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Transatlantic trade and investment negotiations:

Reaching a consensus on investor-state dispute settlement

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Executive Summary

Since Germany and Pakistan negotiated the first modern bilateral investment treaty in 1959, more than 3,000 trade and investment agreements have been concluded among 180 countries to protect foreign investment.[1] Many of these agreements contain a mechanism called "investor-state dispute settlement" (ISDS), which enables a foreign investor to invoke arbitration against a host government for the breach of certain investor protections.

More than two years ago, the United States and the European Union launched negotiations to forge a new Transatlantic Trade and Investment Partnership (TTIP) to deepen their already extensive economic ties.[2] The talks have advanced more slowly than many had hoped, and ISDS has become one of the subjects of heightened controversy. At the G-7 meeting in June 2015, U.S. and EU leaders instructed their teams to accelerate work on all outstanding issues with the goal of finalizing the outline of an agreement as soon as possible—and preferably by the end of this year.[3] Both sides are now preparing for the next round of negotiations beginning October 19 under increased pressure to make concrete progress. The conclusion earlier this month of the Trans-Pacific Partnership (TPP) the United States has been negotiating with Japan and 10 other Asia-Pacific partners provides further motivation to complete TTIP.

Government officials, legislators, and progressive and conservative groups on both sides of the Atlantic have raised concerns about ISDS.[4] Some question the logic of a state protecting foreign investors, but not its own domestic investors, by enabling a foreigner to file a claim against a state before an independent arbitration tribunal. Others acknowledge the value of ISDS but contend that it should be excluded from agreements between developed economies, such as TTIP. Still others call for reforms to improve the ISDS process and reduce the potential for abuse.

Last year the European Commission froze negotiations on TTIP's investment chapter pending completion of public consultations. In May of this year, the Commission published a draft concept paper outlining a proposed path forward, including affirmation of the right of governments to regulate in the public interest, and the creation of both a bilateral and an international appellate mechanism.[5] Last month, the Commission published a detailed proposal embodying these and other ideas, for which it is seeking member state support before presenting to the United States.[6]

This paper explores the rationale behind the development of ISDS and its relevancy today. Reviewing the debate and modifications that have already been made, it corrects the record on a number of contentious points. It concludes that the reasons for maintaining the mechanism in future agreements are more persuasive than those supporting elimination. At the same time, TTIP negotiators must consider improvements that would instill greater confidence in the legitimacy and integrity of the process.

A number of relatively non-controversial reforms have already been proposed that build upon enhancements made by the United States in 2004 in its Model Bilateral Investment Treaty (Model BIT) and by the EU in its recent trade and investment negotiations with Canada and Singapore. Additional improvements are expected to be part of the TPP investment chapter, which is being prepared for publication. However, other potential improvements, including those suggested in the EU's latest proposal, merit further analysis of their potential risks and benefits.

Two steps can accelerate this process. First, U.S. and EU negotiating teams should reach agreement on a number of key principles to guide their work in the weeks ahead. This step should not be too difficult. Such principles should include the following elements:

- There should be a neutral forum for adjudication, independent of the potential for bias inherent in a host state's legal system.
- An arbitration tribunal should operate under established principles of international law with consistency and predictability.
- The arbitrators should be beyond reproach in terms of independence, impartiality, and integrity.
- The tribunal should have the authority to dismiss frivolous and other non-meritorious claims early in the process.
- The proceedings should be transparent and open to the public.
- An option for annulment, and possibly appeal, should be considered.

Second, in light of the complexity of the issues under discussion and the importance of avoiding unintended consequences, the United States and the EU should appoint a senior group of experts to review in detail several of the more provocative proposals that have been put forward by the EU—such as creating an appellate mechanism for TTIP or, more broadly, an international ISDS court. This should be a broad group of experts representing a range of academic, legal, business, public interest, and other expertise, and reflecting deep knowledge of international investment law, arbitration rules, and judicial and regulatory decision-making. To build greater public support, the group should include voices that support modifications as well as oppose them, in an effort to analyze the strengths and weaknesses of the various options, and to identify consensus where possible.

Relevance of investor-state dispute settlement

Under international investment treaties,[7] states agree to provide each other's investors with basic protections consistent with internationally recognized principles, and, in the case of the United States and the EU, core property protections found in their own legal systems. These protections include prohibitions against government expropriation of property without adequate compensation, the denial of justice in domestic proceedings, and discriminatory treatment.[8] Such investment agreements provide that an investor harmed by a state's failure to uphold these obligations may file an arbitration claim to resolve the dispute, hence the name "investor-state dispute settlement," or ISDS for short. An increasing number of trade agreements incorporate similar obligations and offer foreign investors the better of national treatment or most-favored nation treatment.

