

## Report – ISDS – A Fact and Experience Based Review

TABC and NAM jointly hosted a half-day conference with expert panels to share their insights into the proceedings of international arbitration with Brussels policymakers, business and non-governmental representatives. In the past months investor-state dispute settlement (ISDS) has been the subject of increased public scrutiny and criticism by some. Given the complexity of this mechanism, which is part of thousands of bilateral and international investment treaties, this event sought to provide in-depth information to enable an informed and balanced evaluation of this tool. The panellists from a variety of backgrounds, including arbitration institutions, academia, business and the UN Commission for Trade Law were well suited to provide facts and figures about the process and its rules in effort to return to a fact- and experience-based discussion.

The panelists' remarks are summarized below. Overall key points made during the conference included:

- ISDS is a decades old enforcement mechanism, first created in Europe, that seeks to ensure enforcement of international law obligations that nations undertake, typically related to treating foreign investors fairly and without discrimination and providing compensation for government seizure (direct or indirect of property). It provides a strong protection against political risk in developed and developing countries.
- While the number of cases have grown, so too have investment flows. A few countries have faced a high number of cases, while most have not faced any cases at all.
- ISDS is important for small businesses who have no other recourse to a foreign government's actions, although it can be costly for small businesses to use.
- ISDS cases typically involve government actions regarding individual investors (including relating to permits, licenses and contracts) rather than broad policies, laws or public welfare regulations and have not produced any significant restriction in governments' desire or action to take regulatory measures to protect the environment, public health or welfare.
- EU member states face an increasing number of cases by investors from other European countries. At the same time, some member states are not willing to annul their intra-EU BITs, thereby renouncing investment protection. The EU also has many offensive reasons to care about ISDS given its substantial outbound investment levels worldwide, particularly with the United States, and its continuing desire to attract investment to boost its economy.
- The U.S. Model BIT has undergone several reviews. The EU in contrast does not have a model text yet since investment policy has become an EU competency fairly recently. The TTIP is an opportunity to modernize the complex system of existing BITs of EU member states. The investment provisions can be improved to ensure they are designed to protect investors from political risks of government action and clarifying the core rules.

- There has been an increasing trend toward transparency in ISDS with changes made by the United States in the North American Free Trade Agreement (NAFTA) and subsequent investment models and by UNCITRAL, whose transparency rules came into force earlier this year. The [rules](#) have been developed by UNCITRAL member and observer states on the basis of consensus. Notably, the transparency requirements in the Comprehensive Economic and Trade Agreement (CETA) go beyond UNCITRAL.
- ISDS is important to include in TTIP given the important role that investment plays in growth in both the United States and Europe and in order to enhance the integrity of the international rule of law.
- Businesses are concerned about investment protection provisions in the EU-Canada Comprehensive Economic and Trade Agreement (CETA), emphasizing that the compromise reached in the EU-Canada text provides for a lower level of protection in comparison to existing BITs of both the United States and European member states.

### Alexander Graf Lambsdorff MEP

In his keynote remarks, Graf Lambsdorff emphasised the crucial importance of global value chains as key to trade and investment. The protection of investors is a fundamental element to attract foreign direct investment (FDI). The notion that ISDS was a new phenomenon is mistaken. A number of EU member states have BITs with each other and many of them are not willing to annul these agreements. To the contrary, they want to ensure continuously high levels of protection in the host countries.

Lambsdorff further pointed out that no case has ever been won against his home country Germany, indicating that well governed states have little to fear. Nevertheless, the Vattenfall arbitration against Germany has triggered an emotional debate with major political repercussions, even though the ruling is still pending.

While the number of ISDS cases has increased, so too have global investment stocks. In response to concerns about a potential 'regulatory chilling effect,' Graf Lambsdorff noted that public services are excluded from the negotiations. The importance of including investment protection has ultimately been acknowledged by the German economics minister Sigmar Gabriel who agreed to proceed with the CETA without reopening the talks. Commissioner Malmström reconfirmed the support of all member states for the CETA, emphasizing that modern investment protection is indispensable for a 21<sup>st</sup> century agreement. Industry's ask for legal certainty is neither unreasonable nor unfair, and will benefit the overall investment climate in the EU at a time when the need to attract foreign investors is fundamental to revive the sluggish European economy.

