

## Reply to the European Commission's Public Consultation on Investment Protection and Investor-to-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)<sup>1</sup>

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*June 2014*

This reply is based on the consultation document "Public consultation on modalities for investment protection and ISDS in TTIP."<sup>2</sup>

<sup>1</sup> Retrieved from [http://trade.ec.europa.eu/consultations/index.cfm?consul\\_id=179](http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179)

<sup>2</sup> Retrieved from [http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc\\_152280.pdf](http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf)

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June 2014

Written by Nathalie Bernasconi-Osterwalder

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## Introduction

On March 27, 2014 the European Commission launched public consultations on the investment chapter of the Transatlantic Trade and Investment Partnership (TTIP), a trade and investment agreement under negotiation between the European Union (EU) and the United States. The first negotiation round took place in July 2013 and the European Commission is targeting mid-2015 as the date for the conclusion of the TTIP. In response to the increased public interest in the TTIP and criticism surrounding the secrecy of the negotiations as well as the content of the investment chapter, particularly the envisaged inclusion of investor-state dispute settlement (ISDS), the EU decided to conduct a 90-day public consultation process on 12 main questions related to investment protection standards and ISDS. Comments can be submitted via an online questionnaire until July 6, 2014.<sup>3</sup> In this context, the European Commission also held a stakeholder meeting with business and non-business participants in May 2014.<sup>4</sup>

This report replies to the European Commission's questions and statements related to the TTIP public consultation. The report seeks to inform the general public as well as European institutions about the legal implications of the proposed investment chapter text.<sup>5</sup>

## A. Substantive investment protection provisions

### Question 1: Scope of the substantive investment protection provisions

#### The European Commission states:

"The scope of the agreement responds to a key question: *What type of investments and investors should be protected?* Our response is that investment protection should apply to those **investments** and to **investors** that **have made** an investment in accordance with the laws of the country where they have invested. [...]"

Many international investment agreements have broad provisions defining "investor" and "investment". In most cases, the definition of "investment" is intentionally broad, as investment is generally a complex operation that may involve a wide range of assets, such as land, buildings, machinery, equipment, intellectual property rights, contracts, licences, shares, bonds, and various financial instruments. [...] In many investment agreements, the **definition of "investor"** simply refers to natural and juridical persons of the other Party to the agreement, without further refinement. [...]"

The EU wants to avoid abuse. This is achieved primarily by improving the definition of "investor", thus eliminating so-called "shell" or "mailbox" companies owned by nationals of third countries from the scope: in order to qualify as a legitimate investor of a Party, a juridical person must have substantial business activities in the territory of that Party. At the same time, the EU wants to **rely on past treaty practice** with a proven track record. The reference to "investments made in accordance with the applicable law" is one such example. Another is the clarification that protection is only granted in situations where investors have already committed substantial resources in the host state—and not when they are simply at the stage where they are planning to do so."

<sup>3</sup> For general information on the consultation process, see [http://trade.ec.europa.eu/consultations/index.cfm?consul\\_id=179](http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179); the online questionnaire is available at <http://ec.europa.eu/yourvoice/ipm/forms/dispatch?form=ISDS>

<sup>4</sup> A video of the stakeholder meeting in May 2014 is available at <https://scic.ec.europa.eu/streaming/index.php?es=2&sessionno=6616758da438b02b8d360ad83a5b3d77>

<sup>5</sup> The report builds on Nathalie Bernasconi-Osterwalder & Howard Mann, *A Response to the European Commission's December 2013 Document "Investment Provisions in the EU-Canada Free Trade Agreement (CETA)"* (IISD Report, February 2014). Retrieved from <http://www.iisd.org/publications/pub.aspx?pno=2898>.

**Reference text provided by the European Commission:**

Text developed in the EU-Canada agreement (CETA)

'investment' means:

Every kind of asset that an investor owns or controls, directly or indirectly, which has the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, and a certain duration. Forms that an investment may take include:

- a) an enterprise;
- b) shares, stocks and other forms of equity participation in an enterprise;
- c) bonds, debentures and other debt instruments of an enterprise;
- d) a loan to an enterprise;
- e) any other kinds of interest in an enterprise;
- f) an interest arising from:
  - i. a concession conferred pursuant to domestic law or under a contract, including to search for, cultivate, extract or exploit natural resources,
  - ii. a turnkey, construction, production, or revenue-sharing contract, or
  - iii. other similar contracts;
- g) intellectual property rights;
- h) any other moveable property, tangible or intangible, or immovable property and related rights;
- i) claims to money or claims to performance under a contract;

For greater certainty, 'claims to money' does not include claims to money that arise solely from commercial contracts for the sale of goods or services by a natural person or enterprise in the territory of a Party to a natural person or enterprise in the territory of the other Party, domestic financing of such contracts, or any related order, judgment, or arbitral award.

Returns that are invested shall be treated as investments. Any alteration of the form in which assets are invested or reinvested does not affect their qualification as investment.

**covered investment** means, with respect to a Party, an investment:

- a) in its territory;
- b) made in accordance with the applicable law at that time;
- c) directly or indirectly owned or controlled by an investor of the other Party; and
- d) existing on the date of entry into force of this Agreement, as well as investments made or acquired thereafter.

**investor** means a Party, a natural person or an enterprise of a Party, that seeks to make, is making or has made an investment in the territory of the other Party. But "investor" does not mean:

- a) an enterprise of a Party, if the enterprise is owned or controlled by an investor of the other Party or of a non-Party and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized; or,
- b) a branch or representative office of an enterprise of a Party or a non-Party.

**Question:** "Taking into account the above explanation and the text provided in annex as a reference, what is your opinion of the objectives and approach taken in relation to the scope of the substantive investment protection provisions in TTIP?"

**IISD Reply:**

Definition of Investment

The term "investment" is arguably the most critical term to define. The definition will determine which foreign capital flows will be covered by the agreement. It determines the scope of the treaty and which investments benefit from the TTIP provisions. The Commission notes that "investment protection should apply to those **investments** and

to **investors** that **have made** an investment in accordance with the laws of the country where they have invested.” The Commission also states that “protection is only granted in situations where investors have already committed substantial resources in the host state—and not when they are simply at the stage where they are planning to do so.” Finally, the Commission notes that “protection is only granted in situations where investors have already committed substantial resources in the host state—and not when they are simply at the stage where they are planning to do so.”

These statements make the reader believe that the treaty only applies once the investment is made but not before or at the time of admission. However, the language provided in other excerpts leads to another conclusion. First, the text provided by the Commission defines “investor” as “a Party, a natural person or an enterprise of a Party, that seeks to make, is making or has made an investment in the territory of the other Party” (emphasis added). The terms “seeks to make” and “is making” effectively extend the scope of the treaty to the pre-establishment phase. Second, the texts on national and most-favoured nation treatment indicate that the Commission intends to cover the phase when the investment is being established, and not just the post-establishment phases. This is described further below in the context of the discussion relating to investment liberalization through national treatment and market access rules.

In terms of the scope of the term “investment,” the text provided by the European Commission shows that it has opted for a traditional open-ended, asset-based definition of investment. The text defines investment as “every kind of asset.” It then provides an indicative list of such assets that can qualify as investment, covering enterprises, equity, bonds and debt instruments, intellectual property rights and others—independent of whether or not they are associated with a functioning enterprise in the host state. In other words, any of these assets are covered, even if owned and controlled wholly from outside the host state as opposed to owned by an operating business in the host state, including, for instance, such tangible or intangible properties as an offshore bank account, holiday home, rights under domestic law or contract, minority shareholding in a foreign company, or a company’s “goodwill.” This contrasts with a so-called enterprise-based definition (which requires the establishment or acquisition of an “enterprise” in the host state, rather than just an “asset”), or a closed asset-based definition (which sets out an exhaustive and limited list of assets that constitute an investment), both of which would be more predictable and less prone to arbitral activism to expand the scope of investment arbitration to unexpected areas.

The Commission appears to want to limit the risk of expansive arbitral interpretations through language requiring that an asset needs to have certain characteristics of an investment in order to qualify as an investment under the treaty. These are “the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk, and a certain duration.” However, the language (i.e., the phrase “such as”) indicates that to qualify for protection under the treaty, investments do not need to fulfill all listed requirements, but that one alone will suffice—a very simple condition to satisfy. This qualification is clearly insufficient to protect host states from expansive interpretations by investment tribunals, as it will have limited impact on the initial expansive language of “any asset.” Moreover, it will not exclude portfolio investments from its scope, as even these types of stock market or bond investments will fall within the definition and the parameters of these conditions.

Finally, the Commission states that investment protection should apply only to those investments made “in accordance with the laws of the country where they have invested.” The proposed language refers to investments made “in accordance with the applicable law at that time.” A review of case law indicates, however, that tribunals have limited the meaning and scope of this requirement “in an apparent desire to widen their ability to uphold jurisdiction

over investment treaty claims.”<sup>6</sup> This provision, therefore, is no guarantee to ensure that only investors that have made their investment in compliance with the law will be afforded protection under the treaty.

### Definition of Investor

The definition of investor is the second element determining the scope of the agreement. It determines which investors are protected, and may also exclude certain types of investors—either to prevent opportunistic use of the agreements or to target investors with real operational investment.

The EU states that it precisely wants to avoid abuse and eliminate so-called “shell” or “mailbox” companies owned by nationals of third countries from the scope. We agree that—in contrast to the approach taken in most EU member state BITs—this issue has been addressed by requiring that an enterprise needs to have substantial business activities in the territory of the alleged home state. However, it does not in any way reduce the use of the investor-state process by thousands of potentially covered investors, including any multinational company with just some “substantial” business activity in the United States.

## Question 2: Non-discriminatory treatment for investors

The European Commission states:

“The standards of national treatment and most-favoured nation (MFN) treatment are considered to be **key provisions** of investment agreements and therefore they have been consistently included in such agreements, although with some variation in substance. [...] Regarding **national treatment**, many investment agreements do not allow states to discriminate between a domestic and a foreign investor once the latter is **already established** in a Party’s territory. Other agreements, however, allow such discrimination to take place in a limited number of sectors. Regarding **MFN**, most investment agreements do not clarify whether foreign investors are entitled to take advantage of procedural or substantive provisions contained in other past or future agreements concluded by the host country. Thus, investors may be able to claim that they are entitled to benefit from any provision of another agreement that they consider to be more favourable, which may even permit the application of an entirely new standard of protection that was not found in the original agreement. In practice, this is commonly referred to as “**importation of standards**”. [...]