Both trade and investment agreements contain detailed provisions for establishing an arbitration panel, which typically consists of three people with relevant expertise. The investor elects one arbitrator, the state selects a second one, and the third is chosen by the first two arbitrators or a designated international body. Tribunals are typically established under international procedural rules, such as those developed by the International Centre for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law. A tribunal has the authority to award compensation, but no power to change or overturn domestic laws or regulatory decisions.

Unlike in the area of international trade, there is no single multilateral body or framework that oversees international investment policy or adjudication. The World Bank's development of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States in 1966 was an important step forward, creating a venue and procedures that parties could use to conduct ISDS proceedings.[9] However, neither the convention nor ICSID addresses the substantive aspects of investment law, which are left to arbitration panels or, in some cases, to international or domestic courts to interpret. A number of additional international bodies also lend expertise and assistance to support arbitrations, including the United Nations Commission on International Trade Law, the International Chamber of Commerce, and the London Court of International Arbitration.

ISDS is not a new concept, having been developed nearly 50 years ago.[10] Before then, investors had few options for pursuing claims of expropriation, discriminatory treatment, or a denial of due process on their own.[11] Expropriation, in particular, was a highly charged political issue as newly independent colonies and developing countries sought to exert greater control over their natural resources. In the past, the United States and other countries had resorted to "gunboat diplomacy" in support of their commercial interests.[12] A less bellicose option was for a foreign investor to seek redress in the host state's domestic court, but the degree of protection and respect for the rule of law varied widely. Alternatively, an investor could seek the assistance of its own state, which could pursue a claim through diplomatic discussions or, once the investor had exhausted domestic remedies available in the host state, through espousal of the claim before the International Court of Justice. These solutions, however, were largely ineffective: From 1945 to 1959, nearly 900 seizures of foreign investors' property by host states occurred without remedy.[13]

In the 30 years following negotiation of the first modern investment treaty in 1959, about 400 such agreements were concluded. Initially, developed countries exporting capital sought to protect their citizens' investments in developing countries that were importing capital. But as trade and investment flows increased among all countries, the 1980s saw a dramatic increase in the desire for investment agreements between developing economies. Over the following 15 years, more than 2,000 such agreements were negotiated.[14] Indeed, few, if any, other subjects of international law have been the focus of as many agreements.[15]

Today the United States is party to 50 trade and investment agreements, while the EU and its member states are party to over 1,400, which is nearly half of all investment agreements in force worldwide.[16] Many trading partners with which the United States has an ISDS mechanism in place include the majority of the TPP countries (Canada, Chile, Mexico, Peru, Singapore, and Vietnam). The remaining five TPP partners —Australia, Brunei, Japan, Malaysia and New Zealand—are themselves parties to more than 100 other agreements that include ISDS.

There are sound reasons why most states have continued to embrace ISDS provisions in their trade and investment agreements. First, as noted, the domestic quality of legal protections and systems varies greatly among states. There continue to be legal systems that do not function in accordance with accepted standards of fairness and due process, despite the requirements of treaty obligations and customary international law. It is not surprising that the largest number of ISDS disputes has been filed against Venezuela and Argentina.[17] Offering ISDS as an alternative method of dispute resolution is therefore a matter of fairness. Further, over time the mere ability to bring claims through an arbitration process can encourage improvements in domestic judicial systems. Why, for example, should a German investor in Buenos Aires be able to file a claim for expropriation against the Argentinian government when an Argentinian investor cannot? The answer is not to eliminate redress for the foreign investor, but to exert greater pressure on weaker legal systems to enact reforms.

Some acknowledge that ISDS provides the most viable recourse when state action injures a foreign investor in violation of a treaty obligation, but argue that the process only has salience in agreements between developed and developing economies, and does not belong in an agreement between two advanced economies like the United States and the EU. But even within the EU, there are significant distinctions in the quality of its 28 different legal systems. The Global Enabling Trade Report prepared by the World Economic Forum cites Romania and Hungary as falling in the bottom half of 138 countries surveyed for their judicial efficiency and impartiality in deciding commercial disputes.[18] The Czech Republic, which after Venezuela and Argentina is the country with the most investor claims filed against it, came in 55th place. An ISDS mechanism in TTIP would therefore help ensure that U.S. investors will receive the same level of protection in all EU countries.

