they are guaranteed in the EU, which arguably offers one of the highest levels of protection of any national legal system.

In fact, both solutions have found their way into the current version of the Regulation on financial responsibility in a legally non-binding—but politically powerful—manner. Based on a prior version of this paper submitted to the members of INTA,[73] they accepted by unanimity to include two recitals that mirror the US approach,[74] which were approved in the Plenary of the European Parliament on 23 May 2013 (against the opposition of the small parties which categorically rejected either investment arbitration or the EU altogether):[75]

> *(3a) Financial responsibility cannot be properly managed if the standards of protection afforded in investment agreements were to exceed significantly the limits of liability recognised in the Union and the majority of the Member States. Accordingly, future Union agreements should afford foreign investors the same high level of protection as, but no higher level of protection than, Union law and the general principles common to the laws of the Member States grant to investors from within the Union.*
>
> *(3b) Delineation of the outer limits of financial responsibilities under this Regulation is also linked to the safeguarding of the Union's legislative powers exercised within the competences defined by the Treaties, and controlled for their legality by the Court of Justice, which cannot be unduly restrained by potential liability defined outside the balanced system established by the Treaties. Accordingly, the Court of Justice has clearly confirmed that the Union's liability for legislative acts, especially in the interaction with international law, must be framed narrowly and cannot be engaged without the clear establishment of fault.*[1] *Future investment agreements to be concluded by the Union should respect those safeguards to the Union's legislative powers and should not establish stricter standards of liability allowing a circumvention of the standards defined by the Court of Justice.*
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> [1]*Judgment of the Court of Justice of 9 September 2008 in Joined Cases C-120/06 P and C-121/06 P*, FIAMM and Fedon v Council and Commission *([2008] ECR I-6513).*

[72] See text accompanying n 52.

[73] See above n *.

[74] INTA Report A7-0124/2013 of 26 March 2013, <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2013-0124&language=EN> (amendments 4 and 5).

[75] European Parliament (Plenary), text adopted on 23 May 2013 in Procedure 2012/0163(COD), P7_TA-PROV(2013)0219, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2013-0219+0+DOC+XML+V0//EN> (amendments 4 and 5).

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As a side note, the Plenary also adopted an amendment relating to the use of investor-state arbitration. Whereas the text proposed by the Commission in Recital 2 reads:

> *Agreements providing for* investment protection *typically* include an investor-to-state dispute settlement mechanism, which allows an investor from a third country to bring a claim against a state in which it has made an investment . . .,[76]

the INTA Committee and the Plenary, opposed only by the votes of the far-left parties who reject investor-state arbitration categorically, opted for the following clarification:

> *In the cases where it is justifiable, future* investment protection *agreements concluded by the Union can* include an investor-to-state dispute settlement mechanism, which allows an investor from a third country to bring a claim against a state in which it has made an investment.[77]

The justification for this amendment in the INTA report suggests that this amendment should have a direct bearing on the ongoing discussion on whether to include investor-state-arbitration provisions in the negotiations with the US over the TTIP; the amendment could also justify emulating the US–Australian FTA approach of limiting dispute settlement to the state-to-state level:

> It should be highlighted that it is not a necessity to include ISDS provisions in future EU investment agreements and that their inclusion should be a conscious and informed policy choice that requires political and economic justification. Even if there is a general policy choice in favour, the question whether to include ISDS should be decided for each International Investment Agreement in the light of the particular circumstances.[78]

It remains to be seen how much weight the Council and the Commission will give to the principles laid down by the Parliament's amendments. Not very promising is the Commission's reply to a recent parliamentary question concerning the inclusion of ISDS provisions in the CETA negotiations with Canada. The Commission alleges that '[t]here have been several instances in the past of foreign investors being expropriated in Canada and who have been denied compensation and access to the Canadian courts'.[79] In its answer to a follow-up question, the Commission referred to the *Abitibi-Bowater v Canada* and the *Gallo v Canada* cases.[80] While the first case suggests a significant

[76] COM(2012) 335 final (n 1) (emphasis added).
[77] See above nn 74 and 75 (amendment 3) (emphasis added).
[78] See above n 74 (amendment 3).
[79] Answer given by Mr de Gucht on behalf of the Commission on 29 January 2013, Parliamentary question E-011230/2012, <http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2012-011230&language=EN>.
[80] Answer given by Mr De Gucht on behalf of the Commission on 22 March 2013, Parliamentary question E-001132/2013, <http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2013-001132&language=EN>.