The EU considers that, as a matter of principle, **established investors should not be discriminated** against after they have established in the territory of the host country, while at the same recognises that in certain rare cases and in some very specific sectors, discrimination against already established investors **may need to be envisaged**. The situation is different with regard to the right of **establishment**, where the Parties **may choose whether or not to open certain markets or sectors**, as they see fit.

On the “**importation of standards**” issue, the EU seeks to clarify that MFN **does not allow procedural or substantive provisions to be imported from other agreements**. The EU also includes **exceptions** allowing the Parties to take measures relating to the protection of health, the environment, consumers, etc. Additional carve-outs would apply to the audio-visual sector and the granting of subsidies. These are typically included in EU FTAs and also apply to the non-discrimination obligations relating to investment. Such exceptions allow differences in treatment between investors and investments where necessary to **achieve public policy objectives**.”

<sup>6</sup> Jarrod Hepburn (2014, April 24). “In Accordance With Which Host State Laws? Restoring the ‘Defence’ of Investor Illegality in Investment Arbitration.” *Journal of International Dispute Settlement*, 5 (forthcoming). Retrieved from [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2428859](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2428859). See also Rahim Moloo and Alex Khachaturian (2010, September 27). “The Compliance With the Law Requirement in International Investment Law.” *Fordham International Law Journal*, 34. Retrieved from [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1683523](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1683523).

**Reference text provided by the European Commission:**

*Text developed in the EU-Canada agreement (CETA)*

**Section X: Non-Discriminatory Treatment Article X.1: National Treatment**

1. Each Party shall accord to investors of the other Party and to covered investments, treatment no less favourable than the treatment it accords, in like situations, to its own investors and to their investments with respect to the establishment, acquisition, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.

The treatment accorded by a Party under paragraph 1 means, with respect to measures adopted or maintained by a government in Canada other than at federal level, or by a government of or in an European Union Member State, treatment no less favourable than the most favourable treatment accorded by that government, in like situations, to investors of the other Party and to covered investments of Canada or of the European Union respectively, including jurisdictions of that government.

**Article X.2: Most-Favoured-Nation Treatment**

1. Each Party shall accord to investors of the other Party and to covered investments, treatment no less favourable than the treatment it accords, in like situations, to investors and to their investments of any third country with respect to the establishment, acquisition, conduct, the operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.

2. The treatment accorded by a Party under paragraph 1 means, with respect to measures adopted or maintained by a government in Canada other than at federal level, or by a government of or in an European Union Member State, treatment no less favourable than the most favourable treatment accorded by that government, in like situations, to investors and to covered investments of Canada or of the European Union respectively, including jurisdictions of that government.

3. Paragraph 1 shall not be construed to oblige a Party to extend to the investors of the other Party the benefit of any treatment resulting from existing or future measures providing for recognition.

4. For greater certainty, the “treatment” referred to in Paragraph 1:

- a. does not include investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements, including compensation granted through such procedures, and
- b. shall only apply with respect to treatment accorded by a Party through the adoption, maintenance or application of measures.

3. [sic!] Paragraph 1 shall not be construed to oblige a Party to extend to the investors of the other Party the benefit of any treatment resulting from:

- (a) treatment granted as a process of economic integration, which includes commitments to abolish substantially all barriers to investment, together with the approximation of legislation of the parties on a broad range of matters within the purview of this Agreement.
- (b) any international agreement for the avoidance of double taxation or other international agreement or arrangement relating wholly or mainly to taxation.

**Article Y: General exceptions**

1. For the purposes of Chapters X through Y and Chapter Z (National Treatment and Market Access for Goods, Rules of Origin, Origin Procedures, Customs and Trade Facilitation), Section 2 (Establishment of Investments) and Section 3 (Non-discrimination of Investment), GATT 1994 Article XX is incorporated into and made part of this Agreement.

The Parties understand that the measures referred to in GATT 1994 Article XX (b) include environmental measures necessary to protect human, animal or plant life or health. The Parties further understand that GATT 1994 Article XX (g) applies to measures for the conservation of living and non-living exhaustible natural resources.

2. For the purposes of Chapters X, Y, and Z (Cross-Border Trade in Services, Telecommunications, and Temporary Entry and Stay of Natural Persons for Business Purposes), Section 2 (Establishment of Investments) and Section 3 (Non-discrimination of Investment)) GATS Article XIV (a), (b) and (c) is incorporated into this Agreement.

The Parties understand that the measures referred to in GATS Article XIV (b) include environmental measures necessary to protect human, animal or plant life or health.

*Question: "Taking into account the above explanations and the text provided in annex as a reference, what is your opinion of the EU approach to non-discrimination in relation to the TTIP? Please explain."*

**IISD Reply:**

#### Pre-establishment rights

The Commission's stated position on national treatment is not consistent with the text provided. Its position states that "as a matter of principle, **established investors should not be discriminated** against after they have established in the territory of the host country." It continues, noting that the "situation is different with regard to the right of **establishment**, where the Parties **may choose whether or not to open certain markets or sectors**, as they see fit." These statements make the reader believe that the agreement does not include obligations for investment liberalization and market access—which it does.

The Commission's explanation above can easily lead the reader to believe that the investment chapter only applies once the investor is established. The language of the proposed text, however, indicates the opposite: the EU will indeed grant pre-establishment rights by extending the national treatment and most-favoured nation (MFN) obligations to the "establishment, acquisition, conduct, the operation, management, maintenance, use, enjoyment and sale or disposal" of investments" (emphasis added), thereby clearly covering both pre- and post-establishment activities. Through this language the scope of the investment chapter extends beyond investment protection to investment liberalization, including pre-establishment rights.

In its consultation document, the European Commission is also silent on whether the EU and United States seek to include other market access provisions and the prohibition of performance requirements in the TTIP as included in the draft CETA text of November 2013 and April 2014. Moreover, the consultation document leaves open the question of whether ISDS would apply to investment liberalization commitments and—if included—performance requirement prohibitions. While EU member states' BITs did not include investment liberalization elements, the United States has done so for almost two decades, and has subjected these to ISDS. It is therefore to be expected that the United States will insist that the EU consider subjecting liberalization commitments to ISDS. The issue of pre-establishment rights, market access, and the prohibition of performance requirements, as well as the possibility of subjecting these issues to ISDS, should have been included in the public consultation.

#### MFN treatment

In earlier notes relating to the CETA, we pointed to the danger that the most-favoured nation (MFN) treatment clause alone could be sufficient to undermine all of the objectives the European Commission states it seeks in its improved drafting. In response to this concern, the European Commission notes here that "the EU seeks to clarify that MFN does not allow procedural or substantive provisions to be imported from other agreements." This is the right objective, but the language currently proposed does not achieve this goal. The relevant paragraph here is the following:

For greater certainty, the "treatment" referred to in Paragraph 1 [MFN obligation]:

- a. does not include investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements, including compensation granted through such procedures, and
- b. shall only apply with respect to treatment accorded by a Party through the adoption, maintenance or application of measures.

Paragraph (a) is a useful clarification and responds to a host of arbitral decisions that allowed the importation of procedural rights. However, it creates a direct implication that other provisions from pre-existing treaties are covered by the MFN provision, i.e., the substantive provisions that set the rights of investors and obligations of states. This is common practice now for arbitrators who routinely allow investors to import provisions from other investment treaties that are more favourable to them, the so-called “importation of standards” noted in the EU consultation text. This means that a U.S. investor could, for instance, invoke guarantees that the EU member state where an investment is located has negotiated in a bilateral treaty, thereby circumventing more carefully drafted wording in the TTIP.

Paragraph (b) has been added since earlier CETA draft texts, supposedly to avoid the importation of these substantive provisions agreed in other investment treaties. The problem is that the language provided by the Commission to avoid this scenario does not achieve the stated purpose. By stating that the MFN obligation “shall only apply with respect to treatment accorded by a Party through the adoption, maintenance or application of measures,” the Commission does nothing to exclude the importation of guarantees provided in other investment treaties because the broad term “measure” will likely include provisions in investment treaties. The Commission does not provide an excerpt of the definition of what constitutes a “measure” under the TTIP. The definition provided in the April 2014 CETA text indicates, however, that the term is wide:

**measure** includes a law, regulation, rule, procedure, decision, administrative action, requirement, practice or any other form of measure by a Party.

This broad language quite clearly includes investment treaties and the guarantees provided therein. As a result, the Commission’s proposed language does not achieve the stated goal of disallowing the importation of substantive rights from other treaties, undoing the benefits of better drafting in the TTIP.

What is certain is that any language attempting to exclude the substantive provisions including by clear implication in paragraph (a) will have to be very clear. Paragraph (b) demonstrably lacks this needed clarity. A better approach could be to use the language included in the 2004 Canadian Model BIT:

#### ANNEX III

##### Exceptions from Most-Favoured-Nation Treatment

1. Article 4 shall not apply to treatment accorded under all bilateral or multilateral international agreements [in force or signed prior to the date of entry into of this Agreement].

Regarding the general exceptions, we note the application of Article XX of the GATT to the non-discrimination provisions of the investment chapter. However, we fail to see any utility in this incorporation. In a previous text, the drafters sought to adapt Article XX to the specifics of the investment chapter. Here, it is simply incorporated by reference. We were not convinced of the usefulness of the attempted adaptation in the previous texts, but we are fully convinced of the non-utility of simply incorporating a trade-related paragraph as an exception for regulating investments. Investments are regulated in a wide range of ways as a matter of daily life for any business. Products are regulated in much more limited ways. Simply applying an exception for the regulation of a product on the panoply of regulations for the establishment, operation, production processes, business approaches, human rights issues, etc. of an investment, all of which go far beyond measures regulating the importation, sale, or marketing of a product, is to assume they are similar regulatory processes. They are not, and the utility of the exception here, bringing all of the baggage of WTO litigation to investment law and in the hands of private investors, is to invite more danger than any benefit can possibly provide.