The situation in the United States can also vary from state to state. As the European Commission has noted, foreign investors in the United States have had reason to be concerned. The Commission has cited the *Loewen v. United States* case, where a Mississippi funeral home operator was awarded $500 million by a state court, including punitive damages, in a contract dispute with a Canadian competitor. Before the Canadian investor could appeal, it had to post a bond worth more than the award. It refused to do so, settled the case, and then brought an ISDS claim alleging that it had done so under duress. The tribunal dismissed the case for lack of jurisdiction, but not without strong words for the unfairness it found in the Mississippi proceedings against the foreign investor.[19]

Even if the EU and U.S. legal systems were consistent across the board, it would be hard to limit ISDS provisions only to agreements where one party has a weaker legal system. While some states with less robust systems may choose to embrace ISDS as a way to encourage foreign investment, others will resist being singled out in such a manner. Eliminating ISDS from TTIP would make it more difficult for the EU and the United States to secure such protection for its investors in other bilateral investment agreements that each is negotiating with other countries, including China. Furthermore, in an agreement that includes the possibility of other countries joining in the future—such as TPP does now and TTIP may allow—it would be difficult to have ISDS apply only to certain parties within that same agreement.

Second, there is an inherent potential for national bias and an unfair playing field when a foreign investor's only remedy is to ask one part of the host government to repudiate the act of another part of the very same government. As the Obama administration has highlighted, "the potential for bias can be high in situations where a foreign investor is seeking to redress injury in a domestic court, especially against the government itself."[20] This holds true whether the host state is the United States, an EU member state, or another country.

Third, while the propensity to use gunboat diplomacy has declined significantly, the idea of politicizing investment disputes and creating new sources of interstate friction—by insisting that only states should be able to raise a claim on behalf of one of its investors—is not a popular one. Establishing an arbitration panel that is independent of either party to resolve disputes between an investor and a host state may not be a perfect solution, but it is preferable to the alternatives.

Fourth, key aspects of a claim often turn on interpretations of treaty law and customary international law, topics in which domestic courts are less experienced. Less compelling, however, is the argument that ISDS is necessary to encourage foreign investment. Investment agreements provide greater certainty and predictability, which is attractive to investors. But the absence of an investment agreement has not kept U.S. or EU investors from making substantial investments in many countries, including Brazil, China, and India.[21]

Both sides are keenly aware that ISDS is a two-way street. Officials in Brussels and Washington thus share an interest in exploring how to develop an appropriate balance between protecting foreign investors and preserving important public policy interests. Although the United States has faced only 17 such cases in the past 25 years and won each of the 13 that concluded, this unblemished record is unlikely to last. Brussels, newly empowered to represent EU member states in investment negotiations, is well aware that European investors have successfully invoked ISDS against other EU member states for years, and that they represent the largest group of ISDS users globally. Indeed, EU governments have been respondents in nearly 100 cases brought by investors from another EU member state, whereas they have faced only 29 cases brought by investors from outside of the EU.[22] This supports the view that ISDS continues to serve a key role today, even in an agreement between the United States and the EU.

Concerns with investor-state dispute settlement

This section examines a number of arguments made by critics in order to shed light on which have merit and should be addressed in the TTIP negotiations. Some concerns that have been raised about how ISDS operates are substantive, while others are procedural. In a few areas, concerns are based on incomplete information or have already been addressed by existing improvements. In other areas, steps to address concerns should be assessed in order to help build greater confidence in the process.

While ISDS is not a new mechanism for dispute settlement, it has become one of the more contentious elements of current debates about trade agreements, not only in the context of TTIP but also with respect to TPP and the EU-Canada Comprehensive Economic and Trade Agreement. A number of factors explain the increased attention. First, several high-profile cases have raised concerns about a state's ability to regulate in the public interest. The two examples most often cited are the Vattenfall and Philip Morris arbitrations. In the Vattenfall case, a Swedish utility that operates two nuclear power plants in Germany is demanding compensation under the European Energy Charter because Berlin decided to shut down its nuclear sector after the Fukushima disaster, which the company argues rendered its investment worthless.[23] In the Philip Morris litigation, the company filed a claim against Australia over its tobacco packaging law, which required the removal of branding and trademark elements other than the company name.[24] Philip Morris claims this constituted a denial of fair and equitable treatment and deprived it of the underlying value of its investment in the Australian market. A year earlier, Philip Morris had filed a similar challenge against Uruguay. None of these three cases have been decided yet. Concerns, however, have reportedly led TPP negotiators to carve out challenges to tobacco-related regulation from ISDS.[25]

Attention has also focused on the increase in the number of investment agreements, raising the possibility of increased litigation under various ISDS provisions. Often overlooked, however, are studies that demonstrate that this increase correlates with substantial growth in foreign investment flows.[26] In addition, it is necessary to put the number of cases filed in perspective. While the number of ISDS cases has risen over the years, there has never been a claim brought under the great majority of investment agreements.[27] Of the 608 known ISDS cases filed before the end of 2014, 356 cases have been concluded.[28] By comparison, the United States has indicated that during the last few decades in which it successfully defended the 13 ISDS cases that went to judgment, individuals and companies have filed hundreds of thousands of challenges against federal, state, and local governments' actions in domestic U.S. courts.[29] Given the substantial scope of international investment, including roughly 80,000 multinational companies with 100,000 affiliates, and the more than 3,000 treaties that exist, the number of disputes proceeding to arbitration is actually a fraction of the number of potential cases.[30]

