

## **Public consultation on investor-state arbitration in TTIP – Comment**

### **(Question 13)**

### **General Assessment**

The Commission's consultation document is an extraordinary text. On the one hand, the document contains fierce (and, in our opinion, fully justified) criticism of the international investment treaty arbitration regime as it has developed over the last two decades or so in a rapidly expanding number of awards under some 2800 Bilateral Investment Treaties, NAFTA, and the Energy Charter. Both explicitly and implicitly, the document disapproves of widespread expansive interpretations of nearly every provision found in investment treaties: from Most Favored Nation to umbrella clauses, from National Treatment to Fair and Equitable Treatment, from indirect expropriation to threshold issues of corporate nationality. The document also implicitly condemns the investment arbitration community for its failure to police itself adequately in matters of ethics, independence, competence, impartiality, and conflicts of interest. By implication, the document acknowledges that the institutional design of investment arbitration has given rise to reasonable perceptions that the decision-making process is biased against some states and investors as well as various interests of the general public.

And yet, on the other hand, the Commission seems content to entrust to these same actors the vital constitutional task of weighing and balancing the right to regulate of sovereign states and the property rights of foreign investors. This task is one of the most profound roles that can be assigned to any national or international judicial body. The proposed text requires arbitrators to determine whether discriminatory measures are 'necessary' in light of the relative importance of the values and interests the measures seek to further; whether the impact of non-discriminatory 'indirect expropriations' have a 'manifestly excessive impact' on investors in light of the regulatory purpose of these measures; whether other non discriminatory measures amount to arbitrariness or fall short of standards of due process and transparency, and whether prudential regulations are 'more burdensome than necessary to achieve their aim'. To entrust these decisions

to the very actors who have an apparent financial interest in the current situation and moreover remain unaccountable to society at large is a contentious situation. In light of the criticism inherent in the consultation document, not to mention the fundamental concerns of many observers of the system, there seems to be consensus that the regime falls short of the standards required of an institutionally independent and accountable dispute settlement system.

In our view, the logical implication of the Commission's stance is to raise the key question that is not asked in the consultation document: why consider including investor-state arbitration in the TTIP at all? The rationale for bilateral investment treaties was traditionally linked to views about the potential impact on foreign investment of uncertainty caused by weak legal and judicial systems in host countries. While such a vision of failed statehood should in itself be examined further, it suffices to point out, in the context of the relationship between the US and the EU, that it is difficult to argue realistically that investors have cause to worry about domestic legal systems on either side of the Atlantic. Above all, with FDI stocks of over €1,5 trillion either way, it is implausible to claim that investors in fact have been deterred. It is true, as the Commission points out, that nine Member States already have BITs in place with the US. It may also be true that, for these nine Member States, the new arrangement might be a better alternative than 'doing nothing.' That, however, hardly seems enough reason to impose on the other two thirds of Member States a Treaty that profoundly challenges their judicial, legal and regulatory systems. The consultation document comes up with one additional argument: that the rights each party grants to its own citizens and companies 'are not always guaranteed to foreigners and foreign investors.' The claim is unsubstantiated. Even if it is accepted, there is no obvious reason why the incorporation in TTIP of a simple norm of non discriminatory legal protection and equal access to domestic courts could not address the problem perfectly adequately.

Commissioner De Gucht has announced an ambitious programme to 're-do' investment law, make the system 'more transparent and impartial', 'build a legally water-tight system', and 'close these legal loopholes once and for all.' As we have shown in detail, the consultation document and reference text fail to achieve this. Specifically, the text:

- a) Fails to exclude acquisitions of sovereign debt instruments from the scope of the Treaty;
- b) Allows anyone with a substantial business activity in the home state who holds *any* 'interest' in an enterprise in the host state to bring a claim;
- c) Fails to spell out legal duties of investors in host states;
- d) Fails to control the expansion of investment arbitration to purely contractual claims;
- e) Fails to protect the 'right to regulate' as a general right of states alongside the many elaborate rights and protections of foreign investors, let alone as a component of the FET and Expropriation standards;
- f) Allows for unwarranted discretion for arbitration tribunals in various 'necessity' tests;
- g) Fails to further the stated principle of favoring domestic court proceedings;
- h) Fails to regulate conflicts of interest in the adjudicative process;
- i) Fails to formulate a policy on appellate mechanisms with any precision;
- j) Fails to formulate a policy on avoiding 'Treaty shopping' with any precision; and
- k) Fails to formulate a policy on third party submissions with any precision;