## Question 3: Fair and equitable treatment

### The European Commission states:

“The FET standard is **present in most international investment agreements**. However, in many cases the standard is **not defined**, and it is usually **not limited or clarified**. Inevitably, this **has given arbitral tribunals significant room for interpretation**, and the interpretations adopted by arbitral tribunals have varied from very narrow to very broad, leading to much controversy about the precise meaning of the standard. [...]

The main objective of the EU is **to clarify the standard**, in particular by incorporating key **lessons learned from case-law**. This would eliminate uncertainty for both states and investors.

Under this approach, a state could be held responsible for a breach of the fair and equitable treatment obligation **only for breaches of a limited set of basic rights**, namely: the denial of justice; the disregard of the fundamental principles of due process; manifest arbitrariness; targeted discrimination based on gender, race or religious belief; and abusive treatment, such as coercion, duress or harassment. This list may be extended only where the Parties (the EU and the US) specifically agree to add such elements to the content of the standard, for instance where there is evidence that new elements of the standard have emerged from international law.

The “**legitimate expectations**” of the investor may be taken into account in the interpretation of the standard. However, this is possible **only where clear, specific representations have been made by a Party** to the agreement in order to convince the investor to make or maintain the investment and upon which the investor relied, and that were subsequently **not respected** by that Party. The intention is to make it clear that an investor cannot legitimately expect that the general regulatory and legal regime will not change. Thus the EU intends to ensure that the standard is **not understood to be a “stabilisation obligation”**, in other words a guarantee that the legislation of the host state will not change in a way that might negatively affect investors.

In line with the general objective of clarifying the content of the standard, the EU shall also strive, where necessary, to provide protection to foreign investors in situations in which the host state uses its sovereign powers to avoid contractual obligations towards foreign investors or their investments, without however covering ordinary contractual breaches like the non-payment of an invoice.”

### Reference text provided by the European Commission:

#### *Text developed in the EU-Canada agreement (CETA)*

##### Section X: Investment Protection

##### Article X.X.: Treatment of Investors and of Covered Investments

1. Each Party shall accord in its territory to covered investments of the other Party and to investors with respect to their covered investments fair and equitable treatment and full protection and security in accordance with paragraphs 2 to 7.
2. A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or series of measures constitutes:
  - a. Denial of justice in criminal, civil or administrative proceedings;
  - b. Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings.
  - c. Manifest arbitrariness;
  - d. Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; e. Abusive treatment of investors, such as coercion, duress and harassment; or
  - f. A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.
3. The Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment.
4. When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated.
5. For greater certainty, ‘full protection and security’ refers to the Party’s obligations relating to physical security of investors and covered investments.
6. For greater certainty, a breach of another provision of this Agreement, or of a separate international Agreement, does not establish that there has been a breach of this Article.

*Question: "Taking into account the above explanation and the text provided in annex as a reference, what is your opinion of the approach to fair and equitable treatment of investors and their investments in relation to the TTIP?"*

**IISD Reply:**

As the Commission notes, the fair and equitable treatment (FET) obligation is the most widely invoked standard in investment treaty arbitration and tribunals have delivered such widely differing interpretations that it is difficult to predict when the actions of a state will violate the standard, leading to fundamental uncertainty. The Commission states that it wishes to address this problem and proposes to provide a general enunciation of the FET obligation. It then goes on to paragraph 2, which is a list of government conduct that is meant to provide clarity and certainty, and restrict the scope for arbitral mischief. This closed list seems reasonable and also useful to provide the investor with clear protection from unacceptable treatment by the state (though there is no guarantee that tribunals under the currently proposed arbitration system will follow this guidance). The proposed text does not include a problematic second prong, which was included in an earlier CETA draft text, and introduced the notion of fair and equitable treatment as recognized under customary international law. That approach would have led to a reversal of the objectives achieved in the closed list. While the language proposed in the consultation document has avoided this mistake, the desired predictability remains diminished by paragraph 4 on legitimate expectations, which allows "a tribunal ... [to] take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation."

In this respect, the European Commission asserts that a breach of legitimate expectations is limited to situations where an investor relied upon "clear, specific representations" by a State when the investment was made or maintained and that were subsequently not honoured by the State. But rather than requiring that legitimate expectations are triggered only by a "specific promise" or a "written commitment," as the EU is proposing in relation to a so-called "umbrella clause" in the CETA draft text of April 4, 2014, the consultation text refers to "a specific representation," a much more open term. As a consequence, the threshold for the investor to establish "legitimate expectations" is very low, adding increased uncertainty and subjectivity.

The European Commission—without explicitly naming it—also aims to include an "umbrella clause," a clause that the European Parliament identified as problematic because it raises contract issues to the treaty level.<sup>7</sup> In this context, the Commission notes that the "EU shall also strive, where necessary, to provide protection to foreign investors in situations in which the host state uses its sovereign powers to avoid contractual obligations towards foreign investors or their investments, without however covering ordinary contractual breaches like the non-payment of an invoice." We can therefore expect that the Commission will propose to include an umbrella clause in the treaty that would allow an investor to circumvent the designated forum under the contract to bring the claim under the treaty. The EU proposed such a clause in the CETA negotiations as can be seen in the April 2014 draft text.

In sum, the proposed text on FET is an improvement over earlier versions, for example in the CETA context. However, legal uncertainty has not been avoided, as the FET provision is open to expansive interpretation of the notion of legitimate expectations. The possible introduction of an umbrella clause will also be problematic because it may further expand the scope of "legitimate expectations."

<sup>7</sup> Committee on International Trade (Kader Arif) (2011, March 22). *Report on the future European international investment policy (2010/2203(INI))*. Retrieved from <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0070&language=EN>

## Question 4: Expropriation

The European Commission states:

"In investment agreements, expropriations are permitted if they are for a **public purpose, non-discriminatory**, resulting from the **due process of law** and are accompanied by prompt and effective **compensation**. This applies to both **direct expropriation** (such as nationalisation) and **indirect expropriation** (a measure having an effect equivalent to expropriation). **Indirect expropriation** has been a **source of concern** in certain cases where regulatory measures taken for legitimate purposes have been subject to investor claims for compensation, on the grounds that such measures were equivalent to expropriation because of their significant negative impact on investment. Most investment agreements **do not provide details or guidance in this respect**, which has inevitably left arbitral tribunals with significant room for interpretation. [...]"

The objective of the EU is **to clarify** the provisions on expropriation and to **provide interpretative guidance** with regard to indirect expropriation in order to **avoid claims against legitimate public policy measures**. The EU wants to make it clear that non-discriminatory measures taken for legitimate public purposes, such as to protect **health or the environment**, **cannot be considered equivalent to an expropriation**, unless they are manifestly excessive in light of their purpose. The EU also wants to clarify that the simple fact that a measure has an **impact on the economic value** of the investment does not justify a claim that an indirect expropriation has occurred."

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

### Article X: Expropriation

1. Neither Party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation"), except:

- (a) for a public purpose;
- (b) under due process of law;
- (c) in a non-discriminatory manner; and
- (d) against payment of prompt, adequate and effective compensation.

For greater certainty, this paragraph shall be interpreted in accordance with Annex X.9.1 on the clarification of expropriation.

2. Such compensation shall amount to the fair market value of the investment at the time immediately before the expropriation or the impending expropriation became known, whichever is earlier. Valuation criteria shall include going concern value, asset value including the declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

3. The compensation shall also include interest at a normal commercial rate from the date of expropriation until the date of payment and shall, in order to be effective for the investor, be paid and made transferable, without delay, to the country designated by the investor and in the currency of the country of which the investor is a national or in any freely convertible currency accepted by the investor.

4. The investor affected shall have a right, under the law of the expropriating Party, to prompt review of its claim and of the valuation of its investment, by a judicial or other independent authority of that Party, in accordance with the principles set out in this Article.

5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements ('TRIPS Agreement').

### Annex: Expropriation

The Parties confirm their shared understanding that:

1. Expropriation may be either direct or indirect:

- a) direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and
- b) indirect expropriation occurs where a measure or series of measures by a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.

2. The determination of whether a measure or series of measures by a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:
- a) the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
  - b) the duration of the measure or series of measures by a Party;
  - c) the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and
  - d) the character of the measure or series of measures, notably their object, context and intent.
3. For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

**Question:** *“Taking into account the above explanation and the text provided in annex as a reference, what is your opinion of the approach to dealing with expropriation in relation to the TTIP? Please explain.”*

**IISD Reply:**

Expropriation provisions in investment chapters and treaties determine in which situations a state will have to compensate the affected rights holder. While generally allowing states to expropriate, investment treaties require that any expropriation must be compensated. In addition, investment treaties require that an expropriation be for a public purpose, non-discriminatory and in accordance with the due process of law. Thus, the crucial question is: What qualifies as a direct or indirect expropriation in the first place?

Especially with regard to the interpretation of indirect expropriation, tribunals have applied fundamentally different concepts in their assessment of the issue. In some cases, only the financial impact of the measure on the investor—not its purpose—was considered relevant, while in others, non-discriminatory measures taken in good faith for public welfare reasons were deemed to not constitute expropriation and therefore were not compensable. Under the first approach, virtually any environmental, health protection, consumer protection or similar measures could potentially qualify as an expropriation requiring compensation of foreign investors by the government.

In order to be clear, the proposed reference text specifies in an annex what characteristics should be looked at when determining what constitutes an indirect expropriation, including economic impact, the expectations of the investor and the character of the measure. More importantly, the annex specifies that certain measures do not constitute an indirect expropriation subject to compensation in the first place. In particular, it carves out from the definition of indirect expropriation, “non-discriminatory measures ... to protect legitimate public welfare objectives, such as health, safety and the environment.” These non-discriminatory measures will in principle not be compensable because they cannot be viewed as indirect expropriation.