Linked to the need for economic stimulus is the geopolitical dimension. It is crucial to remember that TTIP is not negotiated in isolation but in parallel to numerous other bilateral trade and investment negotiations, e.g., Japan, India but also a bilateral investment treaty (BIT) with China. If investment protection were removed from TTIP, this would severely limit agreements with other countries. Moreover, the EU should consider ISDS as an offensive interest as European investors expect highest levels of protection in the U.S. It is understandable that EU headquartered companies are in certain circumstances hesitant to use U.S. courts.

Graf Lambsdorff acknowledged that improvements and modernisation of existing ISDS provisions is necessary. He noted the definition of fair and equitable treatment, the

independence of arbitrators, and transparency as issues to be addressed. Some innovations need to be considered to avoid ambiguity in legal texts. The concept and the design of an appeal mechanism should be considered. Several reviews of the U.S. Model BIT have been undertaken, showing that reforms are necessary.

In his final statement Lamsdorff reiterated: Let's make no mistake – if ISDS were removed from TTIP this would not be the end of the campaign against free trade. The business community needs to make their voice heard, and be loud and clear about the positive effects on jobs and growth. The debate about TTIP should not be hijacked by the anti-free trade, anti-market economy, and anti-American narrative. Countries like Italy and Spain strongly support the trade agenda because they see a myriad of opportunities for their products. The benefits of international trade and investment have to be communicated more clearly to the European citizens.

### Leopoldo Rubinacci, DG Trade

Rubinacci brought the discussion back to the purpose of investment protection and the importance of being able to enforce international commitments. The first question should, therefore, be whether international rules for the protection of investors are a good concept in principle. If that is the case there is a need to ensure an enforcement mechanism such as ISDS.

The necessity of ISDS is also evident when comparing it to broader trade issues such as compliance with tariffs. Such rules impact a broad range of companies. In contrast, an investment dispute involves merely one investor, making state-to-state resolution neither applicable nor appropriate. ISDS was invented for precisely this reason: To provide a neutral platform for a foreign investor whose basic rights such as non-discrimination have been infringed. The government of the investor does not get engaged, *i.e.*, preventing economic disputes from turning into political ones.

The TTIP negotiations are the first occasion since the Millennium Round that a trade issue has been politicised. In response to the public opposition particularly to the investment chapter, the European Commission opened a public consultation to listen to the concerns of stakeholders and to help define the EU's policies in this area. In their consideration, the Commission will ensure the protection of investment of European companies abroad while at the same time ensuring that foreign investors feel secure when investing in the EU. After all, the EU lost significant investment flows during the economic crisis and urgently needs to attract FDI. In this context it is worth noting that EU member states have been the highest users of ISDS.

The European Commission supports the modernisation of the ISDS provisions. The consultation is part of this effort. Many businesses argue in favour of highest levels of protections as included in some member state BITs. CETA arguably provides less protection but is a solid agreement. In the reform process, transparency is a major issue. The CETA is going beyond UNCITRAL's transparency rules. This is a crucial element in the argument with the critics: If the proceedings of some of the current most controversial cases were available to the public, misconceptions could be better addressed.

The consultation has triggered a record number of inputs based. In addition to the high number of similar submissions, the Commission has received many substantive suggestions. The rich material continues to be reviewed and the results will be published in 2015. During the first months of the new year they will be discussed even more actively with MEPs and member states to decide what the ISDS provisions should look like. In this context it is important to note the conditionality in the mandate which may require all 28 parliaments to approve the final text.

## **Panel 1: A Review**

### Prof. Dr. Christian Tietje

Prof. Tietje outlined the origins of bilateral and plurilateral investment protection treaties as well as facts and figures about the number of cases and agreements over the past 20 years. The scope of ISDS over the course of several decades has evolved significantly. 2013 brought the number of concluded cases to 274 of which 43% were ruled in favour of the state, 31% in favour of the investor and 26% were settled. While BITs in the 1970s and 1980s covered merely compensation in case of expropriation, they evolved to be more comprehensive in the 1990s as parts of deep and comprehensive FTAs that increasingly take into consideration public interests and sustainable development.

