

## **Investor to State Dispute Settlement (ISDS)**

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### **Developments ISDS**

- Since 1959 states have concluded between them more than 3000 agreements containing provisions on the mutual protection of investments (Investment Protection Agreements, IPA's). These agreements provide benefits to both investors and states. Investors can count on better protection. For states is IPA a feature of a favorable investment which enables them to attract foreign investment. This helps to boost economic growth and employment.
- Dispute settlement between investors and states through international arbitration (ISDS) gives the investors the opportunity to invoke these agreements directly. After leading an inconspicuous existence for many years ISDS has evolved rapidly in recent decades. The obligation to exhaust local remedies is no longer found in IPA's concluded in the last decennium. This requirement does not appear in Dutch IPA's.
- ISDS is an instrument which protects investors in two situations: where an investor's own government is unable or unwilling to provide effective assistance and

where the national legal system of the host country, for any reason whatever, provides insufficient protection for foreign investors. ISDS has also the advantage of being a fast and flexible, and mostly cheaper, procedure.

- ISDS has been modernized substantially over the years. The youngest generation of ISDS provisions such as the Free Trade Agreement between the EU and Canada (CETA) and also the model bilateral investment treaty of the US differ greatly from the provisions of the IPA's in the last century.
- The number of ISDS cases brought under the various IPA's has increased considerably (at present a few dozen a year) as has the total volume of foreign direct investments worldwide. The total number of known ISDS disputes, including pending cases, by the end of 2014 was 606, of which 356 have been concluded. The arbitral award was in favor of the state in 37 % of the cases and in favor of the investor in 25 % of the cases. The dispute was settled before the tribunal made an award in 28 % of the cases.
- The majority of claimants are large Western corporations but more than 20 % of the claimants are individuals or very small corporations. The size of claims awarded is hampered by the lack of transparency. Examination of the scarce data available show an average of damages awarded of around 10 million USD.

- The total volume of foreign direct investment amounted to over 25.000 billion USD in 2014, Dispute settlement between investors and states is of particular interest to the Netherlands. The Netherlands have concluded around 100 IPA's. It is amongst the top world sources and recipients of foreign direct investments (FDI).It ranked 9<sup>th</sup> in terms of FDI outflows in 2013 (USD 37 billion) and 16<sup>th</sup> with inflows of USD 24 billion. Dutch firms belong to the largest claimants in ISDS disputes (61) second only after the US (127). Investors from the EU have however submitted more than twice as many claims as the US in the last 20 years (277).

### **Investment protection rules.**

- The substantive law provisions of IPA's are very similar in broad outline. Their aim is to ensure fair and equitable treatment, prevent discrimination and lay down conditions for expropriation. Concepts which occur in such agreements are *national treatment*, *most-favored nation treatment (MFN)* and *fair and equitable treatment (FET)*.
- Older IPA's often contain fairly summary ISDS provisions leaving arbitrators a considerable scope for interpretation and the exercise of their discretion.In the new generation of IPA's, such as CETA, rules are much more detailed.

## **Investment protection procedures.**

- An international investor who is party to a dispute can often choose between different sets of procedural rules for ISDS. The most commonly used rules are those of the Washington Convention (1965). They provide for a procedure which is entirely separate of national judicial-decision making. Under these rules arbitration can be facilitated by the *International Centre for Settlement of Investment Disputes (ICSID)*, which is part of the World Bank. Much use is also made of the *UN Commission on International Trade (UNCITRAL)*. These provide for a procedure which is heavily reliant on domestic law and domestic courts, for example in relation to enforcement of arbitral awards. Usually the *Permanent Court of Arbitration (PMA)* provides for arbitration procedures under these rules. It can also facilitate arbitration under all other procedural rules.

## **EU dimension.**

- Since the Treaty of Lisbon (2009) the EU retains exclusive competence for direct foreign investments. Thus the EU has obtained the exclusive competence to negotiate and conclude IPA's with third countries. It does so on the basis of a negotiating mandate of the Council. If an agreement is concluded it has to be approved by the Council and the European Parliament. The Free Trade Agreement with Singapore and Canada are examples of EU trade agreements which

contain investment protection provisions including a new generation of very detailed ISDS provisions. The negotiations on these agreements have been concluded but the texts are still subject of legal scrubbing.