However, the wording “except in rare circumstances” allows the possibility that certain public welfare measures would constitute indirect expropriation. This wording has been criticized by some as potentially undermining the character of the “carve-out” for police-power measures, since it leaves to the tribunal to decide what is a rare circumstance, instead of formulating a clear carve-out. The language proposed slightly alleviates the risk in that it adopts a long period of Canadian drafting that clarifies “in rare circumstances” to refer to situations “where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive.” This clarification is more precise and limitative of the risks of claims than that found in U.S. treaties and its 2004 and 2012 model treaty, which include the reference “except in rare circumstances” without providing any indication of

what this might mean. Given the U.S. longstanding practice, and may be difficult for the Commission to negotiate the approach proposed in the consultation document.

## Question 5: Ensuring the right to regulate and investment protection

The European Commission states:

“Most agreements that are focused on investment protection are **silent about how public policy issues, such as public health, environmental protection, consumer protection or prudential regulation, might interact with investment.** [...]”

The objective of the EU is to achieve a **solid balance** between the **protection of investors** and the Parties’ **right to regulate**.

First of all, the EU wants to make sure that the Parties’ **right to regulate is confirmed as a basic underlying principle**. This is important, as arbitral tribunals will have to take this principle into account when assessing any dispute settlement case.

Secondly, the EU will introduce **clear and innovative provisions** with regard to investment protection standards that have raised concern in the past ... Third, the EU will ensure that **all the necessary safeguards and exceptions are in place**. ... In terms of the procedural aspects relating to ISDS, the objective of the EU is to build a system capable of adapting to the states’ right to regulate [...]”

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

**Preamble** [Extract]

“REAFFIRMING their commitment to sustainable development and convinced of the contribution of international trade and investment to sustainable development,

RECOGNISING the right of the Parties to take measures to achieve legitimate public policy objectives on the basis of the level of protection that they deem appropriate,

DETERMINED to strengthen their economic, trade, and investment relations in accordance with the objective of sustainable development, in its economic, social and environmental dimensions, and to promote trade and investment in a manner mindful of high levels of environmental and labour protection and relevant internationally recognised standards and agreements to which they are Parties,

DESIRING to encourage enterprises operating within their territory or subject to their jurisdiction to respect internationally recognized standards and principles of corporate social responsibility notably the OECD Guidelines for multinational enterprises and to pursue best practices of responsible business conduct,

SEEKING to establish clear and mutually advantageous rules governing their trade and investment and to reduce or eliminate the barriers to mutual trade and investment,

BUILDING on their respective rights and obligations under the WTO Agreement and other multilateral, regional and bilateral agreements and arrangements to which they are party;”

**Article X: Reservations and Exceptions**

“1. Articles X- (National Treatment), X- (Most-Favoured-Nation Treatment), (...) do not apply to:

(a) an existing non-conforming measure that is maintained by a Party at the level of:

- (i) the European Union, as set out in its Schedule to Annex I;
- (ii) a national government, as set out in its Schedule to Annex I;
- (iii) a provincial, territorial, or regional government, as set out in its Schedule to Annex I; or
- (iv) a local government.

(b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or

(c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles X- (National Treatment), X- (Most-Favoured- Nation Treatment), (...).

2. Articles X- (National Treatment), X- (Most-Favoured-Nation Treatment), (...) do not apply to measures that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.
3. Without prejudice to Article X [Expropriation] and Article X [Treatment of Investors and Covered Investments], no Party may adopt any measure or series of measures after the date of entry into force of this Agreement and covered by its schedule to Annex II, that require, directly or indirectly, an investor of the other Party, by reason of nationality, to sell or otherwise dispose of an investment existing at the time the measure or series of measures becomes effective.
4. In respect of intellectual property rights, a Party may derogate from Article X.3 (National Treatment), Article X.4 (Most-Favoured-Nation Treatment) where permitted by the TRIPS Agreement, including any amendments to the TRIPS Agreement in force for both Parties, and waivers to the TRIPS Agreement adopted pursuant to Article IX of the WTO Agreement.
5. (...) Articles X.3 (National Treatment), X.4 (Most-Favoured-Nation Treatment) (...) do not apply to:
  - (a) procurement by a Party or a State Enterprise for goods and services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of goods and services for commercial sale, whether or not that procurement is "covered procurement" within the meaning of Article II of (Chapter XX - Public procurement); or
  - (b) subsidies or government support provided by a Party including direct or potential transfer of funds, the foregoing of government revenue (such as a tax credit), and the provision of goods or services."

**Audiovisual:**

"For the EU, the Section on Establishment and Section on Non-Discriminatory Treatment do not apply to measures with respect to Audiovisual services."

**ARTICLE X: PRUDENTIAL CARVE-OUT**

1. Nothing in this Agreement shall prevent a Party from adopting or maintaining measures for prudential reasons, including:
  - (a) the protection of investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier;
  - (b) ensuring the integrity and stability of a Party's financial system.
2. These measures shall not be more burdensome than necessary to achieve their aim.
3. Without prejudice to other means of prudential regulation of cross-border trade in financial services, a Party may require the registration of cross-border financial service suppliers of the other Party and of financial instruments.
4. Subject to Article X [National Treatment] and Article Y [Most Favoured Nation], a Party may, for prudential reasons, prohibit a particular financial service or activity. Such a prohibition may not apply to all financial services or to a complete financial services sub-sector, such as banking.

**Article X Safeguard measures**

In exceptional circumstances of serious difficulties for the operation of monetary and exchange rate policy, in the case of Canada, or for the operation of the economic and monetary union, in the case of the European Union, or threat thereof, safeguard measures that are strictly necessary may be taken by the concerned Party with regard to capital movements or payments, including transfers, for a period not exceeding six months. The Party having adopted or maintained such measures shall inform the other Party forthwith and present, as soon as possible, a time schedule for their removal.

**Article X Balance of Payments**

1. Nothing in this Agreement shall be construed to prevent the Parties from adopting or maintaining safeguard measures with regard to capital movements or payments, including transfers, in case of serious balance-of-payments or external financial difficulties, or under threat thereof.
2. The measures referred to in paragraph 1 shall:
  - a) not discriminate among countries;
  - b) be consistent with the Articles of the Agreement of the International Monetary Fund, as applicable;
  - c) avoid unnecessary damage to the commercial, economic and financial interests of the other Party;
  - d) be temporary and phased out progressively as the situation specified in paragraph 1 improves.
3. In the case of trade in goods, nothing in this Agreement shall be construed to prevent a Party from adopting restrictive measures in order to safeguard its balance-of-payments or external financial position. Such measures shall be in accordance with the General Agreement on Tariffs and Trade (GATT) and the Understanding on Balance of Payment Provisions of the GATT 1994.

4. In the case of trade in services, nothing in this Agreement shall be construed to prevent a Party from adopting restrictive measures in order to safeguard its balance-of-payments or external financial position. Such measures shall be in accordance with the General Agreement on Trade in Services (GATS).

5. Any Party maintaining or having adopted measures referred to in paragraph 1 or 2 shall promptly notify the other Party of them and present, as soon as possible, a time schedule for their removal.

6. Where the restrictions are adopted or maintained under this Article, consultations shall be held promptly in the Trade Committee, if such consultations are not otherwise taking place outside of this Agreement. The consultations shall assess the balance-of-payments or external financial difficulty that led to the respective measures, taking into account, inter alia, such factors as:

- (a) the nature and extent of the difficulties;
- (b) the external economic and environment; or
- (c) alternative corrective measures which may be available.

The consultations shall address the compliance of any restrictive measures with paragraphs 1 and 2. All findings of statistical and other facts presented by the IMF relating to foreign exchange, monetary reserves and balance-of-payments shall be accepted and conclusions shall be based on the assessment by the IMF of the balance-of-payments and the external financial situation of the Party concerned.

**Question:** *“Taking into account the above explanation and the text provided in annex as a reference, what is your opinion with regard to the way the right to regulate is dealt with in the EU’s approach to TTIP?”*

**IISD Reply:**

The preamble

The reference text provided in the consultation document does not include an explicit “right to regulate” provision, neither in the body text, nor in the preamble. Instead, it includes a general statement in the preamble that refers to “RECOGNISING the right of the Parties to take measures to achieve legitimate public policy objectives on the basis of the level of protection that they deem appropriate.” This will require tribunals to assess what is “legitimate,” a very broad and undefined term. Moreover, the language used appears to limit the right of parties to “protection” measures, when the more general “right to regulate” is much broader.

Beyond the language on the right to regulate, we note the ongoing pattern of the promotion of voluntary approaches to corporate standards in this agreement, as opposed to their legal rights and the legal obligations on governments. This is seen in the preambular paragraph: “DESIRING to encourage enterprises operating within their territory or subject to their jurisdiction to respect internationally recognized standards and principles of corporate social responsibility notably the OECD Guidelines for multinational enterprises and to pursue best practices of responsible business conduct [...]”

Hard rights in the text against generalized desires to encourage levels of corporate conduct simply do not equate one to the other as a matter of law. Rather, the stark difference is open to reinforcement by tribunals, with resulting limitations on the right to regulate. Here, it is important to note that the EU recognizes the capacity to enforce certain standards on investors through investment treaties. In the CETA draft text dated April 3, 2014, Article x-17.3 states: “For greater certainty, an investor may not submit a claim to arbitration under this Section where the investment has been made through fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process.” Thus, the parties are imposing a clear penalty for breach of the obligation to make the investment in accordance with applicable law, at least for certain types of breaches of the law. That they have recognized this in principle is inevitable: it has already been applied by some tribunals over the past years. That it is expressed in the CETA text shows that there is no legal barrier to imposing an obligation on investors and a penalty for failure to

comply. Rather, it is a choice of the parties not to do so and instead to include generalized, hortative references to non-binding standards. The paragraph provided in the consultation process, in our view, does not show an affirmative approach to promoting high standards of investors, but rather the very absence of the resolve to do so.

#### Safeguards and Exceptions

The European Commission notes that it will “ensure that all the necessary safeguards and exceptions are in place.” Indeed, the draft text contains, amongst others, a carve-out for prudential measures, and allows for safeguard measures in “exceptional circumstances of serious difficulties for the operation of monetary and exchange rate policy” as well as “safeguard measures with regard to capital movements or payments, including transfers, in case of serious balance-of-payments or external financial difficulties, or under threat thereof.” We generally agree this is a significant improvement on prior EU member state texts and that it addresses some of the concerns related to the free transfer of capital provisions. This will add some level of protection for governments in financially stressed times.