The text, in fairness, is rather better than many Investment Treaties. Some of its flaws, as we have discussed, could be addressed. But the nature of the problems associated with investor-state arbitration is not quite as straightforward as the Commission presents it. In a strange cat-and-mouse game, the Commission's objective seems to be to 'outwit' arbitrators by closing down 'loopholes', eradicating discretion, and putting in place firm 'rules' on transparency of proceedings and impartiality of arbitrators. Analysis of the consultation document and the reference text, however, does not allow for the conclusion that this objective is likely to be achieved.

Yet investor-state arbitration raises some profoundly troublesome political issues regardless of arbitrator discretion. Investor-state arbitration delivers undue structural advantages to foreign investors and risks distorting the marketplace at the expense of domestically-owned companies. The benefits to foreign investors include their exclusive right of access to a special adjudicative forum, their ability to present facts and arguments in the absence of other parties whose rights and interests are affected, their

exceptional role in determining the make-up of tribunals, their ability to enforce awards against states as sovereigns, the role of appointing bodies accountable directly to investors or major capital-exporting states, the absence of institutional safeguards of judicial independence that otherwise insulate adjudicators in asymmetrical adjudication from financial dependence on prospective claimants, and the bargaining advantages that can follow from these other benefits in foreign investors' relations with legislatures, governments, and courts. At root, the system involves a shift in sovereign priorities toward the interests of foreign owners of major assets and away from those of other actors whose direct representation and participation is limited to democratic processes and judicial institutions.

In our view, this public consultation offers a good opportunity for the European Union to reflect seriously on its competences in matters of FDI under the Common Commercial Policy. As the Consultation Notice mentions, EU Member States have some 1400 BITs in place. The vast majority of them are concluded with developing countries. There is little evidence linking the conclusion of the Treaties to increased flows of FDI, and there is little evidence that they contribute to other development goals, such as encouraging good governance. In our view, these Investment Treaties and their arbitration mechanisms are in clear tension with the values of Articles 2 and 3 of the TEU that the Union is to promote in its relations with the wider world. Instead of seeking to extend the system of investment arbitration to relations with the United States, the Commission should be working towards redefining its policy on Investment Treaties, both new and existing, in ways that make it compatible with the founding values of the European Union. This requires a clearer balancing between investor rights and responsibilities and the preservation of national policy space to ensure that the interests of other stakeholders such as workers, consumers and the wider community as a whole are upheld by government.

## **Question 1 Scope**

### **1) Sovereign debt instruments**

In light of the reasoning of (majorities of) the Tribunals in the recent *Abaclat* and *Ambiente* cases,<sup>1</sup> it is clear that the definition of ‘investment’ proposed by the Commission will not suffice to exclude acquisitions of sovereign debt instruments, including those on secondary markets. It could, perhaps, be argued that the provisions of prudential carve-outs and safeguard measures discussed under Question 5 stand against claims brought by (speculative) investors in, for example, Greek government bonds complaining about ‘haircuts’ and the general handling of the sovereign debt crisis in the Eurozone. But the prudential carve-out only allows measures to ensure the integrity and stability of a party’s financial system in so far as these measures are ‘not more burdensome than necessary to achieve their aim’, and the safeguard clause only allows ‘strictly necessary’ measures in exceptional circumstances of serious difficulties for the operation of the economic and monetary union. It will, hence, fall on arbitration Tribunals to decide whether the measures involved were ‘necessary’, a task that should not properly be assigned to such bodies.

In light of the social misery and hardship the sovereign debt crisis has brought, it requires little discussion to conclude that the mere thought of speculative investors in government bonds seeking damages before investment arbitration Tribunals is utterly unacceptable. The only appropriate way of excluding this possibility is clearly and unequivocally to exclude acquisitions of sovereign debt from the definition of ‘investment.’

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<sup>1</sup> *Abaclat and Others v Argentina*, ICSID Case No ARB/07/05, Decision on Jurisdiction and Admissibility, 4 August 2011, and *Ambiente Ufficio v Argentina*, ICSID Case No ARB/08/09, Decision on Jurisdiction and Admissibility, 8 February 2013.