Most NAFTA cases are lost by investors. Many NAFTA cases involve natural resources, *i.e.*, conflict-prone sectors where there is oftentimes significant government involvement.

On the notion of regulatory chill, Prof. Tietje undertook a detailed study of this issue with Associate Prof. Dr. Freya Baetens (Leiden University) for the Dutch government resulting in the a report entitled: [“The Impact of Investor-State Dispute Settlement in the Transatlantic Trade and Investment Partnership.”](#) Prof. Tietje noted that the majority of cases involve the executive rather than the legislative branch action and involve single investors rather than broad policies. This indicates that investment protection provisions can serve as an additional check on the executive power. In light of the low number of cases involving legislatures, the potential for regulatory chill appear to be overrated.

With regard to CETA, Prof. Tietje pointed out that ISDS can only be applied post-establishment while market access is not covered. While in early arbitral practices there was a tendency of greater interpretation of provisions, this has become much more restrictive over the past years. The CETA text goes a step further and defines the “fair and equitable treatment” protection in a closed list. The definition of indirect expropriation has also been defined in a more circumscribed text that includes limitations to ensure the government’s right to regulate in the public interest.

In closing, Prof. Tietje emphasised that the inclusion of the ISDS in TTIP is necessary because even advanced judicial system such as the EU and the U.S. sometimes fail to afford due process. Moreover, the geopolitical dimension is crucial, particularly vis-à-vis emerging markets such as China.

When asked about the quality of investment protection in the CETA, Prof. Tietje responded that it is a compromise. Even though it is not a ‘gold standard’ and allows for less protection than some existing model BITs, this compromise is better than no investment protection at all. At the same time there is a distinct risk that governments will be unable to protect ISDS in TTIP. Several groups opposing the provisions are not interested in facts but view the debate in the broader dimension of globalisation. It is particularly challenging as only business and bureaucracies support the inclusion of ISDS in the agreement.

### Judith Knieper, UNCITRAL

UNCITRAL has 60 standing member states that are elected in a way that the regions of the world are well represented. Each zone is represented with a certain number of states. In addition to the member states, observer states participate in the talks, though without a vote. Since 1966 decisions are taken on the basis of consensus. Ninety states were involved to establish UNCITRAL’s “Transparency in Treaty-based Investor-State Arbitration Rules.” In

addition, 40 international organisations, non-governmental organisations (NGOs) and intergovernmental organisations observed the talks. The initial decision to work on the transparency rules was taken in 2008. The rules are available in the six official UN languages. They consist of eight articles which reflect both public interests and investors' interests. The rules require for all key documents to be published online. Hearings are conducted in public. Since the new rules were only adopted in April this year, no cases have been filed yet under the new rules. Canada has put all of the NAFTA cases online to showcase the new rules. Transparency is a powerful tool to build broader support for the provisions. The publication of documents allow for control and broader legitimacy. It is surprising that many NGOs who mistrust governments tend to praise national courts in the debate about ISDS. It indicates a trust in state institutions, which has not been seen by these groups before.

#### Kristin Campbell-Wilson, Stockholm Chamber of Commerce (SCC)

ISDS is an alternative method of dispute resolution. Other forms are mediation, conciliation and negotiation. International arbitration often occurs on commercial grounds. The purpose for ISDS is to provide neutrality and predictability (e.g., with regard to the language in which the case is conducted in). Influence over the choice of arbitrators helps ensure competency and knowledge for those handling the case. ISDS is quicker than public courts and enforceability is possible in 150 states (i.e., those countries that have signed the New York Convention on the Enforcement of Arbitral Awards). With 62 cases the SCC is one of the leading arbitration institutes in the world. The energy sector is the most recurring sector in SCC arbitrations, which is likely to be due to the Energy Charter Treaty. ISDS is often used by individuals and very small corporations with limited foreign operations. Some 22 percent of ISDS cases have been brought by individuals and/or small investors, compared to only 8 percent having been brought by fortune 100 companies.