However, the present wording of the proposed provision on safeguard measures would allow investors to challenge the measures and invite an arbitral tribunal to ascertain whether there were “exceptional circumstances” and “serious difficulties” so as to render them necessary. Leaving such issues to investor-state tribunals will necessarily bring in uncertainty and unpredictability. The six-month time limit for the duration of measures is also a matter of concern, as it may not allow enough time for the desired macroeconomic results to be achieved. The provision on ‘Restrictions in Case of Balance-of-Payments and External Financial Difficulties, on the other hand, does not include a specific time limit for adoption, which, in our view, is a preferable approach.

## B. Investor-to-state dispute settlement (ISDS)

### Question 6: Transparency in ISDS

The European Commission states:

"In most ISDS cases, no or little information is made available to the public, hearings are not open and third parties are not allowed to intervene in the proceedings. [...]

The EU's aim is to ensure transparency and openness in the ISDS system under TTIP. The EU will include provisions to guarantee that hearings are open and that all documents are available to the public. In ISDS cases brought under TTIP, all **documents will be publicly available** (subject only to the protection of confidential information and business secrets) and **hearings will be open to the public**. Interested parties from **civil society will be able to file submissions** to make their views and arguments known to the ISDS tribunal [...]"

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

**Article x-33: Transparency of Proceedings**

1. The UNCITRAL Transparency Rules shall apply to the disclosure of information to the public concerning disputes under this Section as modified by this Chapter.
2. The request for consultations, the request for a determination, the notice of determination, the agreement to mediate, the notice of intent to challenge, the decision on an arbitrator challenge and the request for consolidation shall be included in the list of documents referred to in Article 3(1) of the UNCITRAL Transparency Rules.
3. Exhibits shall be included in the list of documents mentioned in Article 3(2) of the UNCITRAL Transparency Rules.
4. Notwithstanding Article 2 of the UNCITRAL Transparency Rules, prior to the constitution of the tribunal, Canada or the European Union as the case may be shall make publicly available in a timely manner relevant documents pursuant to paragraph 2, subject to the redaction of confidential or protected information. Such documents may be made publicly available by communication to the repository.
5. Hearings shall be open to the public. The tribunal shall determine, in consultation with the disputing parties, the appropriate logistical arrangements to facilitate public access to such hearings. Where the tribunal determines that there is a need to protect confidential or protected information, it shall make the appropriate arrangements to hold in private that part of the hearing requiring such protection.
6. Nothing in this Chapter requires a respondent to withhold from the public information required to be disclosed by its laws. The respondent should endeavour to apply such laws in a manner sensitive to protecting from disclosure information that has been designated as confidential or protected information.

**Question:** "Taking into account the above explanation and the text provided in annex as a reference, please provide your views on whether this approach contributes to the objective of the EU to increase transparency and openness in the ISDS system for TTIP. Please indicate any additional suggestions you may have."

**IISD Reply:**

The EU has appropriately addressed the concerns about the lack of transparency in investment arbitration proceedings. The proposed text integrates transparency through incorporation of the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, which officially came into effect on April 1, 2014. These provide for a significant degree of openness throughout the arbitral proceedings.<sup>8</sup> The proposed text provided even goes beyond what is required in the UNCITRAL Rules and extends to all arbitrations beyond those conducted under UNCITRAL Rules.

<sup>8</sup> See Lise Johnson and Nathalie Bernasconi-Osterwalder (2013, August), *New UNCITRAL Arbitration Rules on Transparency: Application, Content and Next Steps*. Retrieved from [http://www.iisd.org/pdf/2013/uncitral\\_rules\\_on\\_transparency\\_commentary.pdf](http://www.iisd.org/pdf/2013/uncitral_rules_on_transparency_commentary.pdf)

## Question 7: Multiple claims and relationship to domestic courts

The European Commission states:

"[...] Existing investment agreements **generally do not regulate or address** the relationship with domestic courts or other ISDS tribunals. [...]

As a matter of principle, the EU's approach favours domestic courts. The EU aims to provide incentives for investors to pursue claims in domestic courts or to seek **amicable solutions** – such as mediation. The EU will suggest different instruments to do this. One is to prolong the relevant time limits if an investor goes to domestic courts or mediation on the same matter, so as not to discourage an investor from pursuing these avenues. Another important element is to make sure that investors **cannot bring claims on the same matter at the same time in front of an ISDS tribunal and domestic courts**. The EU will also ensure that companies affiliated with the investor cannot bring claims in front of an ISDS tribunal and domestic courts on the same matter and at the same time. If there are other relevant or related cases, ISDS tribunals must take these into account. This is done to **avoid any risk that the investor is over-compensated** and helps to **ensure consistency** by excluding the possibility for parallel claims."

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

### Article x-21: Procedural and Other Requirements for the Submission of a Claim to Arbitration

1. An investor may submit a claim to arbitration under Article x-22 (Submission of a Claim to Arbitration) only if the investor:
  - a) delivers to the respondent, with the submission of a claim to arbitration, its consent to arbitration in accordance with the procedures set out in this Chapter;
  - b) allows at least 180 days to elapse from the submission of the request for consultations and, where applicable, at least 90 days to elapse from the submission of the notice requesting a determination;
  - c) fulfils the requirements of the notice requesting a determination of the respondent;
  - d) fulfils the requirements related to the request for consultations;
  - e) does not identify measures in its claim to arbitration that were not identified in its request for consultations;
  - f) provides a declaration, where it has initiated a claim or proceeding, seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration, that:
    - i. a final award, judgment or decision has been made; or
    - ii. it has withdrawn any such claim or proceeding;
 The declaration shall contain, as applicable, proof that a final award, judgment or decision has been made or proof of the withdrawal of any such claim or proceeding; and
  - g) waives its right to initiate any claim or proceeding seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration.
2. Where the submission of a claim to arbitration is for loss or damage to a locally established enterprise or to an interest in a locally established enterprise that the investor owns or controls directly or indirectly, both the investor and the locally established enterprise shall provide a declaration pursuant to subparagraph 1(f) and a waiver pursuant to subparagraph 1(g).
3. The requirements of paragraphs 1(f), (g) and 2 do not apply in respect of a locally established enterprise where the respondent or the investor's host State has deprived an investor of control of the locally established enterprise, or has otherwise prevented the locally established enterprise from fulfilling the requirements in subparagraph 1(f), (g) or 2.
4. Upon request of the respondent, the Tribunal shall decline jurisdiction where the investor or, as applicable, the locally established enterprise fails to fulfil any of the requirements of paragraphs 1 and 2.
5. The waiver provided pursuant to subparagraph 1(g) or paragraph 2 as applicable shall cease to apply:
  - i. where the Tribunal rejects the claim on the basis of a failure to meet the requirements of paragraphs 1 or 2 or on any other procedural or jurisdictional grounds;
  - ii. where the Tribunal dismisses the claim pursuant to Article x-29 (Claim manifestly without legal merit) or Article x-30 (Claims Unfounded as a Matter of Law); or where the investor withdraws its claim, in conformity with applicable arbitration rules, within 12 months of the constitution of the tribunal.

**Article x-23: Proceedings under different international agreements**

Where claims are brought both pursuant to this Section and another international agreement and:

- a) there is a potential for overlapping compensation; or
- b) the other international claim could have a significant impact on the resolution of the claim brought pursuant to this Section,

a Tribunal constituted under this Section shall, as soon as possible after hearing the disputing parties, stay its proceedings or otherwise ensure that proceedings pursuant to another international agreement are taken into account in its decision, order or award.

**Article x-19: Mediation**

1. The disputing parties may at any time agree to have recourse to mediation.
2. Recourse to mediation is without prejudice to the legal position or rights of either disputing party under this chapter and shall be governed by the rules agreed to by the disputing parties including, if available, the rules established by the Services and Investment Committee pursuant to Article x-42(5)(d).
3. The mediator is appointed by agreement of the disputing parties. Such appointment may include appointing a mediator from the roster established pursuant to Article x-25 (Constitution of the Tribunal) or requesting the Secretary General of ICSID to appoint a mediator from the list of chairpersons established pursuant to Article x-25 (Constitution of the Tribunal).
4. Disputing parties shall endeavour to reach a resolution to the dispute within 60 days from the appointment of the mediator.
5. If the disputing parties agree to have recourse to mediation, Articles x-18(5) and x-18(7) (Consultations) shall not apply from the date on which the disputing parties agreed to have recourse to mediation to the date on which either disputing party decides to terminate the mediation, by way of a letter to the mediator and the other disputing party.

**Question:** *“Taking into account the above explanation and the text provided in annex as a reference, please provide your views on the effectiveness of this approach for balancing access to ISDS with possible recourse to domestic courts and for avoiding conflicts between domestic remedies and ISDS in relation to the TTIP. Please indicate any further steps that can be taken. Please provide comments on the usefulness of mediation as a means to settle disputes.”*

**IISD Reply:**

The consultation text provided allows foreign investors to sue the state directly before international investment arbitration tribunals without first having to exhaust local remedies. This contrasts with the approach taken in other areas of public international law, such as human rights or diplomatic protection, where domestic courts and processes need to be resorted to prior to initiation of the international proceeding. Given the approach proposed here, which enables direct access to international arbitration, we do not see that anything in the text “favours domestic courts” or “aims to provide incentives for investors to pursue claims in domestic courts” as the European Commission claims it does.

Similarly, the language provided stands in contrast with the Commission’s stated objective that it wishes to provide incentives “to seek amicable solutions – such as mediation.” The explicit provisions for mediation contained in the text will do little to prevent disputes. The current draft Article x-19 on mediation simply states in paragraphs 1 and 2 that the disputing parties “may at any time agree to have recourse to mediation” and that “recourse to mediation is without prejudice to the legal position or rights of either disputing party under this chapter.” Since disputing parties can always agree to submit to mediation, this adds nothing to what is already a given. Compared to an earlier CETA draft, the new version of the text omits saying explicitly that recourse to mediation is “voluntary,” but nonetheless the language indicates that there is no requirement for mediation on the part of an investor prior to going to ISDS. Apart from this, “amicable” deals cut with the threat of investor-state arbitration in the background may not always be adequate, especially where legitimate policy measures are adapted to accommodate the investor or high compensation is paid out of the public purse where domestic law does not foresee compensation.

