TTIP: Shaping the Future of Investor–State Dispute Settlement?

Sapfo Constantatos
Standard Chartered Bank

Andrew Coop
Department for Business, Innovation and Skills

Lorenzo Cotula
International Institute for Environment and Development

Christian Leathley
Herbert Smith Freehills LLP

Andrea Shemberg
London School of Economics and Political Science

Chair: Andrew Cannon
Herbert Smith Freehills LLP

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Introduction

At an event organized by the International Law Programme at Chatham House and Herbert Smith Freehills LLP, the implications of investor–state dispute settlement (ISDS) provisions in the proposed Transatlantic Trade and Investment Partnership (TTIP) were explored. This summary provides an overview of the main themes that emerged during the discussion.

The meeting was held under the Chatham House Rule. All speakers spoke in a personal capacity.

Background

TTIP is a major free trade agreement (FTA) currently being negotiated between the United States and the European Union. TTIP is intended to drive economic growth on both sides of the Atlantic. Supporters anticipate that it will provide some of the benefits of a single market, such as consistent standards and regulatory cooperation.

The inclusion of ISDS provisions within the investment chapter of TTIP has attracted debate among a range of stakeholders. On 13 January 2015, the European Commission issued a detailed report on the outcome of its public consultation on the proposed treaty. Of approximately 150,000 responses received, 97 per cent opposed either TTIP in general or the inclusion of ISDS in it. The United Kingdom submitted the most replies – 35 per cent of the total – of any EU member state.

Despite criticisms, the number of investment treaties continues to grow. According to statistics released by the UN Conference on Trade and Development (UNCTAD), 2014 saw the conclusion of 27 international investment agreements. Bilateral investment treaties (BITs) and ISDS have now become the standard for investment protection. Arbitral tribunals established under the International Centre for Settlement of Investment Disputes (ICSID) have concluded 356 matters, with 37 per cent of cases having been decided in favour of states, 25 per cent having been decided in favour of the investor and 28 per cent having reached settlement. However, the standards and protections vary between treaties, and the decisions rendered under them can differ on basic points of construction.

The relevance of investment protection and ISDS

The relationship between BITs, political risk and investment flows is complex. There is some debate on whether, to what extent and under what circumstances BITs and investment protection chapters in FTAs increase foreign investment. While it is unlikely that the presence of an investment treaty would, in itself, be an overriding factor in a decision to make an investment in a particular country, a guaranteed level of protection that could not be undermined by state action would form part of the decision-making calculus; the signing of BITs and the state response to claims would signal a positive investment environment.

In practical terms, investors will attempt to mitigate their investment risk by, for example: seeking substantive protections in their contract with a state or private entity; ensuring that a favourable legal system governs these obligations; and requesting a form of dispute resolution that refers disputes to a private arbitration tribunal or a court of a different country. This is one way in which states agree to limit the exercise of their sovereignty. Another is through the provision of investment protections, and mechanisms such as ISDS for their enforcement, in exchange for the benefits received through investment.

This summary was prepared by Chanu Peiris.
Differing views were expressed with regard to the utility of an investment chapter and ISDS mechanisms in the TTIP context. Doubts were raised about whether the European Commission had adequately assessed and articulated the costs and benefits of the proposed provisions. Given that both the US and the EU respect the rule of law, enjoy functioning judicial and legal systems, and have extensive foreign investment, it was queried whether the ISDS provisions contained in the investment chapter are necessary. It was also noted that there are significant risks of exposure to arbitration claims, even in countries where the rule of law applies. For example, Philip Morris Asia is using an ISDS mechanism to sue the Australian government over its introduction of plain cigarette packaging laws, while Canada has faced 23 arbitration claims under the North American Free Trade Agreement (NAFTA). Where a greater number of investors benefit from the protections and ISDS mechanism, there is a greater likelihood of claims.

Other participants suggested that an ISDS mechanism should be included in TTIP as it provides a depoliticized system in which foreign investors and host states may resolve disputes. One prevailing consideration in the ISDS context is that the system is asymmetrical: it is always the state that provides the protections, and always the state that is the respondent to claims. However, while it could be argued that international investment arbitration threatens state sovereignty, it is ultimately the state that decides which powers to cede and the extent to which it does so. Furthermore, it must be borne in mind that the state can ultimately exercise police powers and may rely on the protection of sovereign immunity. It was also noted that alternatives to ISDS, such as permanent courts, attract their own financial and political costs. ISDS, which affords flexibility and relatively low political and financial costs, could be the best dispute resolution mechanism.

