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Submission on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)

The Association for International Arbitration (« AIA ») is a non-profit organization based in Brussels (Belgium) open to all those interested in Alternative Dispute Resolution (ADR), irrespective of nationality and level of experience. Since its creation in 2001, AIA strives to bring together the global community in the field of ADR. However, AIA is not an arbitration institute and does not administer arbitration proceedings. Its members are law professionals – arbitrators, attorneys, in-house counsel and academics.

The AIA welcomes the opportunity given by the European Commission to make comments on a possible approach to investment protection and Investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP).

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GENERAL COMMENT ON THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP (TTIP)

Negotiations for the Transatlantic Trade and Investment Partnership (TTIP) started in July 2013. The main criticism of the negotiations is that draft documents and negotiating positions are generally not made available to the public. Thus, the European Commission partly lifted the veil covering the TTIP negotiations, having invited interested parties to comment on its propositions regarding the ISDS.

The TTIP promises to become one of the most influential treaties in the world, affecting the investment flows between two world economic powers. There is no surprise then that the announcement of the intention of the negotiating Parties to include a chapter on the ISDS in the TTIP raised certain concerns of the various stakeholders, ranging from the non-governmental organizations to scholars and citizens. A variety of arguments pro and contra inclusion of the ISDS provisions in the TTIP was advanced. Mostly, the public attention was concentrated around the obstacles the ISDS system presents before sovereigns restricted in their abilities to regulate their internal affairs; abundance of frivolous claims brought by the investors against States; inequality between foreign and local investors resulting for the former in the free access to arbitration, broader substantive rights etc.

However, although all these arguments may sound very convincing, there is always other side of the coin. In this respect, the launch by the European Commission of the online public consultations, accompanied by the answering guide and Commission's commentaries on each topic, represents an opportunity to assess the arguments of the opposing stakeholders and weigh them against each other. This is the purpose pursued by the AIA in the present submission, which modestly strives to provide an objective guidance for the arbitration practitioners, as well as researchers and students.

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ANSWERS TO SPECIFIC QUESTIONS

Question 1: Scope of the substantive investment protection provisions

Explanation of the issue

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.

Approach in most investment agreements

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. At the same time, most bilateral investment agreements refer to "investments made in accordance with applicable law". This reference has worked well and has allowed ISDS tribunals to refuse to grant investment protection to investors who have not respected the law of the host state when making the investment (for example, by structuring the investment in such a way as to circumvent clear prohibitions in the law of the host state, or by procuring an investment fraudulently or through bribery).

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. This has allowed in some cases so–called "shell" or "mailbox" companies, owned or controlled by nationals or companies not intended to be protected by the agreement and having no real business activities in the country concerned, to make use of an investment agreement to launch claims before an ISDS tribunal.

The EU's objectives and approach

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.

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?

ANSWER TO QUESTION 1

We agree with the stated objectives. However, we have questions regarding the approach taken by the EU. In particular, it is proposed to recognize as an investment only a substantial resources commitment in the economy of host State, while the stage of planning is presumed not to fall into this scope. On the other hand, the stage of planning often results in substantial costs for the investor. In this respect, excluding the period of planning from investment protection seems unreasonable as it might lower the previously adopted standards of protection and thus influence the investors' decisions as to whether to invest in the country.

Further, the term **"substantial business activities"** is not self-defining and should either be defined in the TTIP or addressed in explanatory notes. The question of whether a company is engaged in substantial business activities turns on the facts of the case at hand and by leaving the requisite level of activity undefined, states therefore retain the flexibility to make an evaluation on a case-by-case basis. However, by leaving the term "substantial business activities" undefined, the states do not give sufficient guidance to the tribunals for determining whether a state's exercise of its right to deny benefits was correct.

In order to eliminate so-called "shell" or "mailbox" companies owned by nationals of third countries from the scope, we suggest that the EU considers adding to the definition of the investment that the TTIP covers only the investments that result in the flow of capital between the US and EU.