Finally, the European Commission only partially succeeds in addressing the **problem of multiple parallel proceedings**: In order to submit a claim to arbitration under TTIP, the claimant investor has to waive its right to initiate proceedings for compensation elsewhere, which means that the investor is barred from engaging in parallel domestic or other arbitration processes for compensation relating to the same measure. Because many domestic remedies against the State are non-monetary in nature, in contrast to arbitration, where the primary remedy is monetary, parallel proceedings in domestic courts and international arbitral tribunals will continue to be possible. Also, in light of investment tribunals' history of expansive approaches to jurisdiction, it is not excluded that an arbitral tribunal will find it is competent even where another domestic or international process for compensation has been initiated over a dispute relating to the same measure alleged to constitute a breach.

## Question 8: Arbitrator ethics, conduct and qualifications

The European Commission states:

"There is concern that arbitrators on ISDS tribunals do not always act in an **independent and impartial manner**. [...]

The EU aims to establish clear rules to **ensure that arbitrators are independent and act ethically**. The EU will introduce specific requirements in the TTIP on the ethical conduct of arbitrators, including a **code of conduct**. This code of conduct will be binding on arbitrators in ISDS tribunals set up under TTIP. The code of conduct also establishes procedures to identify and deal with any conflicts of interest. Failure to abide by these ethical rules will result in the **removal of the arbitrator** from the tribunal. For example, if a responding state considers that the arbitrator chosen by the investor does not have the necessary qualifications or that he has a conflict of interest, the responding state can challenge the appointment. If the arbitrator is in breach of the Code of Conduct, he/she will be removed from the tribunal. In case the ISDS tribunal has already rendered its award and a breach of the code of conduct is found, the responding state or the investor **can request a reversal** of that ISDS finding.

In the text provided as reference (the draft EU-Canada Agreement), the Parties (i.e. the EU and Canada) have agreed for the first time in an investment agreement to include rules on the conduct of arbitrators, and have included the possibility to improve them further if necessary. In the context of TTIP these would be directly included in the agreement.

As regards the qualifications of ISDS arbitrators, the EU aims to set down detailed requirements for the arbitrators who act in ISDS tribunals under TTIP. They must be **independent and impartial**, with **expertise** in international law and international investment law and, if possible, **experience** in international trade law and international dispute resolution. Among those best qualified and who have undertaken such tasks will be retired **judges**, who generally have experience in ruling on issues that touch upon both trade and investment and on societal and public policy issues. The EU also aims to set up a roster, i.e. a list of qualified individuals from which the Chairperson for the ISDS tribunal is drawn, if the investor or the responding state cannot otherwise agree to a Chairperson. The purpose of such a roster is to ensure that the EU and the US have agreed to and vetted the arbitrators to ensure their abilities and independence. In this way the responding state chooses one arbitrator and has vetted the third arbitrator."

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

### Article x-25: Constitution of the Tribunal

1. Unless the disputing parties have agreed to appoint a sole arbitrator, the Tribunal shall comprise three arbitrators. One arbitrator shall be appointed by each of the disputing parties and the third, who will be the presiding arbitrator, shall be appointed by agreement of the disputing parties. If the disputing parties agree to appoint a sole arbitrator, the disputing parties shall seek to agree on the sole arbitrator.

2. If a Tribunal has not been constituted within 90 days from the date that a claim is submitted to arbitration, or where the disputing parties have agreed to appoint a sole arbitrator and have failed to do so within 90 days from the date the respondent agreed to submit the dispute to a sole arbitrator, a disputing party may request the Secretary-General of ICSID to appoint the arbitrator or arbitrators not yet appointed. The Secretary-General of ICSID shall appoint the remaining arbitrators from the list established pursuant to paragraph 3. In the event that such list has not been established on the date a claim is submitted to arbitration, the Secretary-General of ICSID shall make the appointment at his or her own discretion taking into consideration nominations made by either Party and, to the extent practicable, in consultation with the disputing parties. The Secretary-General of ICSID may not appoint as presiding arbitrator a national of either Canada or a Member State of the European Union unless all disputing parties agree otherwise.

3. Pursuant to Article x-42(2), the Committee on Services and Investment shall establish, and thereafter maintain, a list of individuals who are willing and able to serve as arbitrators and who meet the qualifications set out in paragraph 5. The Committee on Services and Investment shall ensure that the list includes at least 15 individuals.

4. The list established in paragraph 3 shall be composed of three sub-lists: one sub-list for each Party and one sub-list of individuals, who are neither nationals of Canada nor the Member States of the European Union, to act as presiding arbitrators. Each sub-list shall include at least five individuals. The Committee on Services and Investment may agree to increase the number of arbitrators for the list.

5. Arbitrators appointed pursuant to this Section shall have expertise or experience in public international law, in particular international investment law. It is desirable that they have expertise or experience in international trade law, and the resolution of disputes arising under international investment or international trade agreements.

6. Arbitrators shall be independent of, and not be affiliated with or take instructions from any disputing party or the government of a Party with regard to trade and investment matters. Arbitrators shall not take instructions from any organisation, government or disputing party with regard to matters related to the dispute. Arbitrators shall comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration or any supplemental rules adopted pursuant to Article x-42 (Committee on Services and Investment). Arbitrators who serve on the list established pursuant to paragraph 3 shall not, for that reason alone, be deemed to be affiliated with the government of a Party.

7. If a disputing party considers that an arbitrator does not meet the requirements set out in paragraph 6, it shall send a notice of its intent to challenge the arbitrator within 15 days after:

- a) the appointment of the arbitrator has been notified to the challenging party; or,
- b) the disputing party became aware of the facts giving rise to the alleged failure to meet such requirements.

8. The notice of an intention to challenge shall be promptly communicated to the other disputing party, to the arbitrator or arbitrators, as applicable, and to the Secretary General of ICSID. The notice of challenge shall state the reasons for the challenge.

9. When an arbitrator has been challenged by a disputing party, the disputing parties may agree to the challenge, in which case the disputing parties may request the challenged arbitrator to resign. The arbitrator may also, after the challenge, elect to resign. In neither case does this imply acceptance of the validity of the grounds for the challenge.

10. If, within 15 days from the date of the notice of challenge, the challenged arbitrator has elected not to resign, the Secretary-General of ICSID shall, after hearing the disputing parties and after providing the arbitrator an opportunity to submit any observations, issue a decision within 45 days of receipt of the notice of challenge and forthwith notify the disputing parties and other arbitrators, as applicable.

11. A vacancy resulting from the disqualification or resignation of an arbitrator shall be promptly filled pursuant to the procedure provided for in this Article.

**Article x-42: Committee**

The Committee shall, on agreement of the Parties, and after completion of the respective legal requirements and procedures of the Parties, decide to:

- a) establish and maintain the list of arbitrators pursuant to Article x- 25(3)(Constitution of the Tribunal);
- b) adopt a code of conduct for arbitrators to be applied in disputes arising out of this chapter, which may replace or supplement the rules in application, and that may address topics including:
  - i. disclosure obligations;
  - ii. the independence and impartiality of arbitrators;
  - iii. and confidentiality.

The Parties shall make best efforts to ensure that the decisions referred to in (a) and (b) are adopted no later than the entry into force of the Agreement, and in any event no later than two years after the entry into force of the Agreement.

*Question: “Taking into account the above explanation and the text provided in annex as a reference, please provide your views on these procedures and in particular on the Code of Conduct and the requirements for the qualifications for arbitrators in relation to the TTIP agreement. Do they improve the existing system and can further improvements be envisaged?”*

**IISD Reply:**

Several characteristics of the investment arbitration process have led to concerns regarding the independence and impartiality of the arbitrators. Acknowledging these concerns, the European Commission states that it “aims to establish clear rules to ensure that arbitrators are independent and act ethically.” It does this by referring to a **code of conduct** for arbitrators that will be included in the TTIP. Because the Commission does not explain its content in the consultation document, we cannot know whether this code will adequately deal with the aforementioned problems. For example, will it continue to allow arbitrators to be involved in simultaneous investment treaty cases as counsel? Or will this be prohibited? We have not seen this issue addressed in previous CETA draft texts or in US treaties.

The Commission also draws attention to the **roster system** or “lists” of arbitrators that are meant to be established “to ensure [the] abilities and independence” of the arbitrators. However, the language provided in the consultation draft indicates that the Commission has chosen to continue with the system of party appointments predominant in investment arbitration today. Like in ICSID, for instance, under the proposed text the first two arbitrators are nominated by the investor and the state unilaterally—each party appoints one arbitrator—and there is no need whatsoever to choose an arbitrator from the roster. The third and presiding arbitrator is appointed jointly by the disputing parties. The roster only comes into play where the parties fail to appoint the presiding arbitrator within three months of the submission of the claim, or fail to appoint their own arbitrator (this latter situation is not expected to be common under TTIP). This is very similar to the ICSID roster system, where the presiding arbitrator is only chosen from the roster when the disputing parties cannot agree on a president. The roster is therefore only a backup and does not have the power of an exclusive roster for all the arbitrators fulfilling strict conditions of experience, independence and impartiality.<sup>9</sup> As a consequence, all the problems resulting from party appointments, such as arbitrators focusing more on pleasing the nominating parties and being re-appointed in future cases, are not resolved through the roster system proposed for the TTIP. We are therefore of the view that the kind of roster approach used in the proposed text will also fail to address these concerns.

Given the nature and design of arbitration—a for-profit business—perhaps the only way to adequately address concerns raised in the current ISDS context, would be to move towards a system with tenured adjudicators or at least a small group of persons that would form the permanent group of adjudicators from which dispute settlement panels would be formed on a rotational or similar basis. This is not achieved through the roster system proposed.

<sup>9</sup> For example, in the area of sports arbitration, all arbitrators are chosen from a roster and those listed may not act as counsel in sports arbitration cases. No such safeguards are present in the language proposed here.

