Rethinking EU law governing international investment treaties

LSE research by Jan Kleinheisterkamp influenced the European Union's new policies relating to international investment agreements

What was the problem?

International investment law has become a highly controversial political issue in recent years. For some, it is an essential tool for attracting and securing much needed foreign investments; for others it undermines states' sovereign powers to regulate in the public interest.

First introduced during the de-colonisation era, bilateral investment treaties (BITs) set out to encourage investments into developing countries by protecting foreign investors against arbitrary government measures. Most investment treaties offer binding international arbitration in cases of dispute, a process known as 'investor-state dispute settlement', or ISDS. Rather than having to sue in the host states' courts, foreign investors have the right to bring claims for compensation in international tribunals, whose decisions are not subject to appeal.

Increasingly, multinational companies have used ISDS to demand millions and even billions of pounds in compensation from foreign governments over political decisions that adversely affect their corporate interests. As recent examples, the Chinese insurance company Ping An sought compensation from Belgium when it nationalised the bank Fortis in the beginning of the financial crisis; and Swedish investors sued Germany over its decision to phase out nuclear energy in the wake of Japan's Fukushima disaster in 2011.

Increasingly fears are voiced over the implications for national sovereignty –about the ability of governments to make policies and decisions in the interests of the citizens they represent in the light of the threat of huge damage claims by disgruntled foreign corporations.

What did we do?

Since 2008, LSE Associate Professor of Law Jan Kleinheisterkamp has been working on the balance between legal certainty for business and states' mandate to regulate in the public interest in the context of international arbitration.

He first explored the idea of linking legal protection of foreign investments to their original aim of harnessing investment flows for development in poorer nations. He argued that investment treaties must not be allowed to grant foreign investors more rights than those enshrined in the national laws of countries that demonstrate the highest standards of protecting private interests against state interference.

A second strand of Kleinheisterkamp's research explored the potential clash between European Union (EU) law and investment treaty law, beginning with a study commissioned by the European Parliament in which he reviewed the European Commission's draft regulation on transitional arrangements to deal with existing investment treaties. In a series of articles he demonstrated the need to ensure that these agreements do not undermine the democratically struck balances for the regulation of business in the Internal Market of the EU. He focused both on the existing treaties protecting investors of and in the EU member states and on future agreements including those currently in negotiation, in particular the free trade agreements with Canada (CETA) and the United States (TTIP).

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This research laid the basis for a second report to the European Parliament on the financial responsibility of the EU resulting from ISDS, which elaborated the potential impact of future European investment treaties on the rules of liability of the EU and its member states for regulatory actions. Kleinheisterkamp thus showed the necessity to rethink the existing approaches to investor protection or at least to include fundamental safeguards for European policy space.

What happened?

Under the influence of Kleinheisterkamp's first study, the European Parliament's Committee on International Trade (INTA) in 2011 reinforced the European Commission's proposal to review and if necessary terminate existing investment treaties of the EU member states if in conflict with EU policies. The member states, however, prevailed with their view that their treaties should remain in force until replaced by investment agreements negotiated by the EU.

By contrast, Kleinheisterkamp's research directly influenced the EU's 2014 regulation that provides the framework for financial responsibility of the EU and its member states resulting out of ISDS. His second report to INTA discussed the basis of financial responsibility resulting from the Union's future investment agreements and set out how EU policies could be safeguarded. His report argued that either the EU should pause and re-conceptualise investment agreement so as to be in line with the principles on state liability common to member states' laws, or it should—as a kind of short-hand—at least stipulate that future agreements cannot grant greater rights to foreign investors than those conferred by EU law or by member states to EU investors investing within the European Union.

Given the political pressures to finalize ongoing negotiations, especially with Canada and the United States, the latter proposal proved to be politically more viable. On the basis of Kleinheisterkamp's report, the INTA Committee insisted on a clarification in the Regulation that financial responsibility of the EU before investment tribunals could not exceed that established under EU law and that the restrictive case law of the European Court of Justice should set the benchmark.

The European Parliament debated the future of international investment law in May 2013, and formally adopted INTA's propositions without modifications. In its debate, the European Parliament specifically discussed to what degree the EU should accept a financial responsibility towards non-EU investors. There was consensus that this financial responsibility cannot be properly managed if the standards of protection in investment agreements significantly exceed the limits on liability recognised within the EU and by the majority of member states. MEPs of all major parties insisted that non-EU investors cannot be granted greater rights that what EU law and national constitutions grant to EU investors, in line with Kleinheisterkamp's arguments that the very purpose of EU law is already to grant businesses special rights so as to stimulate cross-border economic activity.

The European Parliament defended this principle against the resistance of the member states and the European Commission and it remained when the European Parliament adopted the final text of the regulation in April 2014.

The new regulation establishes the legal framework for all future investment agreements entered into by the EU, and the included safeguard will therefore condition the outcome of the ongoing and future investment agreements of the EU, especially the very controversial Transatlantic Trade and Investment Partnership (TTIP) with the United States.

Jan Kleinheisterkamp is Associate Professor in the Law Department of the London School of Economics. His primary research interest is the international dimension of commercial relations. He has written extensively on international commercial contracts, international arbitration and investment treaty law, and acted as an expert and as an arbitrator in numerous proceedings. Since 2013 he is a member of the advisory group on international arbitration to the UK Government and since 2014 a member of the Governing Body for Dispute Resolution of the International Chamber of Commerce.

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