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misreading of current Canadian law,[81] the second highlights the highly questionable merits of the claim brought and the potential misuse of investor-state arbitration, rather than any failure by the Canadian legal system or courts to protect legitimate private interests.

C. A More Sophisticated Solution

There is, however, a more sophisticated solution that goes beyond merely insisting on 'no greater rights' and trying to negotiate the incorporation of EU law into an agreement with a third country. What is needed is an approach that could accommodate the bilateral and reciprocal logic of an international agreement and 'multilateralize' the *a priori* unilateralist 'no greater rights' logic. The solution would be to extend the comparative approach of Article 340(2) TFEU to the international dimension of investment agreements. This would mean elaborating detailed principles of investor protection not on the basis of existing BITs but primarily on the basis of the rich experience with—and the detailed rules on—state liability in the legal systems of the countries with the highest levels of investment protection and the most sophisticated balancing of private and public interests.[82] The current negotiations with Canada could be the ideal laboratory for such a comparative public law approach, since both Canadian and EU law presumably offer among the highest—and, moreover, equivalent—levels of investor protection.

In that respect, it is regrettable that the Commission originally thought of merely referring to the available interpretations by arbitral tribunals for 'codifying a generally accepted outcome of jurisprudence that both sides are comfortable with' so as 'to spell out the criteria for its application [of the FET standard]'[83] in order to avoid Canada's position of linking the 'Fair and Equitable Treatment' standard to the 'customary international law minimum standard of treatment of aliens'.[84] It is, indeed, highly questionable whether

[81] See the Supreme Court of Canada in *Dunsmuir v New Brunswick* [2008] 1 SCR 190 at 52: 'This does not mean that the presence of a privative clause is determinative. The rule of law requires that the constitutional role of superior courts be preserved and … neither Parliament nor any legislature can completely remove the court's power to review the actions and decisions of administrative bodies. This power is constitutionally protected.'

[82] See more generally on the comparative public law approach Schill's 'Introduction' in S Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 1, 23–37.

[83] See the leaked Meeting Document of 6 November 2012 from the European Commission to the Trade Policy Committee on 'EU Canada Comprehensive Economic and Trade Agreement – Landing Zone', Council Document DS 1744/12 (EU Restricted), 9, <http://www.lapresse.ca/html/1633/Document_UE_2.pdf>; see also Commissioner De Gucht in the Plenary debate in the European Parliament on 22 May 2013 on the Parliamentary questions O-000043/2013 (B7-0120/2013), 22 May 2013, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+CRE+20130522+ITEM-019+DOC+XML+V0//EN>: 'The Commission … is endeavouring to better clarify the content of our investment protection standards without reducing the level of protection, for example by including useful guidance on the practice of arbitral tribunals.'

[84] See (n 58).

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that arbitral case law is sufficiently consistent.[85] Such an approach negligently ignores the much richer and more consolidated experience that Canadian and European courts have with the intricacies of the law of state liability. This could lead to the absurd result that the future EU–Canada agreement could grant European investors in Canada a higher level of protection than European law would afford them, and *vice versa*.[86] It is quite understandable in the light of the time pressure on the negotiations that both the European and the Canadian negotiators prefer working merely with a handful of arbitral decisions on FET rather than venturing into extensive comparative studies of the voluminous Canadian and European law on state liability. It would, nevertheless, be a pity if more time is not devoted to the very first investment agreement to be negotiated by the EU in order to effectively enhance legal certainty and to put the future EU international investment policy on a sounder basis.[87]

The 'no greater rights for foreign investors in the EU' principle now seems to be politically compelling, but its acceptance by the Member States is far from certain. An interesting question is how the 'no greater rights' logic would play out in the future, especially in negotiations with the US, whose negotiators will equally be bound to insist on 'no greater rights for EU investors in the US'.[88] Logically speaking, a 'no greater rights' position on both sides of the negotiation table would lead to rendering international investment protection provisions *ad absurdum*: the whole point of establishing such legal provisions is to grant foreign investors rights that are different from those in the host country. If EU investors are to be treated no better in the US than US investors and, at the same time, US investors are to be treated no better in the EU than EU investors, a chapter on investment protection in the TTIP would simply not make any sense—unless its provisions were to constitute a detailed restatement of the rules of investment protection common to, or at least compatible with, both legal orders. This would then bind arbitral tribunals to the application of rules which would leave no scope for them to deviate from the fundamental principles governing the regimes of state liability in both trading blocs.