With respect to TTIP, each side is concerned that the other is more litigious and thus likely to resort to ISDS more often than would other trading partners. European critics in particular worry that American investors may overwhelm their governments with arbitration requests if no limits are imposed. It turns out, however, that European investors have brought more cases to arbitration in the past 30 years than U.S. investors. EU investors have been claimants in 53 percent of cases, while U.S. investors account for only 22 percent.[31] In fact, the European Energy Charter Treaty has been the most frequently invoked agreement in investment disputes, with a total of 60 cases.[32]

Two additional data points are important in evaluating commonly raised concerns. According to the United Nations Conference on Trade and Development, states have won more cases than investors. Of the 356 ISDS cases concluded by the end of 2014, approximately 37 percent were decided in favor of the host state, 25 percent were decided in favor of the investor, 28 percent were settled outside of a tribunal, and 8 percent were discontinued for other reasons.[33] In addition, empirical research has shown that in cases where investors have prevailed, the awards granted have been substantially less than those sought.[34]

Unfair to domestic investors

As mentioned earlier, one popular argument against ISDS is that its use is limited to foreign investors that have suffered injury from government action or inaction in violation of a treaty obligation, while domestic investors have no comparable recourse. Critics allege that the mechanism is unfair because it accords foreign investors greater rights than domestic investors. However, this is not the case in the United States or the EU, where it is made clear in treaty texts that the agreements accord no greater substantive rights to foreign investors. A domestic investor has the same, if not greater, substantive rights under the U.S. Constitution and the European Convention for the Protection of Human Rights and Fundamental Freedoms[35] as a foreign investor has under an investment treaty. Indeed, claimants opting to proceed under ISDS have fewer rights in that they cannot seek specific relief or punitive damages. As noted, international agreements provide only for the possibility of compensation and not punitive awards.

Vague standards

There are concerns that investors may exploit certain terms in investor protection agreements because they are not well defined.[36] For example, direct expropriation—the coerced transfer of property belonging to a foreign investor by a government—is a relatively straightforward concept to define and judge. Indirect expropriation is another matter and can arise in the context of regulatory action by a government that affects the value of the investor’s property interest, even if that was not the intent. The United States and Europe have taken steps to define this concept with greater clarity. For instance, the relevant text of the EU-Canada agreement draws from the 2004 U.S. Model BIT Review and states:

> 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, nondiscriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.[37]

While the language “except in the rare circumstance” leaves some ambiguity for interpretation, it is harder to characterize legitimate state action as an indirect expropriation.

Regulatory chill

Opponents have claimed that ISDS could have a chilling effect on a state’s ability to regulate, irrespective of steps the United States and the EU have taken in agreements with other partners to reaffirm the right of governments to regulate in the public interest. Critics argue that the fear or threat of being taken to arbitration could prevent a state from developing sound regulatory policies, particularly with regard to the environment, health and consumer safety.

A Dutch study, however, examined NAFTA and the Dominican Republic-Central America Free Trade Agreement and found “no evidence that any government has changed a policy position or refrained from acting in a policy area for fear of potential ISDS claims.”[38] Supporters of ISDS have pointed out that U.S. and EU trade agreements with other countries have actually required them to toughen their regulations in several areas in furtherance of public policy objectives, particularly with respect to labor and environmental standards. Furthermore, most cases have not involved a challenge to broad regulatory action, but rather focused on licensing questions.[39] The Vattenfall and Philip Morris cases, which do raise issues involving the use of governmental regulatory powers, have yet to be decided.

Secretive process

Another claim is that ISDS cases are conducted by secret tribunals. In fact, U.S. investment agreements have required that proceedings be open to the public and that documents be publicly available, which is a position the EU also supports. Transparency continues to improve under new rules established by the United Nations Commission on International Trade Law and the 2014 United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration.[40]

Impartiality of arbitrators

The debate over ISDS has brought out concerns about a revolving door between people who act simultaneously as a judge in one case and as a litigator in another one.[41] There are procedural rules in place to challenge potential conflicts of interest, but serving on one tribunal as an arbitrator while appearing before another tribunal on behalf of a foreign investor has not been viewed as a problem. This has, however, resulted in awkward situations, such as when a person sitting as an arbitrator in one case finds himself in a second case arguing before one of his co-arbitrators, who is also sitting on the second panel. Another concern is that arbitrators may be more sympathetic towards arguments advanced by the foreign investor's lawyers, who may have opportunities to select arbitrators in future cases in which their firms are involved.