## 2) 'Substantial business activities'

The requirement to have 'substantial business activities' in the home country may become a useful check against 'forum shopping'. Yet it also highlights that the problem of forum-shopping originates in the refusal of the majority of arbitrators to pierce the corporate veil, or otherwise put reasonable limits on manipulation of corporate chains of nationality by claimants.<sup>2</sup> That this reference is even necessary should prompt the parties to reconsider their confidence in the system. If the Commission really wants to avoid abuse, moreover, it is surely not enough to focus on the extent of claimant activities in the home country. The reference text defines 'a covered investment' as an investment 'owned or controlled' by an investor of the other Party. But 'investment' itself is defined broadly and includes, for example, any equity stake, corporate bonds, loans and indeed 'any other kinds of interest in an enterprise.' Given the realities of modern financial markets, including equity and bond markets, it is difficult to imagine any company of any size and importance on either side of the Atlantic in which there is no financial 'interest' at all on the other side. It cannot be desirable to allow *any* US holder of a corporate bond issued by a European company to launch an investor-state claim against the home state of that European company.

## 3) 'In accordance with applicable law'

The Commission is worryingly confident about the reference to investments 'made in accordance with applicable law.' This, it is said, 'has worked well' and has a 'proven track record' in enforcing duties of investors. Yet the Commission offers no references to support the claim and the strategy is unlikely to deliver what the Commission seems to expect. It should at the very least be amended to make clear that investors are expected to respect the law of the host country *for the duration* of the investment. In any event,

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<sup>2</sup> See for example *Tokios Tokelés v Ukraine*, ICSID Case No ARB/02/18, Decision on Jurisdiction, 29 April 2004, and *Aguas del Tunari v Bolivia*, ICSID Case No ARB/02/03, Decision on Respondent's Objection to Jurisdiction, 21 October 2005. For a case where the corporate veil was lifted, see *TSA Spectrum v Argentine Republic*, ICSID Case No. ARB/05/5, Award of 19 December 2008.

the claim of a 'proven track record' does not explain why the provision is not more explicit about what is expected of investors before they can launch a claim. References to an absolute prohibition of any form of bribery and an absolute obligation to respect human rights as they are reflected in the law of the host country and in international law would seem to be the bare minimum. Where the applicable law does not – for reasons inherent to the race for foreign capital on the part of host states – provide adequate protection, the applicable law clause should not shield the private investor from liability for human rights violations.

According to the Commission, the reference '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.' It seems obvious that the clause should not 'allow' but *oblige* tribunals to refuse investment protection in such circumstances.

## Question 2 Non-discriminatory treatment

### 1) MFN and Investor-State Arbitration

The reference text usefully excludes access to investor-state arbitration from MFN, contrary to numerous contentious holdings in investment arbitration starting with *Maffezini*.<sup>3</sup> That this reference is necessary should also give the parties reason to reconsider their confidence in the system. The reference also does not extend to the arbitrators' practice, which the Commission claims to want to avoid, of importing new substantive standards (beyond dispute settlement provisions) from other treaties. To be safe, the treaty should make very clear that MFN applies only to domestic regulatory treatment of foreign investors and not to any other treaty.

### 2) Article XX GATT

The incorporation of Article XX GATT, according to the Commission, 'allows the Parties to take measures relating to the protection of health, the environment, consumers, etc.' To that end, the CETA reference text usefully emphasizes that Parties share an understanding of Article XX (b) GATT as including *environmental* measures and of Article XX (g) GATT as including measures aimed at the protection of *living* exhaustible natural resources. However, this importation of Article XX GATT also includes the proportionality test under the provision's *chapeau*. Investment arbitrators will hence decide what is 'necessary' for the protection of health, the environment, consumers etc., an assessment which involves a process of 'weighing and balancing' which begins with an assessment of the relative importance of the interests or values that the challenged measures intend to pursue, and further includes an inquiry into the contribution the contested measure makes towards the stated objectives, and a determination as to whether the measure's restrictive effect is proportionate to its effect towards the

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<sup>3</sup> *Maffezini v Spain*, ICSID Case No ARB/97/7, Decision on Objections to Jurisdiction, 25 January 2000.