The adoption of a 'no greater rights' principle can reasonably be expected to press negotiators to accept the comparative public law approach—especially if

[85] See eg K Vandevelde, 'A Unified Theory of Fair and Equitable Treatment' (2010) 43 International Law and Politics 43; see also J Kalicki and S Medeiros, 'Fair, Equitable and Ambiguous: What is Fair and Equitable Treatment in International Investment Law' (2007) 22(1) ICSID Review 27.

[86] See also S Montt, *State Liability in Investment Treaty Arbitration* (OUP 2009) 76.

[87] See also Kleinheisterkamp (n 10) 431.

[88] See the specific objectives set out in the letter of 20 March 2013 by which the Obama Administration notified Congress of its intent to negotiate the TTIP, <http://www.ustr.gov/sites/default/files/03202013%20TTIP%20Notification%20Letter.PDF>: 'Seek to secure for U.S. investors in the EU important rights comparable to those that would be available under U.S. legal principles and practice, while ensuring that EU investors in the United States are not accorded greater substantive rights with respect to investment protections than U.S. investors in the United States'.

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they take the maxim of legal certainty seriously. It can only be hoped that they will not fudge the issue but will take the time to allow for the elaboration of these principles. Otherwise, the issue will again become delegated to the arbitral tribunals.[89] But even if the standards of protection ultimately remain as vague as they have been in the past—albeit cosmetically polished to soothe concerns—one would hope that arbitral tribunals will recognize that the 'no greater rights' principle imposes a substantive cap on the interpretation of those standards and calls for engagement with comparative law arguments. If tribunals were to ignore this capping logic and the comparative public law solution, the predictable result would be a further political backlash against international investment arbitration.[90] If tribunals embrace this logic, then there is a real chance of international investment arbitration significantly gaining in legitimacy and, moreover, in legal certainty both for states and investors.

V. CONCLUSIONS

The above analysis makes it clear that not only do investment treaties have a significant potential to interfere with the EU regulatory regime for the Internal Market but also to modify the principles of, and especially the limits to, state liability under EU law. As highlighted by the proposal for the Regulation on managing financial responsibility relating to investor-state arbitration, the fact that future EU investment agreements are currently being negotiated on the template provided by existing BITs inevitably raises two fundamental questions: how can the outer bounds of EU liability be properly defined and how can the effective functioning of the Internal Market rules be safeguarded? What is on the table since the vote of the European Parliament on the draft Regulation in May 2013 is the introduction of a cap on investor rights in future EU agreements that would largely make EU law itself the standard for these rights.

This capping logic comes in reaction to the assumption that future EU investment agreements will—in line with existing BITs—grant arbitral tribunals jurisdiction to award foreign investors damages for regulatory treatment afforded by the Union or its Member States within the realm of EU law. As mentioned before, this is not extraordinary from the perspective of existing BITs, but it has two significant implications both of which deviate from the present EU law on the liability of the Union as elaborated by the CJEU.

The first implication is that foreign investors will have access to investor-state arbitration without having to avail themselves first of the recourses available under EU law for breaches of the EU's own safeguards against abuses of

[89] For the problems of such delegation see eg A Roberts, 'Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States' (2010) 104(2) AJIL 179, 185–91.

[90] On the backlash phenomenon see generally M Waibel et al, *The Backlash against Investment Arbitration* (Kluwer 2010).

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public power, ie, where there treatment afforded by the EU or a Member State is illegal under EU law. Prior to the shift of powers to the Union under the Lisbon Treaty, the EU Member States have already accepted—consciously or unconsciously by ratifying BITs—that foreign investors may short-cut existing constitutional procedures for protection of economic actors against excesses by public administration. In contrast, the EU, which was created and designed primarily to allow economic actors to operate across borders, has not yet made any comparable concessions that might compromise its exercise of the powers delegated to it by the Member States. Economic actors in the EU context must rely on the mechanisms provided for by EU law for protecting private interests and for balancing private and public interests. They cannot rely on a simple 'endure and cash in' logic but may only seek damages after having sought the annulment of the provisions on which their treatment has been based within the local jurisdiction.[91] This principle will continue to apply to EU investors in the EU. It will, however, no longer apply to foreign investors in the EU once future EU investment treaties with unqualified investor-state-arbitration provisions enter into force. It needs to be clear that such a policy choice will change the current institutional procedure governing private claims relating to regulatory interventions and entail a reverse discrimination of European investors in the EU.

