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INTERNATIONAL INVESTMENT TREATIES – NEW DEVELOPMENTS AND THEIR EFFECTS ON GERMANY

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Investment protection is a very prominent in subject the current public debate. Hardly a day passes without an article on investment protection and investor-state-dispute settlements (ISDS) appearing. The issue is raised either in the context of the Transatlantic Trade and Investment Partnership (TTIP) or the Comprehensive Economic Trade Agreement (CETA) between Canada and the EU. In its consultation on investment protection and ISDS in TTIP the European Commission received around 150,000 comments, 140,000 of which opposed the inclusion of investment protection provisions in TTIP. ISDS proceedings initiated by Vattenfall and Philipp Morris are cited by critics of ISDS as threatening the right of parliaments to regulate and as having a chilling effect on parliaments, which are encouraged to refrain from legislation because of fear of ISDS claims for damages. On the other hand, owners of Yukos were assigned damages of 50 billion US dollars by an ISDS tribunal in 2014 after their expropriation by Russian authorities. Some countries such as South Africa and Bolivia have recently repudiated at least some of their bilateral investment treaties, because they consider their national legislation as providing sufficient investment protection and are afraid that investment treaties may restrain their domestic economic development. On the other hand, other countries like China are continuing to negotiate and conclude investment treaties.

German companies and investors have always considered foreign investments as vital to securing new markets for the sale of their products or services, and to maintaining their competitiveness in an increasingly globalized economy. In fact, foreign investments by German companies abroad secure employment in the country by increasing demand for German products in other countries and enabling German exporters to implement worldwide supply, retail and customer care networks. Foreign investments by German companies also ensure that raw materials and semi-finished products can be sourced in-house, rather than bought on the open market, thereby reducing the overall cost of German products.

The German government has accompanied German investors abroad since 1959 by concluding bilateral investment treaties with developing and emerging countries, as well as countries in transition. Since then, over 130 treaties have been negotiated, the very first of them with Pakistan. Currently 129 bilateral investment treaties featuring Germany are in force, in addition to the multilateral Energy Charta Treaty, which also contains investment protection provisions. Since the 1980s these treaties have also provided for ISDS to deal with investment protection disputes. Earlier treaties only provided for state-state-settlement procedures, which led to a high level of politicisation of investment disputes.

Germany only considers it necessary to sign bilateral investment treaties with countries that have deficits in legal protection at the time of the treaty’s negotiation. Thus no treaties were concluded with countries with rule of law systems. German bilateral investment treaties, unlike, for example, US-American treaties, do not deal with market access for investments either, but only with the protection of investments made in accordance with the laws valid at the time the investments were made. Thus Germany has always respected the host state’s right to admit or refuse investments. German bilateral investment treaties also expect investors to respect the host country’s laws, unless those laws themselves constitute breaches of the treaty’s investment protection provisions.

For Germany bilateral investment treaties serve three aims. Firstly, they provide a basis for the German federal government to intervene on a diplomatic level on

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behalf of German investments in need of protection. Secondly, they provide sufficient legal protection in the host country, which is a precondition for the German government’s agreement to grant investment guarantees for German direct investments against certain political risks in developing and emerging countries, as well as in countries in transition. Thirdly, if the treaty provides for ISDS, it is also the basis for investors to ensure the respect of the investment protection provision in ISDS proceedings. Up to now, only one ISDS case has been initiated against Germany on the basis of a bilateral investment treaty, whereas two procedures have been initiated against Germany pursuant to the Energy Charta Treaty.

The competence for foreign direct investments was transferred by the Treaty of Lisbon to the EU on 1 December 2009. Since then the EU Commission has been negotiating agreements and provisions on investment protection on behalf of the European Union and its member states, for example as part of CETA, TTIP, as well as the Free Trade Agreements with Singapore, Japan, Vietnam, the investment agreement with China and the investment protection agreement with Myanmar. Pursuant to 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 the member states and third countries (the so-called ‘Grandfathering-Regulation’), EU member states’ existing bilateral investment protection treaties remain in force until they are replaced by investment protection treaties of the EU and the EU member states with the relevant third country.

In the current debate the need for investment protection agreements is questioned. In the opinion of the German federal government investment protection is not necessary in relation to countries with a rule of law system, but only in relation to countries with deficits in legal protection. Investors from the latter countries, when investing in Germany, benefit from the comprehensive legal protection and efficient legal remedies offered by our national and EU law. As a result, the German government seeks to ensure a comparable level of legal protection for German investors in those countries. However, other EU member states, third countries as well as the European Commission, are interested in including investment protection provisions in all free trade agreements that are being negotiated. Therefore we need to decide what level of investment protection we aim to achieve and with which partner countries. Should the aim be a uniform level of investment protection in all treaties, regardless of the level of protection offered by the local legal system in the relevant partner country; or should the level of protection differ according to the country the EU Commission is negotiating with?

