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Investor Protection in Europe: What does the Future Hold?

Ahmed Mazlom · Wednesday, July 7th, 2021

What does the future hold for investment protection in Europe? A colossal question that resonates across board rooms and government halls on both sides of the Channel. With a consortium of investment law experts including Nikos Lavranos (NL Investment Consulting), Ayse Lowe (Bench Walk), Gordon Nardell QC (Twenty Essex), and Laura Rees-Evans (Fietta LLP) joining together, the webinar held on 30 June 2021 provided multi-disciplinary viewpoints that will be of interest to both investors and States alike.

Notably, the speakers switched seamlessly between themes, starting off with third-party funding post-*Achmea*, as well as what the future holds for EU investors, moving on to the ever-evolving impact of Brexit on investment protection (particularly under the framework of the EU-UK Trade and Cooperation Agreement, 'TCA'), discourse on the European Court of Human Rights ('ECtHR') as an alternative forum for investment disputes, before summing up with the impact of the rising tide of corporate social responsibility ('CSR') obligations—with a focus on the endangered elephant in the room, environmental provisions—on the investment treaty landscape in Europe.

Shortly put, despite these developments remaining unresolved or uncertain at the time of writing, the speakers delivered a much-needed contribution in the form of pragmatic solutions that investors, negotiators, and policy makers should take heed of.

Post-*Achmea* Repercussions on Funding (or rather Defunding) Intra-EU Disputes

Post-*Achmea*, Lowe stressed that the most import criterion—recoverability—overshadows even the best of potential claims. *Achmea* triggered shockwaves in the third-party funding industry as appetite to fund claims concerning intra-EU disputes dwindled. Traditional insurance providers also grew reluctant to insure security for costs or arbitral award defaults on behalf of third-party funders. Eventually, this spiralling effect disadvantaged European investors as they faced heightened difficulties in securing external funds and borrowing in general; they became a less attractive 'demographic' to lend to.

Lowe also maintains that across (i) ECT reforms, (ii) the European Parliament draft report on responsible private funding of litigation, and (iii) UNCITRAL Working Group III meetings, the prevailing stance adopted by States ranges from slight distrust to outward hostility towards third-party funding. In her view, the main concern voiced by States is that litigation funders are funding

non-meritorious claims. Whilst in practice she noted that litigation funders serve as gatekeepers against these types of cases. In fact, citing the ICSID July 2020 Statistics Report, the number of registered cases against States have decreased from 52 (in 2012) to 39 (in 2019). Albeit a multitude of factors caused this decrease, Lowe believes litigation funders play a seminal role in this decrease as they reject cases without any prospects of success. Whether it be an outright ban on litigation funding (as endorsed by some States) or requesting parties to disclose any third-party funding relationships to courts (as per the EU Parliament report and UNCITRAL discussions), Lowe sharply dissects these considerations as constituting additional procedural hurdles claimants must adapt to.

Considering the EU Parliament report, opposition against litigation funding is grounded in the contention that third-party funders hinder access to justice. On the contrary, Lowe claims that third-party funders *facilitate* access to justice. In fact, the audience poll indicates that the vast majority support this proposition. Moreover, litigation funding clients mainly constitute small and medium-sized enterprises ('SMEs') that seek external funds as a matter of last resort to gain access to recourse—especially since security for costs makes the contentious process even costlier—rather than large multinationals who are comfortable funding their own disputes and boast in-house expertise.

Ultimately, Lowe proposes that policy makers, whether on a regional level (i.e. the European Parliament) or at an international level (i.e. UNCITRAL) engage with third-party funders in their respective deliberations to create a more comprehensive dialogue between stakeholders.

EU-UK Investment Protection after Brexit

Rees-Evans set the scene for this theme by recalling that the general expectation in the run-up to the UK's departure from the EU was that Brexit would enhance the position of UK investors in the EU and elsewhere, notwithstanding the loss of existing protections under EU law (e.g. free movement of capital). One aspect of this was anticipated to be the maintenance of the UK's existing BITs with EU Member States; BITs that the audience overwhelmingly believed still to provide a valid basis for an ISDS proceeding.