protection of those interests and values.<sup>4</sup> This interpretation is contentious enough in inter-state litigation before the WTO Appellate Body, a serious judicial institution: it involves, after all, a judicial determination of the 'relative importance' of such values or interests as the environment, consumer safety, or public health. It is clear that the test is bound to lead to serious trouble when administered by investment arbitration tribunals tasked with striking 'a balance' between an individual company's economic interests and the democratic collective choice of a body politic. In any event, the incorporation of Article XX GATT will not safeguard adequately a 'right to regulate'. Indeed, a public policy exception clause modeled on Article XX GATT creates a perception that regulatory action which restricts investor rights is prima facie inconsistent with these rights unless the respondent State can discharge the burden of proving that its measures come within the exception. To safeguard a right to regulate of states would require a clear and unequivocal statement of the right in the treaty alongside the many elaborate rights and protections of foreign investors, which would place the burden of proving an infringement upon the claimant investor.

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<sup>4</sup> This is the test as summarized by the WTO Panel in *Brazil-Tyres*, WT/DS332/R, Report of 12 June 2006, para 7.104, imported wholesale by the Tribunal in *Continental Casualty v Argentina*, ICSID Case No ARB/03/9, Award, 5 September 2008.

### Question 3. Fair and Equitable Treatment

#### 1) FET

The traditional understanding of the FET standard was systematic: under normal circumstances, foreign investors are not entitled to different, let alone better, treatment than domestic investors. The FET standard was seen as a back-up standard, operating only in the exceptional circumstances where the political and legal systems of the host country disintegrate to such an extent that the non-discrimination norm fails to protect investors from outrageous governmental behavior that is shockingly insufficient as measured by international standards. In the hands of investment arbitrators, the standard has been radically transformed into an autonomous source of wide-ranging obligations for governments. As summed up by one tribunal, the standard is now understood to demand 'consistent and transparent behavior, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor.'<sup>5</sup>

The Commission rightly seeks to curtail this unwarranted interpretation. The idea is to propose a closed list of basic obligations, and to insert a separate clause that purports to limit the doctrine of 'legitimate expectations' to instances where those expectations are generated by specific representations, which need not be in writing, made by the host state in order to induce the investment upon which the investor relied when making the investment. History suggests that the Commission's approach is unlikely to have the desired effect. States have tried before to curtail the expansive interpretation of FET by explicitly stipulating that it does not require treatment that goes beyond the customary international law minimum standard of treatment of aliens and does not create additional substantive rights.<sup>6</sup> These efforts, however, have turned fruitless in the face of Tribunals' insistence that, for example, 'in fact, the Treaty standard of fair and equitable treatment and its connection with the required stability and predictability of the business environment, founded on solemn and contractual commitments, is not

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<sup>5</sup> *LG&E Energy v Argentina*, ICSID Case No ARB/02/1, Decision on Liability, 3 October 2006, para 131.

<sup>6</sup> See for example Article 5 (2) of the 2012 US Model BIT.

different from the international law minimum standard and its evolution under customary law.’<sup>7</sup> If this line of reasoning is continued,<sup>8</sup> Tribunals will likely consider the doctrine of ‘legitimate expectations’ to flow from – and give meaning to – components of the various ‘basic obligations’ that the Commission proposes, such as ‘due process’ and the prohibition of ‘arbitrariness.’ In that case, the Commission’s efforts to remove the risk of expansive interpretations of the FET standard and the concept of an investor’s ‘legitimate expectations’ will have very little effect.

## 2) Contract claims

More problematic still, the Commission apparently suggests that the widespread tendency in investment law to elevate any breach of contract to a breach of treaty obligations is,<sup>9</sup> by and large, a good idea. By assuming authority over contractual disputes that are subject to their own contractually-agreed forum for dispute settlement, numerous investment treaty tribunals have disregarded principles of party autonomy, sanctity of contract, and avoidance of duplicate litigation which are the hallmarks of arbitration or adjudication generally. The Commission’s text does nothing to address this challenge to markets based on legal equality of all investors and contracting parties, domestic or foreign. The proposal seeks to exclude only ‘ordinary contractual breaches, like the non-payment of an invoice.’ From the systematic point of view described above, there is no justified reason at all to consider contractual claims under the investment treaty unless the breach amounts to a breach of one the ‘basic obligations’; that is, denial of justice, manifest arbitrariness, targeted discrimination and so on.

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<sup>7</sup> *CMS Gas v Argentina*, ICSID Case ARB/01/8, Award, 12 May 2005, para 284. The Tribunal’s reasoning under the FET standard was one of the few passages of the Award that survived the Annulment Committee’s scrutiny. See the Decision of the *Ad hoc* Committee on the Application for Annulment of Argentina, 25 September 2007, para 85.