Question 2: Non-discriminatory treatment for investors

Explanation of the issue

Under the standards of non-discriminatory treatment of investors, a state Party to the agreement commits itself to treat foreign investors from the other Party in the same way in which it treats its own investors (national treatment), as well in the same way in which it treats investors from other countries (most-favoured nation treatment). This ensures a level playing field between foreign investors and local investors or investors from other countries. For instance, if a certain chemical substance were to be proven to be toxic to health, and the state took a decision that it should be prohibited, the state should not impose this prohibition

only on foreign companies, while allowing domestic ones to continue to produce and sell that substance.

Non-discrimination obligations may apply after the foreign investor has made the investment in accordance with the applicable law (post-establishment), but they may also apply to the conditions of access of that investor to the market of the host country (pre-establishment).

Approach in most existing investment agreements

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's objectives and approach

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.

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.

ANSWER TO QUESTION 2

While "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", Table 2, article X.2.4: "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." Does this mean that only investor-to-state dispute settlement procedures including compensation are excluded, not substantive investment protection provisions? If yes, it seems that companies will be able to use the substantive investment protection provisions in any other investment agreement the EU or EU member state ratified until European countries have withdrawn from all of them.

The EU approach to non-discrimination seems to be very reasonable, especially the differentiation between established and non-established investors. At the same time, for the case of discrimination against established investors a provision granting fair compensation would be appropriate.

Additionally, it would be desirable to define in more details the term **"**in like situations".

Question 3: Fair and equitable treatment

Explanation of the issue

The obligation to grant foreign investors fair and equitable treatment (FET) is one of the key investment protection standards. It ensures that investors and investments are protected against treatment by the host country which, even if not expropriatory or discriminatory, is still unacceptable because it is arbitrary, unfair, abusive, etc.

Approach in most investment agreements

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. This lack of clarity has fueled a large number of ISDS claims by investors, some of which have raised concern with regard to the states' right to regulate. In particular, in some cases, the standard has been understood to encompass the protection of the legitimate expectations of investors in a very broad way, including the expectation of a stable general legislative framework.

Certain investment agreements have narrowed down the content of the FET standard by linking it to concepts that are considered to be part of customary international law, such as the minimum standard of treatment that countries must respect in relation to the treatment accorded to foreigners. However, this has also resulted in a wide range of differing arbitral tribunal decisions on what is or is not covered by customary international law, and has not brought the desired greater clarity to the definition of the standard.

An issue sometimes linked to the FET standard is the respect by the host country of its legal obligations towards the foreign investors and their investments (sometimes referred to as an "umbrella clause"), e.g. when the host country has entered into a contract with the foreign investor. Investment agreements may have specific provisions to this effect, which have sometimes been interpreted broadly as implying that every breach of e.g. a contractual obligation could constitute a breach of the investment agreement.

EU objectives and approach

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.

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?

ANSWER TO QUESTION 3

It would be reasonable to define clearly in para. 5 what "physical security of investors and covered investments" means in order to prevent conflicting interpretations by the tribunals.

At the same time, although more specific definition of fair and equitable treatment should be agreed with, we would suggest to clarify which measures of the State should be considered as permissible regulation and what measures fall outside of this scope and violate legitimate expectations of an investor.

Regarding of para. 4, it should be noted that every specific representation by a State Party to a BIT upon which an investor relies while deciding to invest in the country, should not be regarded as creating legitimate expectations: more restraints are needed. In addition, it might be recommended also to indicate what is meant under the "representation of the State" – declaration of the Head of the State, or pronouncement of the Prime-Minister etc.

Question 4: Expropriation

Explanation of the issue

The right to property is a human right, enshrined in the European Convention of Human Rights, in the European Charter of Fundamental Rights as well as in the legal tradition of EU Member States. This right is crucial to investors and investments. Indeed, the greatest risk that investors may incur in a foreign country is the risk of having their investment expropriated without compensation. This is why the guarantees against expropriation are placed at the core of any international investment agreement.

