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EU'S NEW MANDATE

National Treatment To Foreign Investors

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ON 12TH SEPTEMBER 2011, the General Affairs Council of the European Union (EU) officially approved negotiating mandate for investment protection measures under the proposed free trade agreements with India, Singapore and Canada. The secretive manner in which the negotiating mandate was approved raises several legitimate questions about the entire process.

The new negotiating mandate specifically proposes investor-to-state dispute settlement provisions (in addition to state-to-state). This remains highly contentious because it gives special rights to investors to completely bypass the domestic legal system and seek redresses before a panel of international arbitrators. This is especially worrisome since the new mandate calls for "the highest possible level of legal protection and certainty for European investors in Canada/India/Singapore." At the same time, it does not endorse any qualifications or limitations of investors' right to be protected under the new agreements. Since the entry into force of the Lisbon Treaty (1 December 2009), the competence for international agreements concerning foreign direct investments (FDI) has shifted from individual member-states to the EU.

Prior to this date, the European Commission had only the competence in the areas of market access and pre-establishment phase of an investment while all competencies related to the post-establishment phase of an investment were under the domain of individual member-states.

Since 2010, the European Commission (EC), European Parliament (EP) and member-states are working towards the creation of a new regulatory framework. As part of this evolving process, EC seeks to use its new authority for negotiating investment protection agreements under the proposed FTAs with India, Singapore and Canada. This is despite the fact that the demarcation of exact competence between EU member-states and Commission over external investment policies is still not clear.

UNDERMINING EUROPEAN PARLIAMENT

On 6 April 2011, the EP adopted a resolution on a future European international investment policy wherein a number of policy suggestions on substantive and procedural clauses were delineated. Even though the EP resolution is not strong enough to protect policy space and public interests, it recognized several flaws in the current international investment regime and offered valuable suggestions.

With the EC now getting a negotiation mandate for a chapter on investment protection under the FTA negotiations with India, Singapore and Canada, this move not only ignores the

concerns of the European civil society organizations but, more importantly, contradicts the key demands and suggestions put forward by the EP.

To illustrate, there is no mention in the negotiating mandate of the demand put forward by the EP that "speculative forms of investment, as defined by the Commission, shall not be protected." While the mandate explicitly requires the scope of investment protection shall cover intellectual property rights, it does not include EP's key proposal that "the provisions should avoid negatively impacting the production of generic medicines and must respect the TRIPS exceptions for public health."

The new mandate given to the European negotiators for an agreement with India distinctively seeks "unqualified most-favoured nation treatment," whereas the EP resolution specifically calls for "allowing some flexibility in the MFN-clause in order not to obstruct regional integration processes in developing countries."

Although the EP asked the Commission "to assess the potential impact of the inclusion of an umbrella-clause in future European investment agreements and to present a report to both the European Parliament and the Council," but the leaked negotiation mandate has already sought the inclusion of an "umbrella clause."

Similarly, the EP's resolution requested "to include in all future agreements specific clauses laying down the right of parties to the agreement to regulate, inter alia, in the areas of protection of national security, the environment, public health, workers' and consumers' rights, industrial policy and cultural diversity," but the negotiating mandate carefully eliminates the right to regulate in the area of industrial policy. This could have serious ramifications for host countries (particularly the developing ones) to pursue long-term industrial policy and development strategies.

Furthermore, the negotiating mandate ignores the EP's request "to include, in all future agreements, a reference to the updated OECD Guidelines for Multinational Enterprises."

In particular, the mandate seeks higher standards of treatment with the following key clauses:

a) fair and equitable treatment, including a prohibition of unreasonable, arbitrary or discriminatory measures,

b) unqualified national treatment,

c) unqualified most-favoured nation treatment,

d) protection against direct and indirect expropriation, including the right to prompt, adequate and effective compensation,

e) full protection and security of investors and investments,

f) other effective protection provisions, such as "umbrella clause",

g) free transfer of funds of capital and payments by investors,

h) rules concerning subrogation.

A critical analysis of each of these specific measures of the mandate is beyond the scope of this short paper, some important measures are discussed below.

UNQUALIFIED NATIONAL TREATMENT

The principle of (unqualified) national treatment (treating foreign at least as good as local investors) is highly contentious because most countries refrain from giving national treatment to foreign investors without limitations and qualifications. It is well recognized that unlike trade, foreign investment is a much more economically and politically sensitive issue since it essentially means exercising control over ownership of national assets and resources. Interestingly, it is not only developing countries (such as India) that are extremely concerned about foreign companies acquiring control over their national assets and resources. Even within Europe (particularly in France and Germany), policy makers are concerned about the recent acquisitions of their domestic assets and resources by sovereign wealth funds and private investors from the Middle East and Southeast Asia.