<sup>8</sup> In fairness, some recent Tribunals have accepted that the FET standard applies only to the most egregious cases of maladministration and that it is to be defined in accordance with the international minimum standard and its emphasis on the exceptional nature of governmental misconduct. See for example *Glamis Gold Ltd v United States*, UNCITRAL, Award 8 June 2009, and generally UNCTAD *Fair and Equitable Treatment: A Sequel* (New York and Geneva, United Nations, 2012).

<sup>9</sup> The *locus classicus* is *SGS v Philippines*, ICSID Case No ARB/02/6, Decision on Objections to Jurisdiction, 29 January 2004.

## Question 4 Expropriation

The consultation document rightly notes that ‘**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.’ The document then goes on say that ‘the objective of the EU is **to avoid claims against legitimate public policy measures.**’ The CETA reference text, however, does no such thing. The formulation of the relevant clause is as follows:

For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

All this achieves is to invite arbitration tribunals to engage in yet more discretionary proportionality analysis with, arguably, a somewhat stricter standard of review: ‘manifestly excessive’ rather than ‘not necessary.’ Tribunals will have a license to substitute their opinion for that of a democratic government on the relative importance of the purpose the measures at issue seek to achieve, and to engage in cost-benefit analysis to see whether the costs imposed on investors are ‘excessive.’ In the process, they will also feel empowered to analyze, as part of the determination of whether the impact of a measure is ‘excessive’ *in light of its purpose*, whether the measure at issue ‘substantially advances’ that stated purpose.<sup>10</sup>

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<sup>10</sup> The reference is to the test that a unanimous US Supreme Court banned from takings jurisprudence in *Lingle v Chevron*, 544 US 528 (2005), for its failure to ‘help to identify those regulations whose effects are functionally comparable to government appropriation or invasion of private property’ and for empowering and requiring courts to ‘substitute their predictive judgments for those of elected legislatures and expert agencies.’

It may be grounded in several awards of investment tribunals,<sup>11</sup> but to bring proportionality analysis into the definition of what constitutes an ‘indirect expropriation’ is, quite simply, conceptually flawed. The norm governing direct expropriations demands compensation for takings that are (a) for a public purpose, (b) non-discriminatory, and (c) taken under due process of law. The logical implication is that governments are required to pay compensation for *every* measure that constitutes an ‘expropriation,’ however laudable and beneficial to a society as a whole the measure may be.<sup>12</sup> This decoupling of the definition of ‘expropriation’ and the purpose and effect of the measure at issue logically works both ways however: the fact that a non-discriminatory measure designed and applied to protect legitimate public welfare objectives may be thoroughly misguided, may be badly designed, may have unfair distributive consequences, or is not rationally suited to achieve those objectives has no bearing whatsoever on the question of whether it constitutes an ‘expropriation’ or has an effect equivalent to expropriation. Under international law, non-discriminatory measures taken in the exercise of a State’s regulatory powers aimed at the general welfare, and which involve the exercise of States’ ‘police powers’, are simply not ‘expropriations’ requiring compensation.<sup>13</sup>

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<sup>11</sup> See eg *Tecmed v Mexico*, ICSID Case No ARB (AF)00/2, Award, 29 May 2003, para 122.

<sup>12</sup> *Santa Elena v Costa Rica*, ICSID Case No ARB/96/1, Final Award, 17 February 2000, para 72.

<sup>13</sup> See eg *Saluka v Czech Republic*, UNCITRAL, Partial Award, 17 May 2006, para 255.

## **Question 5    Ensuring the Right to Regulate**

The issues dealt with under this section have little to do with a ‘right to regulate’ and serve mainly to legitimize the carve-outs for the audiovisual sector and prudential regulations. We have dealt with the carve-out and the safeguard clause under Question 2. Allowing investment arbitration Tribunals the discretion to determine whether measures taken for prudential reasons are not ‘more burdensome than necessary to achieve their aim’ or whether safeguard measures are ‘strictly necessary’ does *not* amount to a ‘right to regulate.’ By its omissions, the consultation text actually confirms boldly that the right to regulate has not been affirmed and preserved, by a clear and unequivocal statement of the right, alongside the rights and protections of foreign investors.