Whether guidelines should be developed to address these questions deserves further study. One way to address some of the questions that have arisen could be to adopt a "cooling-off" period in which persons interested in serving on arbitration panels indicate that they have not represented claimants in other ISDS cases for a certain period of time and agree not to do so for a period of time after the proceedings end.

Skewed benefits

Critics contend that ISDS benefits only larger corporations able to afford the arbitration process. According to the OECD, however, large corporations bring fewer than 10 percent of known ISDS cases,[42] whereas smaller companies and individuals have accounted for nearly half of all cases brought under international arbitration.[43] It is not surprising that ISDS is beneficial to small- and medium-sized companies, which often lack the resources and expertise to seek redress by navigating an unknown, potentially lengthy, and expensive foreign legal process.

This discussion demonstrates that a number of concerns overlook the facts. It is important to set the record straight, determine which questions are legitimate, and decide how best to address them. Because misconceptions have already influenced public perception of ISDS, it is necessary that the United States and the EU find ways to show that the mechanism is fair and credible. Otherwise, the backlash that has occurred will threaten the inclusion of ISDS in TTIP as well as other agreements.

Proposed reforms

It is ironic that a mechanism intended to depoliticize disputes that could affect relations between states has become so politicized in both the United States and Europe. During a debate in the German Parliament last year, Economy Minister Sigmar Gabriel stated, “We reject these investment protection agreements.”[44] Earlier this year, however, he acknowledged that ISDS was necessary in TTIP to ensure fair treatment of smaller companies and stated that Germany was not looking to abolish ISDS but to find a different path.[45] A majority of EU member states have reminded the EU Commission that its negotiating mandate includes express support for retaining ISDS in TTIP.[46]

The European Parliament’s view of ISDS has also been evolving, but in the other direction. Bernd Lange, chairman of the influential International Trade Committee, has been adamant that the “widespread public criticism and outright rejection” ISDS is facing in Europe must be addressed.[47] He urged the parliament to “come forward with suggestions on what needs to be changed in the approach followed in TTIP and beyond.” The European Parliament passed a non-binding resolution on July 8 with compromise language outlining the need “to replace the ISDS system with a new system.”[48]

There was also heated discussion in the United States as Congress debated what guidance to provide on ISDS in the context of enacting trade promotion authority. In June, Congress decided to retain the same negotiating objective that had been in the 2002 Trade Act.[49] The law enacted calls for securing procedures for resolving disputes between an investor and a government, including by providing for an appellate body or similar mechanism.

Both the United States and the EU have indicated a willingness to consider further steps to improve the operation of ISDS to address concerns and questions that have been raised. The United States already made a number of substantive and procedural improvements more than a decade ago when it developed the 2004 Model BIT. Dispute settlement under NAFTA had forced U.S. officials to focus attention on the “uncertain scope of some BIT obligations and consequently the broad discretion left to arbitral tribunals to interpret those provisions.”[50] As a result of changes made in 2004, the host state has greater regulatory discretion. Exceptions to the ISDS rules were added for claims regarding financial services and tax issues, and new procedures were put in place to enable both states to issue binding interpretative statements. Concerns around the vagueness of certain standards were addressed by clarifying such terms as “fair and equitable treatment” and “indirect expropriation.” The use of ISDS was further circumscribed through the adoption of a statute of limitations on claims. In addition, while a claimant could begin a case in either domestic court or ISDS arbitration, if at any point it chose arbitration, it could not return to court.

The 2004 changes to the U.S. Model BIT also increased transparency by requiring that documents be posted and hearings be open to the public. They made it easier to dismiss frivolous claims and consolidate related claims, as well as to award attorneys' fees to the prevailing party. Both the 2004 and the 2012 modifications left open the possibility of establishing an appellate mechanism as Congress had requested.

The EU incorporated similar provisions in its recent agreements with Canada and Singapore. The EU-Canada CETA, for example, reaffirms the right to regulate and further defines key concepts relevant to ISDS decisions, such as fair and equitable treatment.[51] The states involved can issue binding interpretations of any ISDS treaty provisions that still appear unclear. The text includes steps to ensure that documents are publicly available and hearings are open to the public. In addition, interested parties (e.g., labor unions, NGOs) can make submissions to the tribunal. The tribunal has the authority to reject frivolous claims, and to require the losing party to pay all attorneys' fees. The text includes provisions for a code of conduct for all arbitrators and an agreement to work towards a future appellate mechanism.[52]

In May, the European Commission published a draft concept paper focused on TTIP, which outlined changes it would seek to negotiate.[53] The paper foreshadowed that it would suggest significant changes in several areas, including the right to regulate, operation of the tribunals, and appellate review of decisions.[54] The Commission also called for establishment of an international investment court that would eventually replace the bilateral appellate mechanism that it is seeking to create for TTIP.