Direct expropriations, which entail the outright seizure of a property right, do not occur often nowadays and usually do not generate controversy in arbitral practice. However, arbitral tribunals are confronted with a much more difficult task when it comes to assessing whether a regulatory measure of a state, which does not entail the direct transfer of the property right, might be considered equivalent to expropriation (indirect expropriation).

Approach in most investment agreements

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 EU's objectives and approach

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.

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.

ANSWER TO QUESTION 4

Any expropriation must be compensated. Thus, it is highly important to define what qualifies as a direct or indirect expropriation. Although the definition of indirect expropriation clarifies its scope and rejects an understanding of indirect expropriation which is only based on the

effects of the measure, it is still broad. In order to avoid opening the doors for an indefinite amount of claims, it would be sensible to limit the definition of indirect expropriation to cases "in which a host state appropriates an investment for its own use, or the use of a third party". Additionally, it is necessary to address the notion of "manifestly excessive" in explanatory notes in more details.

We believe that the EU should elaborate on what "public interest" includes. Does it certain issues relating to labour law? Animals' rights?

Question 5: Ensuring the right to regulate and investment protection

Explanation of the issue

In democratic societies, the right to regulate of states is subject to principles and rules contained in both domestic legislation and in international law. For instance, in the European Convention on Human Rights, the Contracting States commit themselves to guarantee a number of civil and political rights. In the EU, the Constitutions of the Member States, as well as EU law, ensure that the actions of the state cannot go against fundamental rights of the

citizens. Hence, public regulation must be based on a legitimate purpose and be necessary in a democratic society.

Investment agreements reflect this perspective. Nevertheless, wherever such agreements contain provisions that appear to be very broad or ambiguous, there is always a risk that the arbitral tribunals interpret them in a manner which may be perceived as a threat to the state's right to regulate. In the end, the decisions of arbitral tribunals are only as good as the provisions that they have to interpret and apply.

Approach in most investment agreements

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. Consequently, the relationship between the protection of investments and the right to regulate in such areas, as envisaged by the contracting Parties to such agreements, is not clear and this creates uncertainty.

In more recent agreements, however, this concern is increasingly addressed through, on the one hand, clarification of the key investment protection provisions that have proved to be controversial in the past and, on the other hand, carefully drafted exceptions to certain commitments. In complex agreements such as free trade agreements with provisions on investment, or regional integration agreements, the inclusion of such safeguards is the usual practice.

The EU's objectives and approach

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 (for instance, the standard of fair and equitable treatment is defined based on a closed list of basic rights; the annex on expropriation clarifies that non-discriminatory measures for legitimate public policy objectives do not constitute indirect expropriation). These improvements will ensure that investment protection standards cannot be interpreted by arbitral tribunals in a way that is detrimental to the right to regulate.

Third, the EU will ensure that all the necessary safeguards and exceptions are in place. For instance, foreign investors should be able to establish in the EU only under the terms and conditions defined by the EU. A list of horizontal exceptions will apply to non-discrimination obligations, in relation to measures such as those taken in the field of environmental protection, consumer protection or health (see question 2 for details). Additional carve-outs would apply to the audiovisual sector and the granting of subsidies. Decisions on competition matters will not be subject to investor-to-state dispute settlement (ISDS). Furthermore, in line with other EU agreements, nothing in the agreement would prevent a Party from taking measures for prudential reasons, including measures for the protection of depositors or measures to ensure the integrity and stability of its financial system. In addition, EU agreements contain general exceptions applying in situations of crisis, such as in circumstances of serious difficulties for the operation of the exchange rate policy or monetary policy, balance of payments or external financial difficulties, or threat thereof.

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. Wherever greater clarity and precision proves necessary in order to protect the right to regulate, the Parties will have the possibility to adopt interpretations of the investment protection provisions which will be binding on arbitral tribunals. This will allow the Parties to oversee how the agreement is interpreted in practice and, where necessary, to influence the interpretation.