It was also suggested that the US and the EU could face charges of hypocrisy if they were to insist on an ISDS mechanism in investment treaties with developing countries without embedding one in TTIP. One participant suggested that on the US side, the fear of diminished bargaining powers with China could be a motivation for the inclusion of ISDS in TTIP.

**Opposition to ISDS and the perceived legitimacy crisis**

The scale of citizen engagement with TTIP has been unprecedented in the field of investment treaty-making. While such engagement is a positive development, it may also be indicative of a wider legitimacy crisis relating to the regulation of transnational private-sector activity. It was noted by one participant that much of the opposition to ISDS reflects the perceived failure of international organizations, institutions, businesses, governments and others to create policies, rules and practices that ensure that international investment supports environmental, social and economic goals while reinforcing good governance. As such, the response to the apparent crisis cannot be simply to implement formal adjustments to the investment chapter in TTIP.

It was suggested that framing the debate in terms of a tension between investor protection and the right to regulate is too narrow. From a human rights perspective, it fails to acknowledge that under international law states have a duty to put in place policies that ensure respect for and fulfilment of human rights. The question that should be posed is whether ISDS can be improved to address the wider legitimacy crisis described above.

One speaker suggested that ISDS could be embedded with better procedures and practices, including: improved transparency; the possibility for affected stakeholders to participate in arbitrations; rules about third-party funding and frivolous claims; rules on conflict of interest for arbitrators; appellate bodies; and a system of precedence. Article 31(1)(3)(c) of the Vienna Convention on the Law of Treaties means that
arbitral tribunals should take into account any relevant rules that apply to the parties to a treaty; these rules could, in theory, include a range of other instruments. Although there has been some practice of incorporating labour and environmental standards in the investment treaty context, such as ‘no lowering of standards’ clauses in US and Canadian BITs, arbitral tribunals on the whole have been reticent to consider human rights arguments. While there is certainly room for thinking creatively and going beyond current treaty practice, the desirability of arbitral bodies interpreting and applying human rights standards was also queried from a domain expertise perspective.

**TTIP and its ISDS provisions as a blueprint**

It is anticipated that TTIP will be a blueprint, or at the very least a benchmark, for future FTAs. Some participants criticized the idea of incorporating ISDS provisions wholesale in treaties involving different countries that have different social, economic and cultural conditions. It was suggested that using TTIP in this manner could deepen mistrust of the ability of governance structures to ensure that international investment treaties deliver on promises of improved prosperity, higher living standards and improved enjoyment of human rights.

It was also observed that current standards for investment protection vary. Many countries already have BITs with EU member states under terms that are more investor-friendly than those of TTIP or the Comprehensive Economic and Trade Agreement (CETA) negotiated between Canada and the EU. One participant suggested that the content of each treaty should be tailored to the needs and circumstances of the parties; and that treaties negotiated with emerging economies should require lower standards of protection from those countries. Other participants considered that certain universal standards could still be expected, and that the right to a hearing by an independent judiciary or protection from arbitrary acts by the state, for example, should be embedded in all investment treaties.

**The European Commission’s four proposed areas of improvement**

Some participants felt that the proposed TTIP text revealed by the European Commission (which in part was derived from the text of CETA) was a marked improvement on a number of treaties concluded by EU member states in recent years. In particular, the text contained tailored provisions on fair and equitable treatment; an annex on indirect expropriation that has become a staple of recent US and Canadian treaties; and rules on transparency in investor–state arbitration that go beyond the provisions of the UN Commission on International Trade Law (UNCITRAL) in this area.

In its report on the consultation, issued on 13 January 2015, the European Commission identified four core areas related to ISDS that, in its view, require further consideration. The first is the creation of an appellate system. It was explained that the US and UK are both reserving their position on this area pending views from the Commission. In the CETA text, the Commission had recognized that there might be merit in this and had established a joint committee to consider it in further detail. Participants expressed differing views as to the feasibility of this project. On the one hand, it was suggested that with TTIP the Commission may want to go further and provide for appeals using a system that could, in time, be used by other investment treaties, including CETA. On the other hand, the considerable practical difficulties and potential cost involved in establishing an appellate court were noted.