As for proposals for the reform of investment protection, one proposal is to exclude investments in certain sectors totally from investment protection (e.g. the financial sector, rescheduling of public debts). To me, this approach is viable in agreements with countries with a strong rule of law-system. Other critics propose to limit investment protection to certain standards. For example in CETA, investments in areas that are subject to market access restrictions are excluded from protection against non-discrimination and most-favoured-nation treatment. In my opinion, these limitations are acceptable, if the host country’s own legal system already provides for effective protection against arbitrary state actions and expropriations.

Other proposals are to have a general reservation allowing states to limit investment protection in the public interest pursuant to relevant GATS provisions, provided such limitations are proportionate. To me, such a limitation would only be acceptable in treaties with countries with a high level of protection under national law.

Another proposal is to limit investment protection to investors with substantial business activities in their original country. This is to avoid treaty shopping by setting up letter box-companies in one of the contracting parties. In CETA such a limitation has already been introduced.

Further proposals include lowering the level of protection under the standard of fair and equitable treatment and against indirect expropriations and a confirmation that investors cannot expect the legislation in the host state, as valid at the time their investment, to remain unchanged. In addition, foreign investors should not benefit from better rights than domestic investors. To me, these proposals are acceptable in treaties with countries with rule of law-legal systems. However, in treaties with countries with deficits in the legal protection for investors, the investment protection should continue to guarantee to investors from Germany a level of protection similar to the level of protection that investors from these countries enjoy in Germany pursuant to our national and EU law.
As for proposals to include more transparency in ISDS-proceedings, the new UNCITRAL transparency rules of 2013 already provide for a very high level of transparency for new investment protection treaties. CETA not only includes the new UNCITRAL transparency rules, but extends transparency obligations to publishing the annexes and exhibits of the parties’ submissions, for example. It is most likely that the EU Commission will request the insertion of these extended transparency rules in all future negotiations on investment protection. In my opinion, an obligation to disclose any third party financing could also be introduced.

The current discussion also focusses on the relation between national remedies and ISDS. It is considered unfair if investors were to be allowed to challenge state measures in the host country’s administrative courts and initiate ISDS-proceedings at the same time. Investors are thus demanded to withdraw pending or waive future national remedies when initiating ISDS procedures (‘no-u-turn’-approach); or to make a final and binding choice between national remedies and ISDS before initiating any proceedings (‘fork in the road-approach’). In my opinion, both approaches are viable in countries with a high level of protection for foreign investors. In countries with a low level of investment protection, both approaches would probably lead to an increase in ISDS cases due to investors’ lack of confidence in the impartiality of the local legal system. Therefore, for the latter countries, it might be preferable to allow access to ISDS if local courts have failed to provide legal protection within a certain time period.

Further improvements in ISDS procedures could be introduced in the selection and work of arbitrators by, for example, setting up bilateral trade and investment courts with fixed lists of judges, preferably professional judges and scientists, as well as rules for assigning cases to the judges. This could be complemented by a code of conduct to ensure that arbitrators remain free from conflicts of interests. To this end, the code of conduct could prohibit judges from acting as lawyers and vice versa.

In order to reduce the number of unjustified ISDS claims, the costs of the arbitration as well as the costs of legal representation of the winning party should always be borne by the unsuccessful disputing party. To limit the cost of ISDS-procedures, the refunding of the costs of legal representation by the unsuccessful party could be limited to certain amounts, e.g. a maximum daily amount or limit for costs per hour to be refunded.

Finally, appeals or review mechanisms could be introduced to ensure the coherence of jurisprudence, and the parties to the agreement could be given the authority to issue binding interpretations of the agreement in order to enhance consistent application of the agreement. In CETA these proposals have already been implemented to a large extent. The treaty provides for the parties’ right to issue binding interpretations of its standards of protection; and also asks the Committee on Services and Investment to discuss whether and how an appeal mechanism should be introduced.

Conclusion

The current debate will undoubtedly have a profound effect on the content of future investment protection treaties. In this respect the next three years may change the content of investment protection treaties seen to date. In my opinion there will still be investment protection agreements, but they will probably provide for a lower level of protection, at least in treaties between states with a high level of investment protection pursuant to their national laws. Most of the treaties will provide for greater transparency in ISDS proceedings and limit parallel challenges of state measures before national courts of the host country and in ISDS. Stricter rules on the selection of arbitrators will probably be introduced to ensure their impartiality. We may also see unsuccessful disputing parties forced to shoulder greater responsibility for bearing the costs of arbitration. Finally, an appeal or review mechanism is likely to be introduced. It remains to be seen what effects this change in investment protection treaties will have on the ability of the German government to provide investment guarantees in its current form.