She explained that cross-border EU-UK investment is now primarily governed by the TCA, replacing EU law. However, the TCA contains limited substantive provisions, with no protection against unlawful expropriation, no reference to a fair and equitable treatment standard, and no full protection and security clause. The TCA is also limited in terms of procedural rights, as it contains neither an ISDS clause nor a right of action under domestic law.

Notwithstanding the preceding disadvantages, Rees-Evans stressed the positive impact of the UK's status as a 'third-country' (in EU parlance) when it comes to ECT disputes. *Achmea* left open the question of the compatibility between intra-EU ECT ISDS proceedings and EU law, but the opinion of Advocate General Szpunar in '*Komstroy*' indicates that the Court could well find them contrary to EU law. Post-Brexit, a UK investor wishing to invoke Article 26 ECT against an EU Member State should not be caught in the crossfire of these developments.

Moreover, post-Brexit, the UK enjoys complete freedom to negotiate International Investment Agreements ('IIAs'). Nevertheless, Rees-Evans considers this point over-exaggerated as the rhetoric pre-Brexit revolved around views that the UK would negotiate solid investment

agreements with non-EU States based on 'now recovered, once lost' bargaining power. In reality, she notes that the UK, whilst an EU Member State, retained the ability to negotiate IIAs with third countries in certain circumstances. Rees-Evans concluded by reflecting on post-Brexit developments in this arena, noting that the UK was yet to set out a cohesive investment policy and instead appeared to be taking a negotiation-by-negotiation approach that evidenced no general commitment to ISDS.

Investor Protections, is the ECHR Forged as a Sword or as a Shield?

Nardell started off by recalling that he and Rees-Evans had previously analysed the potential for European Convention on Human Rights ('ECHR') to act as a shield for investors whose extant arbitral claims under intra-EU BITs were impacted by the May 2020 Termination Agreement. But that left open the question whether the ECHR might also be available as a sword—that is, as an alternative route for investors to found claims against EU Member States. As well as containing 'traditional' non-monetary human rights provisions, the ECHR through Article 1 of its First Protocol ('A1P1') protects against unjustified interference with property rights, overlapping significantly with protection against expropriation and the fair and equitable treatment requirement commonly found in BITs. Moreover, Article 6 of the ECHR provides for procedural guarantees within the domestic legal system.

Through a 'balance sheet', Nardell weighs the advantages and disadvantages of ECHR claims for investors. On the positive side, the ECtHR has given A1P1 a broad scope by giving the concept of 'possessions' a liberal interpretation. Arguably the net of A1P1 is cast wider than the concept of 'investment' in BITs. Hence, when investors seek to bring a claim that proprietary rights under A1P1 have been interfered with by a State, they can sidestep the objection to jurisdiction, often encountered in a BIT claim, that the right in question does not rank as an 'investment'. As other commentators have noted, the proportionality test which the ECtHR applies to A1P1 provides a coherent and transparent basis for balancing the investor's property interest against the public interest served by the measure under challenge. That provides a degree of certainty that benefits both sides in a dispute.

On the negative side of the 'balance sheet', Nardell argues that despite the ECtHR claiming to assess compensation under Article 41 ECHR according to the *restitutio in integrum* (full compensation) principle, in practice it takes a rather unscientific 'equitable' approach which results in much lower awards than would be expected on an equivalent BIT claim. One difficulty is that the ECtHR's procedure does not easily accommodate contested expert evidence on issues such as valuation and future profits.

Enforceability also proves problematic as the ECHR provides a political rather than judicial mechanism for ensuring satisfaction of ECtHR judgments. Unlike BIT awards, judgments of the ECtHR do not automatically become effective in the domestic legal order of the respondent State. So in practice, the ECHR system relies on voluntary compliance by States, under political and diplomatic pressure via the Council of Europe's Committee of Ministers. Domestic remedies must also be exhausted prior to launching a claim before the ECtHR. This prerequisite makes the judicial process costlier and significantly extends the duration of a dispute, as investors must progress through the labyrinth of appeals on a national level, where applicable all the way to the domestic court of last resort. These features tend to make ECHR claims unattractive to funders.