## **TTIP and ISDS**

- ISDS has functioned well in various ways. Nonetheless, the present OSDS system has given rise to concern en justified criticism. The negotiations about the *Transatlantic Trade and Investment Partnership (TTIP)* have fuelled public debate in the Netherlands and elsewhere. Part of the criticism is addressed to TTIP as such but most of the concerns are aimed at ISDS in particular.
- The main issues are the right to regulate of states and the question about whether the conditions of ISDS meet the rule-of- law requirements. ISDS proceedings may make states reluctant to regulate out of fear of receiving large claims for damages from investors (*regulatory chill*). As to the rule-of-law there are concerns on the consistency of arbitral awards, the independence and impartiality of arbitrators and the lack of transparency of international arbitration. Moreover there is the fear that the American claim culture will cross the Atlantic.
- The central question is the balance between the interests of free trade and investment and the right to regulate of states. What is at stake is the right to

regulate public goods such as the protection of the environment and climate, the protection of consumers, public health and public welfare objectives. The fear that the right to regulate may be affected has been fuelled by two ISDS cases: Vattenfall in Germany and Philip Morris in Australia. Both cases are still pending.

- The Philip Morris case about the plain packaging of cigarettes is regularly invoked as an example of *regulatory chill*. The tribunal has however not yet given a ruling. According to a study by Tietje and Baetens commissioned by Minister Ploumen there is little empiric evidence in the NAFTA practice of *regulatory chill*.
- Both the European Commission and Minister Ploumen have taken account of the growing concerns about ISDS. The European Commission has proceeded to an extensive public consultation and Mrs Ploumen has commissioned a wide ranging study by two German experts (Prof. Tietje and Prof. Baetens). Mrs Ploumen has been engaged in extensive consultations with socialist colleagues in the EU. The Dutch Parliament held several debates on the basis of suggested adaptations of ISDS which were mostly in line with the views of Commissioner Malmstroem.
- Commissioner Malmstroem advanced as early as July 2015 several adaptations of the ISDS provisions to be inserted in TTIP. Most of these provisions build upon

the detailed provisions of the CETA agreement with Canada. The right to regulate of states would be enshrined in the agreement itself, arbitrators would be subject to a *code of conduct* and optimal transparency would be pursued. Arbitrators would be chosen from a roster established beforehand by state parties. Moreover TTIP would foresee an Appeal Tribunal with permanent judges and eventually an International Investment Court should be established.

## **EP and TTIP**

- Debates on the EP were complicated by the fact that the socialist group was divided. A considerable number of the members, including the Dutch ones, were opposed to the TTIP negotiations. Eventually on 8 July 2015 a resolution was adopted favoring the pursuit of TTIP negotiations (436 in favor, 241 against). The EPP, the Liberal Democrats, a majority of the S&D and the conservatives voted in favor. ISDS was not shot down but an amendment was adopted which advocated the establishment of a new ISDS system.

## **Report of the Advisory Council on International Affairs (AIV)**

- In its report of April 2015 the AIV favors the inclusion of some form of ISDS in TTIP. It is doubtful that

national judges in the US and in several EU member states can or will provide sufficient protection to foreign investors. Preferential treatment of domestic investors is not forbidden by US law. Moreover international treaty provisions have no direct effect in the US. In the case of the Netherlands such direct effect is recognized.

- The Netherlands are one of the biggest foreign investors in the US. In fact number 3 after UK and Japan. Conversely the US is one of the largest investors in the Netherlands. Without ISDS provisions in TTIP the EU would have a competitive disadvantage vis à vis such countries as Canada and Japan.
- For the longer term the AIV favors an International Investment Court with permanent judges. In first instance such a court should be established within TTIP. Obviously it can only deal with disputes between the US and the EU and its member states.
- The right to regulate of states should be enshrined within the treaty itself. The ISDS system should be modernized building on the provisions of CETA i.e. optimal transparency, a preestablished roster of arbitrators and a binding code of conduct.

### **Toward a new Investment Court System.**

- Last September the European Commission has tabled a new dispute settlement system between investors and states. These proposals are in line with earlier suggestion of Mrs. Malmstroem and with the AIV report. The central feature of these proposals is the establishment within TTIP of an Investment Court System composed of a Tribunal of First Instance (Investment Tribunal) with 15 publicly appointed judges and an Appeal Tribunal with six publicly appointed judges. On the Investment Tribunal judges would be appointed jointly by the EU and the US, It would be composed of 5 US nationals, 5 EU nationals and 5 nationals of third countries. Judges would have very high technical and legal qualifications comparable to those required for the International Court of Justice and the WTO Appellate body. The Appellate Tribunal would be composed of 2 US nationals, 2 EU nationals and 2 nationals of third countries. It would operate in a similar way as the WTO Appellate Body.
- The right to regulate for public policies is fully guaranteed in the new text. The article also ensures that investment protection provisions should not be interpreted as a commitment from governments not to change their legal framework.
- The proposals builds on existing reforms in CETA agreement and the FTA with Singapore i.e.:
  - Full transparency of all documents and public hearings.

- A ban on forum shopping.
- Government control of interpretation.
- Early dismissal of unfounded claims.
- The loser pays principle.

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