On the second core area – the right to regulate – questions were raised regarding the extent to which the Commission should go further than CETA and the US Model BIT, which already have strong protections in place for the right to regulate. CETA, for example, includes the concept of a public welfare proportionality test in the annex on indirect expropriation. One option would be to apply a public welfare
test more widely in TTIP so that it also covered fair and equitable treatment standards. This would require tribunals to examine whether a measure that allegedly breached standards nevertheless addressed a legitimate and proportionate public welfare objective. However, there was also a view that such measures might not make a substantive difference in practice, and that the US might not want to shift the balance from where it currently stands in the US Model BIT. As for the possibility of sectoral carve-outs from the right to bring claims, it was contended that as a general rule, if drafted tightly, the general protections should be sufficient.

The third area the Commission is exploring is the constitution of arbitral tribunals. Critics have claimed that there is systemic bias in arbitral tribunals. With an approved list of arbitrators, a possible future Code of Conduct for Arbitrators, and the requirement that arbitrators agree to the International Bar Association’s code of conduct, it was argued that the CETA text strikes the right balance and that the US and EU are likely to support a similar approach for TTIP.

The final core area is the relationship between domestic and ISDS proceedings. The CETA text prevents an investor bringing parallel ISDS and domestic claims (as Philip Morris Asia has done in Australia). There are many calls from member states and other parties for a ‘fork in the road’ provision, requiring investors at the outset to choose between pursuing ISDS and domestic claims. It was noted that while such a provision could work in principle, questions remained with regard to its implementation and practical operation. Application of the ‘exhaustion of domestic remedies’ principle to investment treaty claims was also explored. One participant noted that investors would always seek to resolve disputes in all other possible ways before bringing an investment treaty claim, and that such a claim was always a method of last resort. While the potential for ISDS after exhaustion of local remedies might provide some comfort to investors who had concerns about some domestic courts, concerns were expressed that investors might still bring claims to ISDS if they did not receive a favourable outcome in domestic courts. One contributor also noted that exhaustion of local remedies was potentially problematic in jurisdictions where the court system was slow, and could deny an investor a right of redress.

While the EU’s consultation was welcomed, the process adopted by the Commission attracted some criticism. The US conducted a one-year multi-stakeholder consultation to arrive at its 2004 Model BIT, and engaged in a further three-year revision process to arrive at its 2012 Model BIT. The Commission’s process, in comparison, was considered inadequate by some participants. They noted that it was unclear whether the text that was the subject of the consultation represented a negotiated outcome or the EU’s proposed model for TTIP. Additionally, the consultation was based on incomplete extracts from a version of CETA that was, at the time, still under negotiation. Without the full draft TTIP text, it is difficult to understand, interpret and comment on the provisions.

The EU’s proposed areas for further consultation cannot be assessed in isolation. It was noted that it is not possible to consider the right to regulate without reference to the scope of fair and equitable treatment or the protection against expropriation. A more holistic approach, based on the totality of the treaty’s text, was recommended for the second part of the consultation process.

**Procedural filters**

Differing views were expressed on the introduction of a filter mechanism to manage the risk of claims for compensation as a result of prudential regulation. The singling out of financial regulation was queried; arguably, financial regulation is not always more important than other types of regulation.
It was also contended that the broad scope of the prudential exception, combined with the filtering mechanism in the consultation reference text, made the investment protections afforded by the treaty illusory – contradicting the purpose of ISDS. Rather than limiting access to remedies, it was suggested that a better approach would be to address concerns about the scope and interpretation of substantive protections. If a state measure is not justified, the tribunal should be allowed to make that determination.

If a procedural filter is ultimately included, it will be necessary to explore ways to ensure that investors can still seek remedies under TTIP. It was suggested that a double-layered filter mechanism could be implemented, with investors being given the express right to make a submission at the first level. Additionally, in circumstances in which public authorities did not agree whether the measure was taken for prudential reasons, consideration should be given to whether the state could continue using this line of defence.