The second implication is that future EU investment treaties will confer jurisdiction upon arbitral tribunals to award damages if they find that EU legislation does not respect the standards of protection provided by the investment treaty, even if that legislation is perfectly legal under the EU treaties. Again, this is not surprising from the perspective of the Member States. In order to obtain reciprocal commitments for their investors abroad, they have chosen to accept liability for damages under their BITs even if the challenged treatment is in full compliance with the standards of protection under their own legal frameworks. The system of protecting individual interests and balancing them with public interests in the EU Treaties has not yet been pierced by such exceptions. In a conscious choice of strengthening democratic decision-making, the CJEU has specifically limited the liability of the Union for legislative policy choices that are in conformity with the EU Treaties.[92] Both the vagueness and the lack of qualification of existing BIT standards, if adopted in future EU agreements, would thus effectively modify the rules of liability of the EU insofar as non-EU investors would have the option of sidelining the existing restrictions by opting for arbitration and invoking the standards found in the new agreements. Again, this—as well as the reverse discrimination of domestic investors that this entails—is a policy choice of which the political stakeholders must be conscious when accepting the assumptions underlying the current proposals.

[91] See Section III.A.

[92] See Section III.B.

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Finally, it becomes clear that no realistic assessment and management of the financial responsibility is possible without some minimal parameters concerning the grounds of liability under the future EU investment treaties. The central problem in this respect is the high degree of indeterminacy of current BIT standards that, if not substantially reviewed at the EU level, risks exposing the EU to unpredictable levels of liability, thereby compromising its policy-making powers. In the light of the challenges of managing such financial responsibility and the need to set parameters for the underlying grounds of liability, it is worthwhile to reflect on the approaches taken by other countries with more experience with investment arbitrations as well as the resulting political pressures—such as the United States—in light of the upcoming TTIP negotiations.[93]

The European Parliament has, indeed, taken a strong political stance to try to condition the framework for managing financial responsibility and thus the content of future EU investment agreements by combining two approaches.[94] One is a negative cap on future treaty standards imposed through a general safeguard that future EU investment agreements shall not provide more protection to foreign investors than European investors are granted by EU law. The other is a positive cap, requiring the incorporation of the detailed existing rules on liability as elaborated by the CJEU. The combination of the negative and the positive dimension of these caps should ensure that the rules on balancing private and public interests that have emerged in the EU context will not be compromised by investment treaty standards and, at the same time, that European investors abroad will enjoy the high level of protection provided for by EU law. Furthermore, and most importantly, they will enjoy an enhanced degree of legal certainty.

Both approaches, however, suffer from the fact that they are highly unilateralist and difficult to square with the principles of reciprocity and the equality of nations that should underlie international treaties. They lead into an outright dilemma, at least at first sight, when the EU is facing negotiations with a country that is committed to the same approaches, such as the US. The clash of two 'no greater rights' positions can then only be resolved by actually comparing the legal orders of both sides so as to distil and restate their common core approaches to investment protection rules. Where necessary, this restatement may be complemented by a pre-statement of synthesized rules based on the comparative public law exercise that will inform as to which new solutions would at least be reconcilable with the respective national legal orders that constitute the benchmark for granting 'no greater rights' for foreign investors. In any case, this is the approach that arbitrators would have to take if the negotiators limited themselves to merely including their respective 'no greater rights' reservation (for example, in the preamble of the agreement) without taking the time to elaborate the specific rules that define in detail what foreign

[93] See Section IV.A.

[94] See Section IV.B.

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investors are entitled to. If faced with the challenge of interpreting vague treaty standards along existing conventional lines, arbitrators will have to engage with such comparative public law logic, and go beyond the relatively unfruitful exegesis of existing arbitral decisions.

The most mature solution would be to pause the burgeoning negotiations with such important trading partners as Canada, the US and China and first work on outlining in much more detail the exact rights to protection that both European investors abroad as well as foreign investors in the EU should be entitled to.[95] This could mean first taking the time to entrust academics with the task of drawing up comparative studies of the laws of those countries recognized as providing the highest degree of investor protection as well as the most elaborate rules on balancing private and public interests. These findings could then be amalgamated with a synthesis of existing arbitral case law to the degree that it is consistent and compatible with those findings. The outcome would be the articulation of principles of investor protection of global aspiration that could inform both the negotiations of specific rules in new EU investment agreements, and their later interpretation by arbitral tribunals. This would be a scientific and sustainable way forward for providing both investors and states with what is the ultimate justification for creating international investment law: not some 'highest possible degree of protection' but the highest possible degree of legal certainty.

[95] See IV.C.

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