Building on that paper, on September 16, the Commission released a draft text for TTIP's investment chapter, in which it proposed to negotiate with the United States after consultations with member states and the European Council. In the text and accompanying Reading Guide,[55] the Commission indicated that it is embracing a number of improvements made in prior agreements, such as open and transparent proceedings, the early dismissal of frivolous claims, adoption of the loser pays principle, and a code of conduct for arbitrators. But the Commission proposes to go farther in several ways.

The Commission suggests preserving the right to regulate through "measures necessary to achieve legitimate public policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection, or promotion and protection of cultural diversity."[56] The United States has indicated that it will reaffirm the right to regulate in TPP's investment chapter, but the language is unlikely to be as broad as the EU's formulation, especially with respect to concepts like "social protection" and "protection of cultural diversity."

In a more dramatic departure, the Commission proposes to establish a TTIP "Investment Court System," which would consist of a "Tribunal of First Instance" (known as the "Investment Tribunal") and a permanent "Appeal Tribunal." The Investment Tribunal would be composed of 15 judges appointed jointly by the United States and the EU, with five from the United States, five from EU member states and five from other countries. Each panel would be randomly constituted and include a U.S. national, an EU national, and a national of a third country. The appellate mechanism for TTIP would be modeled on the WTO Appellate Body, and consist of six members appointed jointly by the United States and the EU, who could review decisions based on legal or fact-based concerns.

This part of the proposal is striking in two key respects. First, it envisions the new role of judge, 15 of whom would be appointed and paid by the states party to the agreement. This raises a number of questions, such as whether a judge interested in reappointment would be as impartial as one who was not eligible. ISDS panels today are typically formed on an ad hoc basis, with each side picking one arbitrator and then those two individuals selecting the third person, who usually chairs the panel. One advantage of this system is that it enables parties to appoint arbitrators with knowledge of certain issues or sectors that might be germane to the dispute. One disadvantage is that the quality of the arbitrators can vary. In cases involving state-to-state dispute settlement, states agree in advance on a roster of qualified individuals willing to serve on a tribunal. This solution is worth exploring in the ISDS context as it could be more independent and flexible than creating a court-type system, and less ad hoc than present arrangements.

Second, the Commission takes the position that a bilateral appellate mechanism must be established in TTIP, which is a departure from current agreements that hold open the possibility of setting up an appeals process in the future. This view deserves further discussion and analysis. In theory, the idea of an appellate mechanism is attractive as a check on the ISDS process. As noted, one of the negotiating objectives Congress has given the administration as part of trade promotion authority is to improve the ISDS mechanism through "providing for an appellate body or similar mechanism to provide coherence to the interpretations of investment provisions." The United States included the possibility of establishing such a mechanism in the 2004 Model BIT, as well as the 2012 review, to address concerns about tribunals issuing contradictory opinions or failing to discharge their duties in an appropriate manner. Just knowing that reversal of a decision is possible could provide an added incentive for the initial tribunal to develop a well-reasoned decision in the first instance.

A drawback, however, is that because states win more cases than investors, the odds are that an appellate mechanism would be used against states more often. In addition, the current system is not without the possibility of relief from certain decisions, albeit for limited reasons, such as under the rules of the International Centre for Settlement of Investment Disputes. In such cases, a losing party can seek annulment of the arbitration award on relatively narrow grounds, including whether "the Tribunal has manifestly exceeded its powers."[57] If successful, the original award is vacated, and either party can restart the process. The advantages and the disadvantages of setting up an appellate mechanism in TTIP, and the possibility of expanding the option of annulment, deserve further consideration.[58]

Setting up an appeals mechanism in TTIP is not the only novel idea put forward by the Commission. Its proposal indicates that, in parallel to the TTIP negotiations, it will begin working "together with other like-minded countries" to set up a permanent "International Investment Court."[59] Such a court, the Commission believes, could in time replace all ISDS mechanisms provided by EU agreements and EU member states' agreements with third countries, and eventually in trade and investment agreements concluded between third countries.

The creation of a permanent court could indeed help create a more coherent body of jurisprudence on substantive and procedural international investment law. As noted earlier, there is no multilateral, comprehensive international agreement on rules to protect foreign investment, and so states have developed international law in this area on an ad hoc basis through bilateral and regional agreements, and the emergence of customary international law. Not surprisingly, the system as a whole lacks some degree of predictability and consistency.