## Question 6 Transparency in ISDS

Where they apply, the UNCITRAL Rules are reasonable, and their incorporation by reference seems a good idea. The Treaty could usefully clarify the nature of a Tribunal's obligations under Article 3 (4) of the UNCITRAL Rules: that provision instructs Tribunals to take into account a) whether the *amicus* has a 'significant interest' in the proceedings and b) whether the *amicus* would be able to assist the Tribunal by bringing a particular and different perspective when 'deciding to allow' third-party submission.' What form this 'decision' should take, and the extent to which it should be motivated, is left open. At the very least, the proposed Treaty should demand of Tribunals to provide a written account of its reasoning under this provision.

Finally, the Commission should ensure that any settlement of a threatened claim, including before the filing of a formal notice of consultations, will be made public.

## Question 7 Multiple claims and domestic proceedings

### 1) Domestic proceedings

‘As a matter of principle’, the document states, ‘the EU approach favors domestic courts.’ There is nothing in the text, however, that suggests any action to further that principle. The referenced CETA text contains only a limited ‘fork in the road’ provision, not materially different from the one found in NAFTA or the US Model BIT. The provision does not oblige or even provide an incentive for investors to seek redress in domestic courts, but merely sets out to oblige investors to choose between domestic courts and international arbitration. As is the case with most such provisions, this one too is bound to prove of limited effect even for its limited purpose; for example, it excludes claims or proceedings initiated in domestic courts for *monetary* damages only, and not claims or proceedings seeking injunctions or declarations of unlawfulness, and it will not exclude (counter-)claims brought by investors in domestic proceedings for the purpose of preserving their rights and interests. The ‘fork in the road’ provision also, rightly, demands claimants to waive their rights to ‘initiate any claim or proceeding seeking compensation or damages before a tribunal or court under domestic or international law with respect to any measure alleged to constitute a breach referred to in its claim to arbitration.’ This, too, fails to exclude domestic proceedings or claims seeking redress other than monetary damages. Indeed, it allows foreign investors to pursue monetary remedies (not the primary remedy in domestic public law) under the treaty and non-monetary orders (not the primary remedy in investment treaty arbitration) in domestic courts. The waiver, moreover, ceases to apply the moment the arbitration tribunal rejects the investor’s claim on *any* procedural or jurisdictional grounds, even when the claim is found to be frivolous and ‘manifestly without legal merit.’ This, it is submitted, severely undermines the intention as per Question 9 of preventing abuse of the arbitration system.

But what of the ‘matter of principle’ of favoring domestic courts? The Commission explains the drawbacks of seeking redress in domestic courts as follows:



'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**.'

If this is the extent of the problem, then the solution is fairly straightforward. The Commission should insist on the time-honored principle of exhaustion of local remedies, with the qualification that investors may be given the opportunity to make the case that domestic proceedings do not offer justice or are not reasonably-available according to a set list of criteria having to do with remedies, immunities, procedural rules, and other objective grounds. If there are grounds to believe that, in the course of domestic judicial proceedings, local companies or local governments have been 'favored' or 'due process rights such as the right to appeal' have been denied, the investors may be given the right to argue before investment arbitration tribunals that the treatment they have been given by the domestic judicial system falls short of the standards of treatment under the Treaty; for example, that it constitutes discrimination or 'denial of justice.'

## 2) Treaty shopping

The CETA reference text also contains a provision seeking to prevent the pernicious phenomenon of 'Treaty shopping'. The language is extraordinarily weak, instructing the Tribunal to 'stay its proceedings or otherwise ensure that proceedings pursuant to another international agreement are taken into account in its decision, order or award.' If the Commission is serious about avoiding investors being grossly over-compensated and about ensuring consistency, it should seek to clarify what is expected of Tribunals to 'otherwise ensure' that parallel proceedings are 'taken into account.'

## Question 8 Arbitrator ethics and conduct

### 1) Rosters

The Commission proposes to set up a roster from which Chairpersons of tribunals are to be appointed. As it explains:

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.

These benefits, obviously, would only arise systematically if the Treaty would break the tradition of allowing parties (or, formally, the other two arbitrators) to agree on a Chairperson themselves. From the CETA text, moreover, it seems that the intention would be to entrust the task of appointing Chairpersons from the roster to the Secretary-General of ICSID a choice that is not explained and for which there appears little justification given the lack of any formal accountability of this officer under the constitutional orders of the US or EU.

