Litigation *Bonanza*

BY SIMON LESTER

In the push for a U.S.-China investment treaty, policymakers would do well to consider the litigation concerns.

The United States has been negotiating foreign investment treaties in their current form since the early 1980s. The initial treaties were mainly with small, developing countries, and did not lead to much in the way of litigation. As a result, they flew under the radar, and did not cause much controversy.

However, with the signing of the North American Free Trade Agreement—which contained an investment chapter that mirrored a stand-alone investment treaty—in 1993, the situation changed. With the large amounts of cross-border investment among the three NAFTA countries, there were many opportunities for lawsuits, often claiming damages in the hundreds of millions of dollars. As a result, concerns were raised about the impact on "sovereignty" and national regulatory autonomy, as private investors sued governments for a range of actions and measures.

In response, the U.S. government made some minor tweaks to its "model" investment treaty over the years. But the changes were modest, and the U.S. approach to investment treaties remains substantially the same.

In recent months, a number of business groups and politicians have been pushing the idea of a U.S.-China investment treaty. If this treaty is pursued, it may provide an opportunity to think carefully about how the United States should handle foreign investment policy. In this regard, there are some fundamental questions that have received little public attention: Are investment treaties the best way to liberalize foreign investment? More specifically, do investment treaties offer the right approach to removing barriers to foreign investment, or do they instead mainly encourage litigation due to some of their vague legal provisions?

Before examining these questions, let's start with a basic assumption: foreign investment, both inward and outward, is good.

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By opening the door for a flood of sometimes questionable lawsuits by foreign companies, a U.S.-China investment treaty could actually undermine an open foreign investment policy, both in China and the United States.

Investment is a fundamental driver of economic growth. The source of the investment is irrelevant, and there are few legitimate concerns—national security is one—with the "foreign" nature of an investment. Mercedes-Benz is investing in Alabama? That's great. The nationality of the owner does not matter to the employees, and it should not matter to anyone else. Chrysler is investing in China? That's great, too. When companies locate in the most efficient production area, consumers benefit and it makes the companies more viable over the long term. Concerns about job losses from shifting production abroad ("outsourcing") are understandable for those affected, but putting up barriers to prevent such market-based outcomes is extremely costly and cannot be sustained in the long run.

Those who disagree will certainly oppose investment treaties, as they oppose foreign investment in general. But that is a different debate. The question here is: For those who believe foreign investment is beneficial, are investment treaties a good policy tool?

In addressing this issue, a useful starting point is an empirical question that investment treaty experts have examined: Do investment treaties actually "promote" foreign investment? Academic studies of this issue are mixed, with conclusions ranging from a large positive impact on foreign investment, a modest positive impact, no impact at all, or even a negative impact.

More importantly, though, it is not even clear that this is the right question to ask. If the goal is to increase the amount of foreign investment, governments could simply offer subsidies to foreign investors. But government subsidies are inherently market distorting, so focusing on the amount of foreign investment is not the right way to think about the issue of liberalizing foreign investment. This leads to a reconsideration of the question. The goal should not be for governments to "promote" foreign investment, with success measured by the quantity of foreign investment. Rather, it should be for governments to remove barriers to foreign investment, so that investors can choose on their own where to invest, based on market considerations. The amounts invested at home or abroad should not be any particular figure; they should be whatever the market determines. The key is to give companies the freedom to invest wherever they want by removing barriers, and allow them to decide on the location.

But which "barriers" should be removed? This question brings us to the litigation issue, and to the actual legal obligations in investment treaties. There are a number of these obligations, of varying complexity, all of which have extensive jurisprudence in the growing body of case law. To keep things simple, consider three key provisions that are found in most investment treaties.

First, these treaties usually include a provision that allows foreign investors to sue governments for alleged violations, commonly referred to as investor-state dispute settlement (investors can sue states directly). For most international legal obligations, only governments can bring complaints, which acts as a filter on legal claims, as the home country government reviews possible claims and decides which ones to bring. With investment treaties, by contrast, foreign investors can pursue litigation completely on their own.

Turning to the substantive obligations, let's focus here on two in particular. First, there is the "national treatment" provision, which says, in essence, that governments should treat foreign and domestic investors equally. This obligation is consistent with the general principle that "foreign" investment is just as good as "domestic" investment, and that the nationality of the investor does not matter (aside from legitimate national security concerns). Arguably, this provision reflects the idea that investors should be able to decide on their own where to invest, with no encouragement or discouragement from a government.

If national treatment were the only obligation, concerns about excessive litigation would be lessened. But there are broader obligations as well, going beyond the "foreign" nature of the investment. As an example, let's look at another provision included in most investment treaties, titled "minimum standard of treatment": "Each Party shall accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security." (This language is from the U.S. model bilateral investment treaty.) If this language seems unclear to you, do not feel bad. Experts in the field cannot

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seem to agree on the meaning of the provision either, and this vagueness opens the door for a wide range of claims that a government has mistreated a foreign investor.

Importantly, as noted, discrimination against foreign investors is already prohibited. Thus, the "Minimum Standard" provision means that there are some actions by governments which are not discriminatory, but nevertheless violate the treaty. Unfortunately, it is not very clear what these actions are, or why they should be prohibited by an international investment treaty. Trying to design a treaty that prevents governments from acting badly, in some general way, is perhaps overly ambitious. It is more akin to a system of global administrative or constitutional law than an attempt to put foreign and domestic investors on equal footing.

When an investor-state dispute mechanism is combined with vague obligations such as "minimum standard of treatment," opportunities for legal claims grow considerably. This can, and has, led to an explosion of litigation in recent years. The United Nations Conference on Trade and Development reports 450 known cases as of 2011. It is possible that, rather than facilitating new foreign investment, these treaties might just be an additional avenue (beyond domestic courts) for foreign investors—who would have made their investment anyway—to sue host governments.

The legal obligations described above should play an important role in any discussion of a U.S.-China investment treaty. If and when the talks begin, the public debate should address the actual content of the treaty, in particular whether certain provisions are necessary to provide a framework for liberalized investment.

The issues cannot be divided into a simple "for" or "against" foreign investment. Rather, they are about what "international investment law" should look like. The specific legal obligations in these treaties will have an impact on how a treaty works in practice, and as a result on how a liberalized foreign investment policy is judged in the court of public opinion. A key question is, do "minimum standard of treatment" rules, combined with investor-state dispute settlement, go too far?

This is not the first time such issues have been raised, as they have been controversial in other U.S. treaties as well. But the U.S.-China economic relationship is particularly contentious, and as a result these issues might face scrutiny beyond that seen in past treaties. Chinese investment has already proved controversial in the United States, with the U.S. government sometimes wary of Chinese ownership of certain U.S. assets. It seems clear that the issue would be even more contentious if Chinese companies—especially state-owned ones—were able to sue the U.S. government directly for perceived bad treatment. By opening the door for a flood of sometimes questionable lawsuits by foreign companies, a U.S.-China investment treaty could actually undermine an open foreign investment policy, both in China and the United States. For those who support liberalized foreign investment, it might finally be time for a serious discussion of how international agreements should deal with these issues. ◆