Cents and sensibility: disputing the TTIP

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The Transatlantic Trade and Investment Partnership, a proposed trade, investment and regulatory deal between the European Union and the United States, has become emblematic of the increasingly polarised debate between proponents and critics of so-called globalisation. The size of the combined EU and USA economies - which together account for 45% of global GDP, or 40% in terms of purchasing power - makes the scale of the proposed agreement of major global significance. Furthermore, the scope of the proposed TTIP - covering multiple issues of market access, regulatory cooperation and rules - is notably broad. Therefore it is perhaps unsurprising that the proposed TTIP, drafts of which have been leaked to the public, has elicited considerable public debate. Such disagreements range from the potential economic value of the agreement to the way in which negotiations are being conducted.

One of the aspects of the TTIP that has elicited particular controversy is the proposed chapter on investment protection, which may include an Investor-State Dispute Mechanism (ISDS) for settling disputes through international arbitration. Under ISDS, qualifying international investors can commence international arbitration proceedings against the state hosting their investments for violations of substantive standards of protection, such as the uncompensated expropriation of their investment or unfair and inequitable treatment.

Between March and July 2014, the EU Commission held a public consultation on investment protection and ISDS in the TTIP, which culminated in its publication of a Report in January 2015. In its Report, the Commission highlighted the following areas for further development: (1) the protection of the right to regulate; (2) the establishment and functioning of arbitral tribunals; (3) the relationship between domestic judicial systems and ISDS; and (4) the review of ISDS decisions through an appellate mechanism.

At the macro level, the Commission reaffirmed in its Report its objective of achieving *"the right balance between protecting investors and safeguarding the EU's and member states' right and ability to regulate in the public interest."* This balancing act appears designed to meet some of the criticisms of ISDS and investment protection, while affirming the important role that ISDS can play in resolving investor-state disputes.

This article provides a brief overview of three issues: (1) the international framework for ISDS and investment protections; (2) the role of ISDS to resolve investor-state disputes; and (3) the fact that states, not investors, determine investment treaty standards.

Investment protection within international investment law

The large number of consultation submissions received by the EU Commission that were critical of ISDS and investment protection might be taken to suggest that they are novel innovations in international law. In fact, an investment chapter in the TTIP would sit within an established international framework of investment treaties and free trade agreements.

The era of modern investment treaties began with the signing of the first bilateral investment treaty (BIT) between Germany and Pakistan in 1959. Since then and alongside the increase in global trade and investment flows, investment agreements between states have proliferated. Indeed, there are now reported to be well over 3,000 international investment treaties between states. Whilst the majority of these agreements are bilateral, investment agreements have been included in a number of multilateral treaties, such as the Energy Charter Treaty (to which the EU is a party). Investment chapters have also been included in many free trade agreements (FTAs). For example, Chapter 11 of the North American Free Trade Agreement (NAFTA) between the USA, Canada and Mexico contains both investment protections and ISDS, in addition to trade provisions.

Investment treaties typically provide substantive standards of protection for qualifying foreign investors (such as a right to compensation in the event of expropriation of their investment). In addition, the vast majority of investment treaties provide qualifying foreign investors with a right to commence international arbitration against the host state of their investment for breaching those substantive standards. Accordingly, while an investment chapter in the TTIP along these lines would be a significant development, not least given the role of the EU, it would not be unique. Rather, it would take its place alongside the numerous other investment agreements currently in force in the international legal system.

ISDS to resolve investor-state disputes

The role of ISDS to resolve investor-state disputes is a different issue to the scope of investment protection standards in treaties. This section addresses the former issue and the following section addresses the latter.

The provenance of modern international arbitration as a means of resolving international disputes is frequently traced back to the Jay Treaty of 1794 between the United States and

Great Britain. Significantly, that treaty created mixed Anglo-American arbitration commissions to resolve both state-state disputes and disputes between individuals and states. As such, it was an important precursor to the ISDS provisions in modern investment treaties. Notably, ISDS is now a characteristic feature of the vast majority of investment treaties, with the OECD estimating that over 90% of existing BITs contain ISDS provisions.

While apparently proposing to maintain ISDS as a feature of the TTIP, the EU Commission has expressed its intention to refine it in certain respects, as compared with existing prevailing practice. For example, the EU Commission has stated its desire to enhance transparency in international arbitration under the TTIP. While arbitrations are generally confidential, the recently promulgated UNCITRAL Rules on Transparency in Treaty-based Investor State Arbitration of 2014 are a potentially significant milestone in enhancing transparency in ISDS that the EU Commission has endorsed. Canada is a leading proponent of transparency in ISDS and tries to ensure that key documents submitted to, or issued by, investor-state arbitral tribunals in disputes to which it is a party are made publicly available, as well as pressing for arbitral hearings to be made open to the public. The EU has made similar proposals regarding ISDS in the TTIP.

The EU Commission has also expressed its interest in the possibility of establishing an appellate mechanism for ISDS arbitral awards under the TTIP. In doing so, the EU is weighing in favour of enhancing the consistency of rulings, as compared with their finality.