The Commission also states that ‘among those best qualified and who have undertaken such tasks will be retired **judges.**’ The investment arbitration community is composed overwhelmingly of international *commercial* arbitrators, with the addition of a few international law professors and a handful of former (and, imprudently, current) ICJ judges: ‘retired judges’ are few and far between, unless one counts as ‘retired judges’ people who have served in such institutions as the International Chamber of Commerce’s International Court of Arbitration, the Iran-U.S. Claims Tribunal, the World Bank’s Administrative Tribunal, the Dubai International Financial Court, or *Ad hoc* divisions of CAS for the Olympic Games.

## 2) Conflicts of interest

The Commission, rightly, has misgivings about the standards of ethical behavior and conflicts of interest that prevail in the investment arbitration regime. The reference text from CETA does not assuage the fears. While it envisages an unresolved or undisclosed code of conduct to be adopted by Parties, it relies for the time being on the International Bar Association Guidelines on Conflicts of Interest in International Arbitration. This instrument, despite being elaborated under the aegis of the IBA, is an act of self-regulation by and for the international arbitration community. The text puts the power to decide on challenges of arbitrators in the hands of the ICSID Secretary-General instead of a judicial official. In light of what was said above this is inappropriate.<sup>14</sup>

The Commission's stated intention is to introduce a code of conduct in the text of the new Treaty. It is so vague on the contents of this code that is difficult to come to any judgment. For example, even if the document mentions concerns arising from the fact that arbitrators often appear in various roles in different proceedings, the document falls short of proposing what is clearly the one single most important rule that is necessary: that arbitrators appointed in cases under the present Treaty may not themselves simultaneously be involved in any capacity other than as an adjudicator in any other investment arbitration, nor have any professional association – whether in the context of a law firm, Barrister's chambers, or any other similar relationship – with anyone who is involved as counsel or party-appointed expert in any investment arbitration. A few arbitrators self-impose this rule. Other arbitration systems, such as, for example the Court of Arbitration for Sport, have versions of this rule.<sup>15</sup> Its absence in a process to review decisions by legislatures, governments, and courts in matters of profound importance to large numbers of people, at potentially vast cost to the public purse, is totally unacceptable.

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<sup>14</sup> Mandatory reading in this regard is Professor Dalhuisen's postscript in *Vivendi v Argentina*, ICSID Case No ARB/97/3, Decision on Argentina's Request for Annulment of the Award rendered on 20 August 2007, 10 August 2010.

<sup>15</sup> Article S18 (3) of the CAS-TAS Statutes of the Bodies Working for the Settlement of Sports-related Disputes states that 'CAS Arbitrators and mediators may not act as counsel for a party before the CAS.' This obviously leaves the gaping loophole of partners and associates of the arbitrator's law firm acting as counsel.

One consideration underlying this rule has its basis in the economic interests involved with the (generously compensated) arbitrator appointments themselves. Here, the suspicion is that arbitrators, when they act as counsel, will appoint another arbitrator who may in turn in a subsequent case, when acting as counsel, appoint the first. This is certainly a concern, but the more important consideration seems to be the economic interests involved with the representation of claimants: law-firms involved in this work have a clear interest in making sure that claims under investment treaties have a good chance of success, and, given the practice of working on contingency fees, a clear interest in higher rather than lower awards. It is imperative, from this point of view, to make sure that no one who stands to profit in any way from the income generated by the representation of parties to investment disputes acts as an arbitrator.

More broadly, in a system where only one side, foreign investors, can bring claims, does not *everyone* – such as a retired judge – who works in the system and wants to continue doing so have an apparent economic interest to encourage more claims? Even with the most robust code of conduct, the absence of basic institutional safeguards of judicial independence undermines fundamentally the claims of investor-state arbitration to neutrality and impartiality.

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

The Commission proposes a kind of summary judgment system to provide ‘an early and effective filtering mechanism for frivolous claims.’ It seems unlikely that this approach will have any effect. Especially in light of the fact that the reference text instructs tribunals to consider the alleged facts to be true, arbitrators will have a hard time dismissing claims as ‘manifestly without legal merit’ under the necessarily vague and open-ended provisions of an investment treaty.