At the same time, the idea of a court is likely to encounter considerable resistance. With approximately 3,000 distinctive investment agreements in existence, the complexity of such an undertaking should not be underestimated. Indeed, it is hard to imagine other states embracing this proposal when one of the chief concerns today is the potential compromise of a state's regulatory authority.

The Commission also proposes to adopt a new approach to deal with concerns over the potential for bias or conflicts of interest among arbitrators. The idea of adopting a strict code of ethics is not new and already reflected in the EU-Canada agreement. In TTIP, however, the Commission proposes a new rule of significance.

The Commission had earlier expressed concern that the current ISDS system does not "preclude the same individuals from acting as lawyers…in other ISDS cases. This situation can give rise to conflicts of interest—real or perceived—and thus concerns that these individuals are not acting with full impartiality when acting as arbitrators."[60] It went on to note that the "ad hoc nature of their appointment is perceived by the public as interfering in their ability to act independently…"[61] Its text proposal therefore would prohibit members of the Investment Tribunal and Appeal Tribunal from working as legal counsel on any investment disputes. Such a rule might ultimately prove useful, but it first merits further discussion.

While the United States has not presented ideas as provocative as the EU's, it indicated during the TPP negotiations a willingness to improve the ISDS process and expand existing protections.

The White House has offered to make it clearer that governments retain the authority to regulate in the public interest and to narrow the definition of the kinds of injuries for which investors can seek compensation.[62] Other measures would address frivolous claims, provide binding guidance to arbitrators, create filters for cases involving financial services, and guarantee transparency. As mentioned, improvements in these areas have already been part of the U.S. Model BIT. Now that the negotiations have concluded, precisely how TPP will build on existing protections in these areas will be clearer once the text is published. Regardless of the modifications in TPP, the TTIP negotiators will want to consider the possibility of additional improvements to increase confidence—especially in Europe—in the integrity of the ISDS process.

Recommendations

Both the United States and the EU recognize that public concerns over ISDS need to be addressed. Because TTIP in particular holds the promise of setting high standards for future trade and investment agreements with respect to ISDS and many other issues, there is an opportunity to influence the process beyond the United States and Europe.

A number of reforms have been proposed that build upon enhancements already made by the United States and the EU in recent agreements and reviews. Other ideas that have been suggested require more in-depth analysis to assess their strengths and weaknesses.

Given the complexity and controversy surrounding ISDS, and the scope of suggestions for improvement that have been put forward, the United States and the EU should take two important steps to move closer towards a solution. First, U.S. and EU negotiating teams should reach agreement on a number of key principles to guide their talks in the weeks ahead. Given the work that each has already done with other partners, this step should not be too difficult. Such principles should include the following elements:

- There should be a neutral forum for adjudication, independent of the potential for bias inherent in a host state's legal system.
- An arbitration tribunal should operate under established principles of international law, with consistency and predictability.
- The arbitrators should be beyond reproach in terms of independence, impartiality, and integrity.
- The tribunal should have the authority to dismiss frivolous and other non-meritorious claims early in the process.
- The proceedings should be transparent and open to the public.
- An option for annulment, and possibly appeal, should be considered.

The second step is for both sides to undertake a more thorough appraisal of the different options by jointly appointing a panel of senior experts to examine a number of ideas for further reform in greater detail. Just as the United States and the EU created a high-level working group in 2011 to explore the initial question of whether to begin negotiations towards a new trade and investment partnership, it makes sense now to call upon experts in the field to review potential ISDS reforms. Unlike the U.S.-EU High-Level Working Group on Jobs and Growth that recommended the launch of TTIP, which was composed solely of government officials, this should be a broad group of experts representing a range of academic, legal, business, public interest, and other expertise reflecting deep knowledge of international investment law, arbitration rules, and judicial and regulatory decision-making. The mandate of the panel should be to assess different ways in which ISDS could be improved to address legitimate concerns without undermining its intended purpose.

As the starting point, the group should review the texts that have been developed by the United States and the EU in other negotiations, such as TPP and the EU-Canada Comprehensive Economic and Trade Agreement, to see where common ground already exists. Based on what both sides have done so far with other partners, the following elements could serve as a starting point for an ISDS mechanism in TTIP:

- Safeguarding a government's right to regulate in the public interest in a fair and non-discriminatory manner, particularly with respect to public health, safety, and the environment;
- Further clarifying key terms and their limitations, such as "fair and equitable treatment" and "indirect expropriation;"
- Dismissing frivolous claims;
- Ensuring that a claimant has substantial business activities in the host country;
- Guaranteeing the transparency of the process, including access by the public, the posting of documents, and the ability of arbitration panels to summon outside experts and parties of interest to make submissions;
- Enabling states to provide binding guidance on interpretation of the treaty provisions; and
- Creating filters for financial services and tax cases.