The procedural improvements proposed by the EU will also make it clear that an arbitral tribunal will not be able to order the repeal of a measure, but only compensation for the investor.

Furthermore, frivolous claims will be prevented and investors who bring claims unsuccessfully will pay the costs of the government concerned (see question 9).

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?

ANSWER TO QUESTION 5

The approach of the Commission emphasizing the right of the State to regulate is reasonable as it shifts the perception of the State's regulating power as of a mere exception to its understanding as an underlying rule. In particular, direct exclusion of States' non-conforming measures from investment protection seems to be a proper solution. At the same time, it is unclear how the preamble which is non-binding in nature may be useful for achieving the EU objectives in this context.

Question 6: Transparency in ISDS

Explanation of the issue

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. This makes it difficult for the public to know the basic facts and to evaluate the claims being brought by either side.

This lack of openness has given rise to concern and confusion with regard to the causes and potential outcomes of ISDS disputes. Transparency is essential to ensure the legitimacy and accountability of the system. It enables stakeholders interested in a dispute to be informed and contribute to the proceedings. It fosters accountability in arbitrators, as their decisions are open to scrutiny. It contributes to consistency and predictability as it helps create a body of cases and information that can be relied on by investors, stakeholders, states and ISDS tribunals.

Approach in most existing investment agreements

Under the rules that apply in most existing agreements, both the responding state and the investor need to agree to permit the publication of submissions. If either the investor or the responding state does not agree to publication, documents cannot be made public. As a result,

most ISDS cases take place behind closed doors and no or a limited number of documents are made available to the public.

The EU's objectives and approach

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.

The EU took a leading role in establishing new United Nations rules on transparency1 in ISDS. The objective of transparency will be achieved by incorporating these rules into TTIP.

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.

ANSWER TO QUESTION 6

The proposition of the Commission to adopt the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration seems reasonable. In spite of the presence in the Rules of exceptions as to the general rule of transparency subject to the tribunal's discretion, these concerns seem to be overestimated. First, there is no rule without exceptions, especially in a sphere as complicated as investor-State arbitration. The preservation of confidentiality in certain occasions may indeed be justified due to essential security interests etc. At the same time, the Commission, providing an example of the similar CETA provision (Article x-33 para. 6), ensures that the disclosure of information required by national laws of the respondent State may not be prevented.

Question 7: Multiple claims and relationship to domestic courts

Explanation of the issue

Investors who consider that they have grounds to complain about action taken by the authorities (e.g. discrimination or lack of compensation after expropriation) often have different options. They may be able to go to domestic courts and seek redress there. They or any related companies may be able to go to other international tribunals under other international investment treaties.

It is often the case that protection offered in investment agreements cannot be invoked before domestic courts and the applicable legal rules are different. For example, discrimination in favour of local companies is not prohibited under US law but is prohibited in investment agreements. There are also concerns that, in some cases domestic courts may favour the local government over the foreign investor e.g. when assessing a claim for compensation for expropriation or may deny due process rights such as the effective possibility to appeal. Governments may have immunity from being sued. In addition, the remedies are often different. In some cases government measures can be reversed by domestic courts, for example if they are illegal or unconstitutional. ISDS tribunals cannot order governments to reverse measures.

These different possibilities raise important and complex issues. It is important to make sure that a government does not pay more than the correct compensation. It is also important to ensure consistency between rulings.

Approach in most existing investment agreements

Existing investment agreements generally do not regulate or address the relationship with domestic courts or other ISDS tribunals. Some agreements require that the investor choses between domestic courts and ISDS tribunals. This is often referred to as "fork in the road" clause.

The EU's objectives and approach

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.

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.

ANSWER TO QUESTION 7

The concerns of the Commission in respect of the inequality between local and foreign investors are understandable. However, the reason for this inequality is that foreign investors bear more risks than the local investors. Therefore it seems that the main question here is not how to eliminate the additional protection of foreign investors, but rather how to balance the different types of protection so that this additional protection was comparable with the risks foreign investors undertake.