## Question 9: Reducing the risk of frivolous and unfounded cases

### The European Commission states:

"As in all legal systems, cases are brought that have little or no chance of succeeding (so-called "frivolous claims"). [...] Under existing investment agreements, there are generally no rules dealing with frivolous claims. [...]"

The EU will introduce several instruments in TTIP to **quickly dismiss frivolous claims**.

ISDS tribunals will be required to dismiss claims that are obviously without legal merit or legally unfounded. For example, this would be cases where the investor is not established in the US or the EU, or cases where the ISDS tribunal can quickly establish that there is in fact no discrimination between domestic and foreign investors. This provides an early and effective filtering mechanism for frivolous claims thereby avoiding a lengthy litigation process.

To further discourage unfounded claims, the EU is proposing that **the losing party should bear all costs** of the proceedings. So if investors take a chance at bringing certain claims and fail, they have to pay the full financial costs of this attempt."

### Reference text provided by the European Commission:

#### *Text developed in the EU-Canada agreement (CETA)*

#### **Article x-29: Claims Manifestly Without Legal Merit**

1. The respondent may, no later than 30 days

after the constitution of the tribunal, and in any event before the first session of the Tribunal, file an objection that a claim is manifestly without legal merit.

2. An objection may not be submitted under paragraph 1 if the respondent has filed an objection pursuant to Article x-30 (Claims Unfounded as a Matter of Law).

3. The respondent shall specify as precisely as possible the basis for the objection.

4. On receipt of an objection pursuant to this article, the Tribunal shall suspend the proceedings on the merits and establish a schedule for considering any objections consistent with its schedule for considering any other preliminary question.

5. The Tribunal, after giving the disputing parties an opportunity to present their observations, shall at its first session or promptly thereafter, issue a decision or award, stating the grounds therefor. In doing so, the Tribunal shall assume the alleged facts to be true.

6. This article shall be without prejudice to the Tribunal's authority to address other objections as a preliminary question or to the right of the respondent to object, in the course of the proceeding, that a claim lacks legal merit.

#### **Article x-30: Claims Unfounded as a Matter of Law**

1. Without prejudice to a tribunal's authority to address other objections as a preliminary question or to a respondent's right to raise any such objections at any appropriate time, the Tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim, or any part thereof, submitted under this section is not a claim for which an award in favour of the claimant may be made under Article x-22 (Submission of a Claim to Arbitration), even if the facts alleged were assumed to be true.

2. An objection under paragraph 1 shall be submitted to the Tribunal no later than the date the Tribunal fixes for the respondent to submit its counter-memorial.

3. If an objection has been submitted pursuant to Article x-29 (Claim Manifestly Without Legal Merit), the Tribunal may, taking into account the circumstances of that objection, decline to address an objection submitted pursuant to paragraph 1.

4. On receipt of an objection under paragraph 1, and subject to paragraph 3, the Tribunal shall suspend any proceedings on the merits, establish a schedule for considering the objection consistent with any schedule it has established for considering any other preliminary question, and issue a decision or award on the objection, stating the grounds therefor.

#### **Reference text (on costs):**

#### **Article x-36: Final Award**

5. A tribunal shall order that the costs of arbitration be borne by the unsuccessful disputing party. In exceptional circumstances, a tribunal may apportion costs between the disputing parties if it determines that apportionment is appropriate in the circumstances of the claim. Other reasonable costs, including costs of legal representation and assistance, shall be borne by the unsuccessful disputing party, unless the tribunal determines that such apportionment is unreasonable in the circumstances of the claim. Where only some parts of the claims have been successful the costs shall be adjusted, proportionately, to the number or extent of the successful parts of the claims.

*Question: “Taking into account the above explanation and the text provided in annex as a reference, please provide your views on these mechanisms for the avoidance of frivolous or unfounded claims and the removal of incentives in relation to the TTIP agreement. Please also indicate any other means to limit frivolous or unfounded claims.”*

**IISD Reply:**

A frivolous claim is a claim that is without any legal merit, sometimes brought in bad faith for the purpose of harassing the other side. The European Commission explains that there are two situations that permit frivolous claims to be rejected very quickly—either where the case is “obviously without legal merit or legally unfounded.”

The European Commission stresses that the proposed text “provides an early and effective filtering mechanism for frivolous claims thereby avoiding a lengthy litigation process.” However, frivolous claims are far from the biggest problem in investment arbitration, if one at all. The proposed provisions may in some cases help reduce the costs of some arbitrations by having unmeritorious cases terminated without the time and expense of full hearings on the merits. But these provisions will only address this cost issue. A case dismissed on either ground would have been won by the state in any event. What these provisions do not address are the expansive interpretations by some tribunals on the merits or on jurisdictional issues. Consequently, this feature, while it may be useful, will only find its utility in reducing the costs of arbitration, not the scope of any decisions that would otherwise be made on jurisdiction or the merits.

## Question 10: Allowing claims to proceed (filter)

**The European Commission states:**

“Recently, concerns have been expressed in relation to several ISDS claims brought by investors under existing investment agreements, relating to measures taken by states affecting the financial sector, notably those taken **in times of crisis in order to protect consumers or to maintain the stability and integrity of the financial system**. [...]”

The majority of existing investment agreements privilege the original intention of such agreements, which was to **avoid the politicisation of disputes**, and therefore do not contain provisions or mechanisms which allow the Parties the possibility to intervene under particular circumstances in ISDS cases. [...]

The EU like many other states considers it **important to protect the right to regulate in the financial sector** and, more broadly, the overriding need to **maintain the overall stability and integrity of the financial system**, while also recognizing the speed needed for government action in case of financial crisis.”

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

1. The provisions of [Investor-to-State Dispute Settlement] apply, as modified by this Article and Annex XXX, to:
  - a. investment disputes pertaining to measures to which this Chapter applies in which an investor claims that a Party has breached Articles X.12 (Investment - Transfers), X.11 (Investment - Expropriation), X.10 (Investment - Compensation for Losses), X.9 (Investment - Treatment of Investors and of Covered Investments), X.15 (Investment - Denial of Benefits), X.3 (Financial Services - National Treatment) or X.4 (Financial Services - Most-Favoured Nation Treatment); or
  - b. investment disputes commenced pursuant to [Investor State Dispute Settlement] in which Article 15.1 (Prudential Carve- Out/Exceptions) has been invoked.
2. Unless the disputing parties agree otherwise, in the case of an investment dispute under sub-paragraph 1(a), or where the respondent invokes Article 15.1 (Prudential Carve-Out/Exceptions) within 60 days of the submission of a claim to arbitration under Article X-22 (Submission of a Claim to Arbitration), the Tribunal shall be constituted from the list established under Article X-19 (Financial Services - Dispute Settlement). Where the respondent invokes Article 15.1 (Prudential Carve- Out/Exceptions) within 60 days of submission of a claim, with respect to a measure to which this Chapter does not apply, the time period applicable to the constitution of the Tribunal under Article X-25 (Constitution of the Tribunal) shall commence on the date the respondent invokes Article 15.1 (Prudential Carve- Out/Exceptions). In the event that the disputing parties are unable to agree on the composition of the Tribunal within the time frame laid down in Article X-25 (Constitution of the Tribunal) either disputing party may request the Secretary-General of ICSID to select the arbitrators from the list established under Article X-19 (Financial Services - Dispute Settlement). In the event that disputing parties are unable to constitute the Tribunal from the list, or that the list has not been established under Article X-19 (Financial Services - Dispute Settlement) on the date the claim is submitted to arbitration, the Secretary-General of ICSID shall select the arbitrators from the individuals proposed by one or both of the Parties in accordance with Article X-19 (Financial Services - Dispute Settlement).
3. The respondent may refer the matter in writing to the Financial Services Committee for a decision as to whether and, if so, to what extent the exception under Article 15.1 (Prudential Carve- Out/Exceptions) is a valid defence to the claim. Such a referral cannot be made later than the date the Tribunal fixes for the respondent to submit its counter-memorial. Where the respondent refers the matter to the Financial Services Committee under paragraph 3 the time periods or proceedings specified in [Investor-to-State-Dispute Settlement] shall be suspended.
4. In a referral under paragraph 3, the Financial Services Committee or the CETA Trade Committee as the case may be, may make a joint determination on whether and to what extent Article 15.1 (Prudential Carve-Out/Exceptions) is a valid defence to the claim. The Financial Services Committee or the CETA Trade Committee as the case may be, shall transmit a copy of any joint determination to the investor and the Tribunal, if constituted. If such joint determination concludes that Article 15.1 (Prudential Carve-Out/Exceptions) is a valid defence to all parts of the claim in their entirety, the investor shall be deemed to have withdrawn its claim and proceedings shall be discontinued in accordance with Article X-32 (Discontinuance). If such joint determination concludes that Article 15.1 (Prudential Carve-Out/Exceptions) is a valid defence to only parts of the claim, the joint determination shall be binding on the Tribunal with respect to those parts of the claim, the suspension of the timelines or proceedings in paragraph 4 shall no longer apply, and the investor may proceed with any remaining parts of the claim.
5. If the CETA Trade Committee has not made a joint determination within 3 months of referral of the matter by the Financial Services Committee, the suspension of the time periods or proceedings referenced in paragraph 4 shall no longer apply and the investor may proceed with its claim.
6. At the request of the respondent, the Tribunal shall decide as a preliminary matter whether and to what extent Article 15.1 (Prudential Carve-Out/Exceptions) is a valid defence to the claim. Failure of the respondent to make such a request is without prejudice to the right of the respondent to assert Article 15.1 (Prudential Carve-Out/Exceptions) as a defence in a later phase of the arbitration. The Tribunal shall draw no adverse inference from the fact that the Financial Services Committee or the CETA Trade Committee has not agreed on a joint determination in accordance with Annex XXX.