A number of additional ideas for improvements should also be considered, including four suggestions that should not be too difficult to evaluate. First, it would be worth exploring a new procedure by which governments could agree jointly that a case brought under the agreement is not an appropriate use of ISDS. This idea builds upon the notion of having filters for financial services and tax cases, whereby such issues can be removed from the jurisdiction of the arbitration tribunal at the request of both governments. During the screening process for frivolous claims, for example, the United States and EU could also have an opportunity to agree jointly that a particular dispute should be dismissed.

Second, an additional way to limit frivolous and non-meritorious claims would be to require—rather than simply authorize—a tribunal to award attorneys' fees to the winning party, absent compelling circumstances. The EU has already done so in recent agreements. The U.S. Model BIT permits the tribunal to award costs but does not require it, and the United States could be willing to go further in TTIP. The expert group should address the merits of such a requirement, including how to avoid inadvertently deterring claims from small investors.

A third idea that deserves further consideration is whether to require a period of time for alternative dispute resolution, such as mediation or conciliation, to elapse before a claim could proceed. Some investment agreements contain a permissive "cooling-off" period while some have a mandatory procedure. If a case has a chance of being settled, it is usually easier to do so at the outset.

Fourth, building an ISDS review clause into TTIP would enable the United States and the EU to monitor aspects such as the type and consistency of awards, and legal developments in international investment law. Consistent with enhanced transparency, both sides could agree on a timeline to publish such reviews. Stakeholders would be able to comment on the results of the reviews and suggest proposals for future enhancements.

The more challenging part of the expert group's contribution to the TTIP negotiations would be to take a fresh look at three of the more controversial ideas put forward by the EU.

Concerns that have been raised about the current system in which individuals can serve simultaneously as an arbitrator in one case and as counsel for a foreign investor in another case should be examined. No one has an interest in diminishing the pool of qualified arbitrators, but the opportunity for real and perceived conflicts to materialize should be minimized. Requiring persons interested in serving on arbitration panels to commit to not representing clients—simultaneously or consecutively—is one potential remedy to assess.

The European Commission's proposal to establish a TTIP Investment Court System that would overhaul the current method of appointing arbitrators and also create an appellate mechanism raises several questions. The current method of appointment has its drawbacks, but there may be improvements possible other than creating a judicial-type system. The Commission's desire to develop an appeals mechanism has certain attractions, but also contains risks for the states involved. The United States has never sought to establish such a process before but, if it is ever willing to test the waters, it would make sense to do so with the EU given the greater frequency with which its investors use ISDS. The experts group should also consider the alternative option of expanding the scope and availability of annulment.

The idea of seeking to establish an International Investment Court also deserves a fair hearing, even if the hurdles appear significant. If the EU is truly committed to this proposal, existing agreements among the 28 member states of the EU provide a laboratory in which to test whether it is possible to create a single legal entity to review disparate treaty provisions and claims. At the same time, even if the experiment were to succeed, other countries may still balk at the notion of ceding more control over investment disputes to an international legal body.

Conclusion

Investors rarely, if ever, enter a foreign market because of ISDS protections. However, consistent with fairness and due process, if the host government violates international investment law, the investor deserves a venue for dispute settlement that is both reliably independent of potential host state bias and effective.

ISDS is facing challenges to its legitimacy that are unlikely to be resolved without additional reforms. This paper has outlined a number of ways in which TTIP can improve upon the operation of ISDS while maintaining the fundamental protections that are accorded to foreign investors. Creating a two-step process to identify the right path forward holds the best chance of finding a solution. There is already convergence on a number of points between U.S. and EU negotiators based on work each side has done with other partners, and so it should not be too difficult to take the first step of reaching agreement on key ISDS principles to be reflected in TTIP. A new high-level panel composed of renowned experts representing a cross-section of views and expertise can then offer additional analysis on specific improvements as U.S.-EU negotiations accelerate.

Finding a solution to the increasingly acrimonious debate over whether, and how, to include ISDS in TTIP can help create stronger public support overall for the negotiations. It would increase the likelihood that other difficult issues weighing down the talks could also be resolved successfully. Furthermore, developing a more efficient and credible process for resolving investor-state disputes in the TTIP context would be useful to both the United States and EU as they pursue future trade and investment opportunities with other partners. In light of the global significance of the U.S.-EU relationship, improvements to ISDS that strike the right balance could also help create new norms for wider adoption.

Endnotes

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shall any state deprive any person of life, liberty, or property without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."; see The Convention for the Protection of Human Rights and Fundamental Freedoms, articles 5, 6, 8, and 13, November 4, 1950, available at https://ec.europa.eu/digital-agenda/sites/digital-agenda/files/Convention_ENG.pdf; *see*, generally, USTR Fact Sheet.

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