In this respect, the proposition of the Commission as to the "fork-in-the-road" provision is reasonable to the extent is does not make the investors wait for unreasonably long periods of time or engage into the negotiations promising to be futile from the very beginning. Indeed, as the arbitral practice shows, the tribunals tended to refuse to dismiss the investors' claims in cases where there was no hope for successful negotiations between the parties [Detailed analysis: Christoph Schreuer, Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road] or where the difference between claims under the contract and claims under the BIT was found [Andrea Dahlberg, Fork-in-the-Road Provisions in Investment Treaty].

With regard to the commentary in the Answering Guide that domestic courts are "designed to be independent and impartial", while arbitral tribunals, to the contrary, are dependant and easily influenced, it does not reflect the reality. There are indeed countries which succeeded in establishing well-functioning independent court system. However, they are not in the majority: national courts of other countries are dependant and may be easily influenced as well. The same may be said about arbitral tribunals: some of them are impartial and independent, some of them are not. However, this is not a sufficient ground to claim that arbitral tribunals are more inclined to rule in favour of the claimant and the state courts are inclines to rule in favour of the respondent State.

Question 8: Arbitrator ethics, conduct and qualifications

Explanation of the issue

There is concern that arbitrators on ISDS tribunals do not always act in an independent and impartial manner. Because the individuals in question may not only act as arbitrators, but also as lawyers for companies or governments, concerns have been expressed as to potential bias or conflicts of interest.

Some have also expressed concerns about the qualifications of arbitrators and that they may not have the necessary qualifications on matters of public interest or on matters that require a balancing between investment protection and e.g. environment, health or consumer protection.

Approach in existing investment agreements

Most existing investment agreements do not address the issue of the conduct or behaviour of arbitrators. International rules on arbitration address the issue by allowing the responding government or the investor to challenge the choice of arbitrator because of concerns of suitability.

Most agreements allow the investor and the responding state to select arbitrators but do not establish rules on the qualifications or a list of approved, qualified arbitrators to draw from.

The EU's objective and approach

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.

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?

ANSWER TO QUESTION 8

Although the intentions of the European Commission to ensure the impartiality and independence of arbitrators are commendable, it is very difficult to see how the Code of Conduct will solve currently posed before the ISDS system problems. It might be pointed out that the Code once included in the TTIP will constitute its integral part and thus be binding upon the parties to the dispute. However, the Code as proposed by the Commission in its substance does not seem to be different from other codes and rules in this area envisaging the same standards. Furthermore, the rules of procedure binding on the parties of a particular case usually contain provisions sufficient for dealing with this kind of problems. All this evidences the absence of necessity in the provisions regulating ethical standards in the TTIP.

With regard to the rules of the CETA (according to the commentary of the Commission concerning to the conduct of arbitrators, namely Articles x-25 "Constitution of the Tribunal", x-42 "Committee") it may be noted that they seem to be not quite related to the question of ethics and conduct of arbitrators.

With regard to the proposed qualifications of the arbitrators, the idea of competent arbitrators should be supported. However, the main question here is what mechanism ensuring the competence of the arbitrators, on the one hand, and not restricting the right of the parties to choose an arbitrator, on the other hand, the Commission has in mind.

The proposal draws attention to the idea of a roster intended to provide for an appointment of the Chairperson of the tribunal if the parties did not agree on this. It seems to be reasonable, although the particular importance of this tool in comparison with other problems, deserving attention, remains unclear.

Question 9: Reducing the risk of frivolous and unfounded cases

Explanation of the issue

As in all legal systems, cases are brought that have little or no chance of succeeding (so-called "frivolous claims"). Despite eventually being rejected by the tribunals, such cases take up time and money for the responding state. There have been concerns that protracted and frequent litigation in ISDS could have an effect on the policy choices made by states. This is why it is important to ensure that there are mechanisms in place to weed out frivolous disputes as early as possible.

Another issue is the cost of ISDS proceedings. In many ISDS cases, even if the responding state is successful in defending its measures in front of the ISDS tribunal, it may have to pay substantial amounts to cover its own defence.