In general, a party wishing to challenge an arbitral award is limited to a challenge in the national courts of the seat of arbitration or, in the case of ICSID (World Bank) arbitrations, by means of the ICSID annulment mechanism before an ICSID ad hoc annulment committee. One of the reasons behind the general lack of an appellate process in arbitration is to ensure finality of arbitral awards and facilitate the timely resolution of disputes. Nevertheless, the TTIP parties are free to agree on a different system for challenging arbitral awards and the EU Commission appears intent on doing so. Such an approach has been anticipated in other investment treaties. For example, the US-Chile FTA 2003 provides for the possibility of inserting an appellate mechanism for ISDS arbitral awards.

While addressing issues such as transparency and the question of appeals for ISDS arbitrations, the EU Commission appears to maintain its support for ISDS in the TTIP. This is notable since in the absence of ISDS, foreign investors may, for all practical purposes, be limited to seeking recourse against a host state in its own courts. This is seldom the preferred option for an aggrieved investor, not least since a sovereign state includes its judiciary (as well as its executive and legislature) as a matter of international law.

Absent ISDS rights, the investor could also seek (having previously exhausted local remedies) to persuade its home state to commence negotiations and proceedings if necessary against the host state of the investment. This is known as 'diplomatic protection'. One of the limitations of diplomatic protection is that it is within the home state's discretion whether or not to bring a claim on the investor's behalf. That can leave the investor beholden to an unpredictable political process beyond its control. Significantly, the home state of the investor may have no wish to engage in a dispute with another state for any number of geopolitical or economic reasons unrelated to the investor's claim.

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Some of the shortcomings of diplomatic protection were demonstrated in the *Barcelona Traction* case before the International Court of Justice (ICJ) between Belgium and Spain. This case concerned a Canadian corporation which operated light and power utilities in Spain and was based on the allegation that Spain had violated a number of its international obligations. Canada ultimately chose not to bring a claim at the ICJ, although Belgium agreed to do so as 88% of the company's shareholders were Belgian. However, the ICJ held in its 1970 Judgment that Belgium had no legal interest in the matter as it was the company's rights which had been infringed and the company was Canadian. Whatever the reason for the Canadian government's decision not to pursue the claim, this did not justify the exercise of diplomatic protection by another government. Notably, this decision and the limitations of diplomatic protection have been a key driver in the emergence of ISDS provisions in investment treaties. Furthermore, one of the benefits of ISDS as compared with diplomatic protection is that it can help to depoliticise disputes.

Accordingly, investors will generally prefer international arbitration to resolve disputes with host states as compared with recourse to the host state's courts or diplomatic protection. Among other benefits of arbitration, the investor and the host state can participate in the constitution of a non-affiliated arbitral tribunal which has experience of international investment law issues.

States determine investment treaty standards

Some of the criticism of ISDS appears to overlook the fact that it is states, not investors, who determine the scope of investment treaty standards. As a matter of international law, states can define protection standards as they wish within a treaty and create qualifications and carve-outs, for example related to public health and environmental measures. For example, Article 12 of the US Model BIT explicitly recognises the importance of environmental regulation and provides that *"The Parties recognize that it is inappropriate to encourage investment by weakening or reducing the protections afforded in domestic environmental laws."* The EU Commission is proposing to address the scope of application of the TTIP and the parameters of certain substantive standards in that agreement, such as the fair and equitable treatment standard and indirect expropriation. Notably, the recently negotiated EU-Canada Free Trade Agreement (CETA) provides greater specificity on the meaning of standards such as fair and equitable treatment and indirect expropriation in that agreement than is typically found in most BITs.

The key point here is that the TTIP negotiating parties can mould substantive provisions in the TTIP into the form they want. There is no restrictive formula of substantive standards that must necessarily be included in any investment treaty.

Conclusion

Notwithstanding the controversy surrounding ISDS in the TTIP, it is far from evident that proposed alternatives such as using local courts as the exclusive forum for investor claims against host states, and a return to diplomatic protection would be a panacea to replace arbitration of investment disputes. As regards substantive protection standards, it is notable that states, not investors, determine them in their treaties.

A frequently overlooked aspect of ISDS and investment protections is that they are reciprocal. As such, they apply to investors of both parties. Notwithstanding some public suggestions that ISDS in the TTIP would only benefit US investors, it is notable that six of the top ten home states for investor claims are EU member states. Furthermore, they are reported to have collectively brought more ISDS claims than US investors in the last 30 years.[2] The mutuality of ISDS and investment protections might therefore suggest that there is a role for both cents and sensibility as the EU Commission looks to open a new consultation on the TTIP in 2015. ■

1. This article does not reflect the views of Withers LLP or its clients.
2. Prof. Dr Christian Tietje and Prof. Dr Freya Baetens, "The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership": Study prepared for the Ministry for Foreign Trade and Development Corporation, Ministry of Foreign Affairs of the Netherlands (24 June 2014), p. 26.