CAPITAL TRANSFERS

Another problematic provision pertains to the free transfer of funds of capital and payments by investor. This particular provision is baffling particularly when there has been a rethink in the international policy circles on active capital account management in the wake of the global financial crisis. Throughout the developing world, policymakers have deployed a wide range of exchange restrictions and capital controls when faced with balance-of-payment problems and volatile capital flows. Such commitments would entitle foreign investors to compensation if a host country imposes currency and capital controls that would prohibit foreign investors to transfer money into and out of the country. Besides, free transfer provisions are very broad in scope as they include profit, dividends, capital gains, royalties, fees and returns in kind. However, in the wake of the Argentine financial crisis of 2001, serious questions have been raised about the ability of host countries to impose capital controls that are inconsistent with their bilateral trade and investment treaty commitments. In December 2001, Argentina had introduced restrictions on capital outflows to maintain financial stability. Under the restrictions, both foreign and domestic investors were barred from transferring funds abroad and wire transfers required prior central bank approval. The authorities had also imposed a ban on foreign currency futures transactions. In 2005, the Argentine authorities introduced several new restrictions on capital inflows to discourage speculative flows entering the country.

In response to capital controls which adversely affected the rights of foreign investors, numerous investor-state claims were filed against Argentina. Close to fifteen US investors submitted claims to investor-state arbitration stating that capital restrictions breached commitments of the US-Argentina BIT. In several instances, investor-state arbitral tribunals ruled against Argentina and awarded hundreds of millions of dollars to US investors. To date, Argentina has maintained that it is not liable under its investment treaties because capital controls were imposed for a legitimate purpose to restore financial and macroeconomic stability.

Particularly in the case of developing countries, the extensive use of investor-state claims in such situations can delay and weaken their policy response to overcome a currency or financial crisis.

UMBRELLA CLAUSE

The negotiating mandate seeks the inclusion of the "umbrella clause" so as to provide additional protection to investors. The umbrella clause (also known as the mirror or parallel effect clause) is a provision that requires each Contracting State to observe all investment obligations entered into with investors from the other Contracting State.

Nowadays the controversial umbrella clauses are found in several bilateral investment treaties (BITs). Subject to diverse interpretations, the umbrella clauses blur the distinction between contract and treaty. Any breach of investor-State contracts could be considered as BIT violations under the umbrella clause. An investor can seek redress of a breach of investment contract between it and the Contracting State through international arbitration under the BIT. Three recent cases at the ICSID (*Vivendi v. Argentina, SGS v. Philippines and v. Pakistan*) exemplified the theoretical and practical ambiguities related to umbrella clauses in the BITs.

INVESTOR-TO-STATE DISPUTE SETTLEMENT MECHANISM

Similar to the controversial Chapter 11 of North American Free Trade Agreement (NAFTA), such investor-state dispute settlement mechanism will allow investors to bring claims against governments of both trading partners before a panel of arbitrators with hardly any public participation or accountability. Private corporations from NAFTA member-countries have exploited the provisions of the agreement to challenge a wider range of regulatory measures on health, environment and public safety that infringe on their expansive investment rights. Most problematic is the interpretation of the concept of "direct and indirect expropriation," which can restrict the ability of governments to carry out social and developmental measures that might adversely affect the profits and businesses of foreign investors. Investors from NAFTA member-countries have used provisions under Chapter 11 to sue governments and demand cash compensation for government policies and regulations which affect their investment rights.

In addition, the mandate also states that "all the sub-federal or local entities and authorities (such as provinces or municipalities) must effectively comply with the investment protection chapter of this agreement." For a country like India with hundreds of municipalities and local authorities, one wonders whether the true ramifications of such investment protection provisions could ever be fully comprehended by such bodies.

SOME UNRESOLVED ISSUES

There are several unresolved issues which question the EU's ability to start such negotiations. For instance, the EU cannot use existing International Centre for Settlement of Investment Disputes (ICSID) and United Nations Commission on International Trade Law (UNCITRAL) dispute settlement mechanisms since it is not a member of these bodies. There is still no clarity

on sharing financial responsibilities between EU and member-states. Who would pay in case the EU loses a case in international arbitration?

By approving such a lop-sided negotiating mandate which puts investors' rights above those of democratically-elected governments, the European member-states have lost an opportunity to pursue a greater balance between investor rights, investor responsibilities, and host government policy space. □□□

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