*Question: “Some investment agreements include filter mechanisms whereby the Parties to the agreement (here the EU and the US) may intervene in ISDS cases where an investor seeks to challenge measures adopted pursuant to prudential rules for financial stability. In such cases the Parties may decide jointly that a claim should not proceed any further. Taking into account the above explanation and the text provided in annex as a reference, what are your views on the use and scope of such filter mechanisms in the TTIP agreement?”*

**IISD Reply:**

If disputes between an investor and the state involving complex macroeconomic issues can be subject to arbitral panels, the possibility provided in the suggested language to leave certain questions to a specialized Committee can be useful. However, where the Joint Financial Services Committee cannot come to an agreement, the issue returns to the investor-state tribunal.

A similar approach was taken in the Canada-China BIT (2012) which provides in Article 20 that, with regard to whether a financial prudential measure constituted a valid exception, the investor-state tribunal must seek a joint decision from contracting states or a decision by a state-to-state arbitral tribunal, if established.<sup>10</sup> In particular, the question of whether the prudential measure constitutes a valid exception is referred to a state-state tribunal in the event that no decision can be reached by the contracting parties. In our view this approach is preferable.

## Question 11: Guidance by the Parties (the EU and the US) on the interpretation of the agreement

**The European Commission states:**

“When countries negotiate an agreement, they have a **common understanding** of what they want the agreement to mean. However, there is a risk that any tribunal, including ISDS tribunals **interprets the agreement in a different way**, upsetting the balance that the countries in question had achieved in negotiations – for example, between investment protection and the right to regulate. This is the case if the agreement **leaves room for interpretation**. It is therefore necessary to have mechanisms which will allow the Parties (the EU and the US) to clarify their intentions on **how the agreement should be interpreted**.

Most existing investment agreements **do not permit** the countries who signed the agreement in question to take part in proceedings nor to give directions to the ISDS tribunal on issues of interpretation.

The EU will make it possible for the non-disputing Party (i.e. the EU or the US) to **intervene in ISDS proceedings** between an investor and the other Party. This means that in each case, the Parties can explain to the arbitrators and to the Appellate Body **how they would want the relevant provisions to be interpreted**. Where both Parties agree on the interpretation, such interpretation is a very powerful statement, which ISDS **tribunals would have to respect**.

The EU would also provide for the Parties (i.e. the EU and the US) to adopt **binding interpretations on issues of law**, so as to correct or avoid interpretations by tribunals which might be considered to be against the common intentions of the EU and the US. Given the EU’s intention to give clarity and precision to the investment protection obligations of the agreement, the scope for undesirable interpretations by ISDS tribunals is **very limited**. However, this provision is an **additional safety-valve** for the Parties.”

<sup>10</sup> Canada-China BIT, retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/china-text-chine.aspx?lang=eng>

Reference text provided by the European Commission:

*Text developed in the EU-Canada agreement (CETA)*

**Article x-27: Applicable Law and Rules of Interpretation**

2. Where serious concerns arise as regards matters of interpretation that may affect investment, the Committee on Services and Investment may recommend to the CETA Trade Committee the adoption of interpretations of the Agreement. An interpretation adopted by the CETA Trade Committee shall be binding on a Tribunal established under this chapter. The CETA Trade Committee may decide that an interpretation shall have binding effect from a specific date.

**Article x-35: The non-disputing Party to the Agreement**

1. The respondent shall, within 30 days after receipt or promptly after any dispute concerning confidential or protected information has been resolved, deliver to the non-disputing Party:

- a) a request for consultations referred to in Article x-18 (Consultations), a notice requesting a determination referred to in Article x-20 (Determination of the respondent for disputes with the European Union or its Member States), a claim referred to in Article x-22 (Submission of a Claim to Arbitration) and any other documents that are appended to such documents;
- b) on request:
  - i. pleadings, memorials, briefs, requests and other submissions made to the tribunal by a disputing party;
  - ii. written submissions made to the tribunal pursuant to Article 4 (Submission by a third person) of the UNCITRAL Transparency Rules;
  - iii. minutes or transcripts of hearings of the tribunal, where available; and orders, awards and decisions of the tribunal.
  - iv. on request and at the cost of the non-disputing Party, all or part of the evidence that has been tendered to the Tribunal unless publicly available.

2. The Tribunal shall accept or, after consultation with the disputing parties, may invite, oral or written submissions from the non-disputing Party regarding the interpretation of the Agreement. The non-disputing Party may attend a hearing held under this Section.

3. The tribunal shall not draw any inference from the absence of a submission pursuant to paragraphs 1 or 2.

4. The tribunal shall ensure that the disputing parties are given a reasonable opportunity to present their observations on a submission by the non-disputing Party to the Agreement.

*Question: "Taking into account the above explanation and the text provided in annex as a reference, please provide your views on this approach to ensure uniformity and predictability in the interpretation of the agreement to correct the balance? Are these elements desirable, and if so, do you consider them to be sufficient?"*

**IISD Reply:**

The inclusion of a process for binding joint interpretation in the CETA is useful, as it can effectively preclude unintended interpretations through arbitral tribunals from being binding on the parties over the longer term. It requires, however, that both parties are willing to express the same understanding of the treaty provisions in the first place.

## Question 12: Appellate Mechanism and consistency of rulings

The European Commission states:

"In existing investment agreements, the **decision by an ISDS tribunal is final.**

[...] **No existing international investment agreements provide for an appeal** on legal issues. International arbitration rules allow for annulment of ISDS rulings under certain very restrictive conditions relating to procedural issues. [...]

The EU aims to **establish an appellate mechanism** in TTIP so as to allow for review of ISDS rulings. It will help **ensure consistency** in the interpretation of TTIP and provide both the government and the investor with the opportunity to **appeal against awards** and to **correct errors**. This legal review is an additional check on the work of the arbitrators who have examined the case in the first place.

In agreements under negotiation by the EU, the possibility of creating an appellate mechanism in the future is envisaged. However, in TTIP the EU intends to go further and create a bilateral appellate mechanism immediately through the agreement."

Reference text provided by the European Commission:

### *Text developed in the EU-Canada agreement (CETA)*

The Committee on Services and Investment shall provide a forum for the Parties to consult on issues related to this Section, including:

- a) difficulties which may arise in the implementation of this chapter;
- b) possible improvements of this chapter, in particular in the light of experience and developments in other international fora; and
- c) whether, and if so, under what conditions, an appellate mechanism could be created under the Agreement to review, on points of law, awards rendered by a tribunal under this Section, or whether awards rendered under this Section could be subject to such an appellate mechanism developed pursuant to other institutional arrangements. Such consultations shall take into account the following issues, among others:
  - i. the nature and composition of an appellate mechanism;
  - ii. the applicable scope and standard of review;
  - iii. transparency of proceedings of an appellate mechanism;
  - iv. the effect of decisions by an appellate mechanism;
  - v. the relationship of review by an appellate mechanism to the arbitration rules that may be selected under Article x-22 (Submission of a Claim to Arbitration); and
  - vi. the relationship of review by an appellate mechanism to domestic laws and international law on the enforcement of arbitral awards.

### **Possible draft provisions establishing an appellate mechanism**

#### Article xx (Award)

Either disputing party may appeal the award to the Appellate Body within 90 days of the issuance of the award. In such an event, if the Appellate Body modifies or reverses the award of the Tribunal then the Tribunal shall, after hearing the disputing parties if appropriate, revise its award to reflect the findings of the Appellate Body. The Tribunal shall seek to issue its revised award within 90 days of receiving the report of the Appellate Body.

#### Article xx (Appellate review)

A standing Appellate Body is hereby established. The Appellate Body shall hear appeals on issues of law covered in the Tribunal's decision or award and legal interpretations developed by the Tribunal.

*Question: “Taking into account the above explanation and the text provided in annex as a reference, please provide your views on the creation of an appellate mechanism in TTIP as a means to ensure uniformity and predictability in the interpretation of the agreement.”*

**IISD Reply:**

The idea of introducing an appellate system is a good one in our view. As we can see from WTO experience, the WTO appellate mechanism is working well. The Appellate Body is well respected, and has contributed to a more predictable trading system through its clarifications regarding key questions of interpretation. The result has been not only better law and consistency but also improved compliance and trust in the system.

The European Commission states: “In agreements under negotiation by the EU, the possibility of creating an appellate mechanism in the future is envisaged. **However, in TTIP the EU intends to go further and create a bilateral appellate mechanism immediately through the agreement**” (emphasis added). It is unclear what this mechanism will look like or how it will function, and therefore it is impossible at this stage to have an opinion on whether it will resolve some of the problems raised in investor–state arbitration. Who will be on the panel? How will they be nominated and chosen? Are they chosen on a longer-term, permanent or ad hoc basis? How will this work in conjunction with the system set up under ICSID or other arbitration rules? These are not easy issues to resolve, especially because no such mechanism has ever been set up or tested in investment arbitration. The two short “possible draft provisions establishing an appellate mechanism” provide no answers to this question whatsoever. Until these issues are settled, and the appellate mechanism is up and functioning, the ISDS options should be entirely put on hold.

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## C. General Assessment

*Questions:*

*“What is your overall assessment of the proposed approach on substantive standards of protection and ISDS as a basis for investment negotiations between the EU and US?”*

*“Do you see other ways for the EU to improve the investment system?”*

*“Are there any other issues related to the topics covered by the questionnaire that you would like to address?”*

**IISD Reply:**

Overall, the European Commission seems to be responsive to some of the concerns that have been raised concerning previously leaked drafts of the CETA investment text. Yet, in several areas—for example, the most-favoured nation treatment, fair and equitable treatment, the right to regulate, and investor–state dispute settlement—inconsistencies remain between the stated objectives and the actual legal text that the European Commission proposes be used as the basis for investment negotiations with the United States.

Further, the consultation document does not shed light on whether the European Commission intends to include investment liberalization elements and the prohibition of performance requirements, and leaves open whether ISDS would apply to these. It does not provide draft language in this respect that would provide a basis for a proper analysis or response.

Finally, the European Commission is determined to allow U.S. investors to challenge European executive, legislative and judicial measures in international investment arbitration instead of domestic courts in Europe and the United States. The Commission does not, however, explain why it finds that investor-state arbitration is desirable or needed in the U.S.-EU context and what problems it is trying to solve with its inclusion. Further, the Commission's intended approach to state-state dispute settlement does not form part of the consultation, and the consultation document does not address its potential to be complementary to or replace investor-state dispute settlement.

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