Approach in most existing investment agreements:

Under existing investment agreements, there are generally no rules dealing with frivolous claims. Some arbitration rules however do have provisions on frivolous claims. As a result, there is a risk that frivolous or clearly unfounded claims are allowed to proceed. Even though the investor would lose such claims, the long proceedings and the implied questions surrounding policy can be problematic.

The issue of who bears the cost is also not addressed in most existing investment agreements. Some international arbitration rules have provisions that address the issue of costs in very general terms. In practice, ISDS tribunals have often decided that the investor and responding state pay their own legal costs, regardless of who wins or loses.

The EU's objectives and approach

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.

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.

ANSWER TO QUESTION 9

The proposition of the Commission in respect of diminishing the caseload by precluding frivolous claims has a rational core. However, there are several concerns which may be raised.

First, the Articles x-29 "Claims Manifestly Without Legal Merit" and x-30 "Claims Unfounded as a Matter of Law" of CETA are provided as a relevant example. At the same time, the differentiation between Art. x-29 and Art. x-30 is unclear: although the different procedure for two types of claims is established, the submission of a claim "manifestly without legal merit" may exclude examination by the tribunal of the claim "unfounded as a matter of law" (Art. x-30 para. 3), which evidences substantial overlap between the two. Therefore, this differentiation does not seem to be useful in the context.

Furthermore, by indicating the absence in the IIAs of mechanisms preventing frivolous claims and it seems that the Commission implies that this is a gap in the investment protection system. It should be noted that some of the IIAs provide for such mechanisms [e.g., Dominican Republic-United States-Central American Free Trade Agreement (CAFTA), Art. 10.20.4 and other treaties (BITs and FTAs) modeled on the 2004 US Model BIT]. The explanation for this situation may be that the notion of the frivolous claim (claim with legal merit, claim unfounded as a matter of law, ill-founded claim, *prima facie* unfounded claim etc.) mostly regarded as a procedural question and, consequently, is usually included in rules of procedure of certain fora (e.g. ICSID Rule 41(5); Art. 35 §3a ECHR, criteria of admissibility; Art. 294 UNCLOS).

On the other hand, although the ICSID is administering the majority of investment disputes, it is not the only one [see "Latest Developments in Investor-State Dispute Settlement" by UNCTAD, IIA Monitor No. 1, March 2011, p. 2; "The ICSID Caseload – Statistics, 2011, No. 2, p. 7]. Based on the number of cases, UNCITRAL goes second. Neither version of the UNCITRAL Rules provides for a specific mechanism allowing for dismissal of frivolous claims. This does raise concerns as to the overflow of the arbitral tribunals with "patently unmeritorious claims" [Potesta M., Sobat M., "Frivolous Claims in International Adjudication: A Study of ICSID Rule 41(5) and of Procedures of Other Courts and Tribunals to Dismiss Claims Summarily", p. 26 (discussing the adjudication by the Iran-US Claims Tribunal upon numerous ill-founded claims arbitrated under the 1976 UNCITRAL Rules)]. However, even in this situation the opinion was voiced that the newly formulated Article 17 of the 2010 UNCITRAL Rules may function as a filter [see Potesta M., Sobat M., op. cit. p. 27].

In light of the above, the absence of dismissal mechanisms in IIAs may be explained as it was considered more appropriate to deal with these questions in the rules of procedure and not in the treaties ensuring the investment protection. Taking this into account, the problem might not seem as dramatic as it is presented to the public, which means that the TTIP will not lose value if provisions similar to the CETA Art. x-29 and x-30 are not included in it.