Astonishingly, the poll results showed no participant replied in the positive on the ECHR as a viable alternative to initiate arbitral claims.

To improve the attractiveness of the ECHR as a viable route for investment claims, Nardell advocates for procedural reforms to the ECtHR including adoption of a more scientific approach to quantum, bringing it more closely into line with other institutions and making the process more familiar for claimants. This and other changes could be achieved without negating the ECtHR's human rights ethos.

IIAs and CSR Obligations in Europe

It is the TCA that Lavranos considers as arguably the most advanced trade agreement to date due to its drafters making an explicit link between investment and environmental protection. Not only does the TCA contain a dedicated chapter on sustainable development, covering environmental standards and the OECD Guidelines, but it is also the first time an IIA consists of specific provisions on tackling climate change combined with direct reference to achieving the Paris Agreement (2016) targets.

Despite these silver linings, Lavranos notes that the aforementioned commitments are in principle only binding upon contracting States. So far as private corporations are concerned, CSR provisions constitute soft law obligations. It is the recent judgment by the Dutch court of first instance against Shell that proves paramount in illustrating that soft law obligations—through dynamic reasoning by judges—can attain 'hard law' status, with subsequent effect obliging corporations to abide by CSR obligations.

Lavranos maintains that the conversion of soft law obligations into hard law status as a phenomenon is not only confined to domestic jurisdictions, but it is also emerging in the international investment law scene. A prime example thereof is found in the Dutch Model BIT (2019) within Article 23, '*a Tribunal, in deciding on the amount of compensation, is expected to take into account non-compliance by the investor*', and in Article 7(4), '*[i]nvestors shall be liable … where such acts or decisions lead to significant damage, personal injuries or loss of life in the host state*'. Irrespective of whether drafters intended for provisions to give rise to soft law or hard law effects, CSR obligations are gradually creating liability for corporations.

These tensions also set the scene for procedural implications on an international level as ISDS claims regarding environmental measures could be excluded or exempted from the jurisdictional scope of a tribunal. Either by the contracting State itself when negotiating prospective IIAs or by the arbitral tribunal in question that determines it lacks jurisdiction on such matters. On a more confrontational basis, States could also initiate counter claims against investors requesting compensation for any environmental damages (i.e. clean-up expenses) incurred by the State (*Perenco v. Ecuador*).

Lavranos foresees an ever-growing intensity between IIAs and CSR commitments, in particular as States are repeatedly condemned by domestic courts for failing to do enough to meet the Paris Agreement climate targets—as the recent judgment by the French Conseil d'Etat illustrates. Consequently, States are forced to adopt ever more far-reaching measures, which will have a knock-on effect on investors. To defuse such tensions, he recommends including specific provisions within IIAs that deal with the consequences of any potential CSR breaches. Such

contemplated provisions must also carefully detail the procedural process activated were such a breach to occur; thus, increasing transparency and managing investor expectations.

Summary

By exchanging views on their respective topics, discussions between the speakers conveyed intricate insights on investment policy. Pertinently, the dialogue between Nardell and Rees-Evans indicated that Brexit is very likely to cause a divergence over time between English law and EU law on the notion of 'public policy'. Expanding on this theme of 'divergence', Lavranos believes such a schism between EU and UK IIA practice will occur as well, especially when it comes to the 'substantive business operations' issue. This condition is embedded in recent EU IIAs, which the UK is no longer bound by.

Ultimately, the synergy between the speakers brought these investment protection issues to the forefront, and in turn, deconstructed investor concerns from diverse angles (rather than the monotonous and bifurcated EU versus UK positions, etc.). By engaging with the audience in the form of multiple polls, the speakers were not confined in predicting the future of investment protection in Europe. Reassuringly, the majority felt optimistic about the future of investor protection in Europe. At least, for now.

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