The results of investor-state disputes administered by the SCC are comparable to the results of other institutes. ISDS is a system developed by states; international arbitration is supported by national legislation. In closing, Campbell-Wilson noted that the SCC is interested to engage with stakeholders to explain the proceedings of international arbitration and to have an open exchange.

#### Fredrik Erixon, ECIPE

Erixon highlighted that much of today's debate already occurred in the 1990s around the WTO meetings in Seattle that gave impetus to the anti-globalisation movement. TTIP critics are not exclusively concerned about the investment chapter but the broader concept of international trade and globalisation.

The political economy is a crucial factor which needs to be taken into consideration when looking at the evolution of trade and investment negotiations. Almost half of the ISDS cases occurred in sectors with high government engagement. Over the past years a trend toward eroding the integrity of treaties has evolved. Politics and politicians are increasingly involved in investment issues. BITs that include ISDS offer companies a path for mediation and arbitration when their legitimate rights have been disregarded. Even in countries with high investment protection the politicisation of investments and interference in markets has advanced recently. The alternatives to prevent mistreatment would be the return to power politics and 'gun boat diplomacy' – the very reason why ISDS was invented.

## **Panel 2 – Business Perspectives**

### Prof. Christoph Benedict, Alstom

In his opening statement Prof. Benedict supported the transparency initiatives underway in UNCITRAL as well as in EU investment treaties. He noted that it was disappointing to see that those who opposed the negotiation of Multilateral Investment Agreement under the auspices of the OECD continue their opposition against ISDS in the TTIP.

Prof. Benedict noted that he is employed by Alstom, a major investor in power systems and trains investing millions of euros in sustainable energy. With the statistics of global and transatlantic FDI flows, it is no-brainer that ISDS is a crucial pillar of a transatlantic trade deal.

Addressing some of the criticism, Prof. Benedict noted that the vagueness which has been criticised in ISDS provisions is equally applicable in other areas of law, including for human rights. Criticism about the independence of arbitrators is applicable to any arbitration system. With regard to transparency Prof. Benedict noted that the legitimacy of international investment treaties is based on their ratification by governments.

### Peter Bay Kirkegaard, DI

A key objective for DI is to advance the TTIP in order to make trade with the US easier, particularly for SMEs. The negative debate about the trade deal and specifically the investment provisions have been blown out of proportion. Interestingly, there is no similar criticism in any other bilateral agreements that the EU is currently negotiating, such as the one with Japan. While critics have argued to remove ISDS, Kirkegaard emphasised the importance of a strong commitment to international law. Even though Danes are not normally known for human rights abuses, Denmark has signed the UN Convention on Human Rights. An additional question to ask is what the price for ISDS would be: no access to the US procurement market? ISDS should not become a stumbling block for the entire agreement.

### Frank Schulte, IPVIC

As an investor in solar energy, Schulte has first-hand experience of an ISDS case. He spearheads a small group of eight solar energy investors associated in the International PhotoVoltaic Investors Club (IPVIC). In order to increase the share of renewable energy, the Czech government introduced incentives and favourable tax provisions for renewable energies. Based on some disputable argumentation, the Czech Republic introduced a retroactive levy on the revenues of solar installations, devaluing the investments made in the sector. After trying national courts without success, the group filed a notice of arbitration against the Czech Republic claiming compensation for financial losses due to the introduction of retroactive measures on the revenues of their investments. The group of several SMEs was formed to mitigate the individual costs for arbitration. The claims are based on the provisions in the Energy Charter Treaty (ECT) and five different BITs. Many small investors are not aware of the ECT and BITs and the protections available to them. More information from institutions such as the SCC would be useful to inform small investors. An additional layer of complexity are the various intra-EU-BITs, particularly with a view to the accession of central and eastern European states to the EU. In some cases certain incentives offered by states are considered state aid under EU law.