Alternatively, if the EU decides to include these provisions in order to ensure one more time the effective filtering of frivolous claims by arbitral tribunal, it may be suggested, first, not to distinguish "claims manifestly without legal merit" and "claims unfounded as a matter of law" (or to distinguish, basing it on more fundamental grounds, clearer articulated) and to provide criteria allowing the identification of claims needed to be dismissed due to their frivolity. In particular, a non-exhaustive list of situations where a claim is to be regarded as ill-founded may be provided; or a guidance may be made as to what is "manifest", "lack of legal merit" etc. [The ECtHR "Practical Guide on Admissibility Criteria" may be a relevant example here. In particular, the "Guide" names four types of "ill-founded" claims which are "fourth-instance" complaints; claims submitted in a clear/apparent absence of a violation; unsubstantiated complaints; confused of far-fetched complaints. (See also: Potesta M., Sobat M., op. cit., p. 4)].

All the costs do not seem to be justified sufficiently. The Commission bases its proposition on the assumption that the losing party is always the one brought frivolous claims to the tribunal. However, it is not always the case. In this respect, it would be more reasonable to choose more flexible approach allowing the tribunal to decide on the allocation of costs and in case of abuse to impose them on the losing party (as the one adopted by CETA Art. x-36) [See in details: Potesta M., Sobat M., op. cit., pp. 27-29. In particular, see the discussion of the powers of the tribunal under the ICSID Rules and CAFTA as to the allocation of costs].

Question 10: Allowing claims to proceed (filter)

Explanation of the issue

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.

To address these concerns, some investment agreements have introduced mechanisms which grant the regulators of the Parties to the agreement the possibility to intervene (through a so-called "filter" to ISDS) in particular ISDS cases that involve measures ostensibly taken for prudential reasons. The mechanism enables the Parties to decide whether a measure is indeed taken for prudential reasons, and thus if the impact on the investor concerned is justified. On this basis, the Parties may therefore agree that a claim should not proceed.

Approach in most existing investment agreements

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's objectives and approach

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.

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?

ANSWER TO QUESTION 10

With regard to the filter mechanisms it may be noted that the title of this provision refers to much broader issues than the text of the provision provides. This is misleading. Although the right of States to regulate in the financial sphere is indeed of great importance, we suggest to deal with it in one of the subparagraphs of the provision devoted to the right to regulate or to put it right after this provision: it would provide a consistent framework for the whole issue instead of the fragmentation created by their division.

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

Explanation of the Issue

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.

Approach in existing investment agreements

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's objectives and approach

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.

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?

ANSWER TO QUESTION 11

In principle, this is a useful mechanism and the inclusion of a process for binding joint interpretation in the TTIP might be useful. However, the Vienna Convention on the Law of Treaties treats the definition of the parties as a means of interpretation, but not as an amendment of the treaty. Therefore, it is not clear how such definitions will considered by the tribunals.

Another point to consider is the amicus curiae submissions. The current trend is amici curiae are seeking to participate more regularly in international arbitrations and are no longer only

non-governmental organisations. We believe it would be beneficial to clarify to what extent participation rights should be afforded to amici curiae.

Question 12: Appellate Mechanism and consistency of rulings

Explanation of the issue

In existing investment agreements, the decision by an ISDS tribunal is final. There is no possibility for the responding state, for example, to appeal to a higher instance to challenge the level of compensation or other aspects of the ISDS decision except on very limited procedural grounds. There are concerns that this can lead to different or even contradictory interpretations of the provisions of international investment agreements. There have been calls by stakeholders for a mechanism to allow for appeal to increase legitimacy of the system and to ensure uniformity of interpretation.

Approach in most existing investment agreements

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's objectives and approach

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.

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.

ANSWER TO QUESTION 12

The idea of an appellate mechanism for investment arbitration is already being intensely discussed in the investment arbitration community. In our view, it is not a bad idea. However,

in TTIP the EU intends to create a bilateral appellate mechanism immediately through the TTIP agreement. In this case the appellate mechanism would only ensure uniformity and predictability of the interpretation of the TTIP, but would not reduce the overall heterogeneity and fragmentation of the interpretation of other EU agreements. In case of creation of an appellate mechanism, the better approach is to consider the establishment of an appellate mechanism which would apply to all investment treaties and not only to the TTIP.

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