## **Question 11 Interpretation Guidance by the Parties**

As an ‘additional safety-valve’, the Commission plans to introduce a system where the EU and the US can issue binding interpretations. The reference text from CETA further provides the possibility for the non-respondent State party to intervene in a dispute. From the consultation text, it appears that the Commission wants to combine these two elements. Where, in a given case, the non-respondent State agrees with the interpretation of the respondent State, ‘such interpretation is a very powerful statement, which ISDS tribunals would have to respect.’ For the parties to a Treaty that confers rights on private parties to intervene directly in an ongoing case and issue binding interpretations is a drastic measure. Above all, the planned clause raises once more the question: if the Commission has so little confidence in arbitration tribunals, why confer on them the highly sensitive task of ‘weighing and balancing’ States’ rights to regulate with the property rights of investors in the first place?

## **Question 12            Appellate mechanism**

The CETA reference text provides only for the possibility of setting up an Appellate Body. The other reference text is so short on detail on the envisaged appeal mechanism as to make meaningful comment impossible. In any event, the Commission's stated intention to introduce a bilateral appellate mechanism -- to ensure consistency and 'to correct errors' -- into the TTIP ISDS should be applauded, on condition that this profound power of review be assigned throughout the process to independent judges, not arbitrators. But yet again, the idea begs the question: if the Commission has so little confidence in arbitration tribunals, why allow them at all to review -- free from rigorous judicial oversight and checks against conflict-of-interest -- the decisions of legislatures, governments, and real courts?

Moreover, the precise relationship between decisions of tribunals, the appellate mechanism and the existing court systems of the US, EU and Member States, will need clarification. It is entirely foreseeable that awards made by investment tribunals under the proposed treaty will have implications for domestic and EU legal rules and will generate appeals to relevant judicial bodies. Thus it is essential that negotiators clarify this important question.

## Signatories

Peter Muchlinski  
Professor of International Commercial Law  
School of Law  
SOAS, University of London

Horatia Muir Watt  
Professor of Law  
Law School  
SciencesPo Paris

Harm Schepel  
Professor of Economic Law  
Kent Law School and Brussels School of  
International Studies  
University of Kent

Gus Van Harten  
Associate Professor of Law  
Osgoode Hall Law School  
York University  
Toronto

Tanja Aalberts  
Director  
Centre for the Politics of Transnational Law  
Vrije Universiteit Amsterdam

Anneli Albi  
Professor of EU law  
Kent Law School  
University of Kent

Donatella Alessandrini  
Reader in Law  
Kent Law School  
University of Kent

Mads Andenas  
Professor of Law  
Faculty of Law  
University of Oslo

Diamond Ashiagbor  
Professor of Labour Law  
School of Law  
SOAS, University of London

Brook K. Baker  
Professor of Law  
School of Law  
Northeastern University  
Boston

Marija Bartl  
Researcher  
Faculty of Law  
University of Amsterdam

Kate Bedford  
Reader in Law  
Kent Law School  
University of Kent

Christian Bellak  
Associate Professor  
Department of Economics  
Vienna University of Economics and Business  
Administration

Jochen von Bernstorff  
Professor of International Law and Human  
Rights  
Law Faculty  
Eberhard Karls-University Tübingen

Andreas Bieler  
Professor of Political Economy  
School of Politics and International Relations  
University of Nottingham

Manfred A. Bienefeld  
Emeritus Professor  
School of Public Policy and Administration  
Carleton University

Francesco Bilancia  
Professor of Constitutional Law  
Law Department  
University of Chieti-Pescara

Jacco Bomhoff  
Associate Professor of Law  
Department of Law  
London School of Economics and Political  
Science



Ciarán Burke  
Professor of International Law  
Law Department  
Friedrich-Schiller-University  
Jena

Daniela Caruso  
Professor of Law  
School of Law  
Boston University

Damian Chalmers  
Professor of EU Law  
Law Department  
London School of Economics and Political  
Science

Monica Claes  
Professor of European and Comparative  
Constitutional Law  
Law Faculty  
Maastricht University

Hugh Collins  
Vinerian Professor of English Law  
Faculty of Law  
University of Oxford

Xenophon Contiades  
Professor of Public Law  
Dean, School of Social and Political Sciences  
University of Peloponnese  
Managing Director, Centre for European  
Constitutional Law -  
Themistocles and Dimitris Tsatsos Foundation

Sabine Corneloup  
Professor of Law  
Centre de recherche sur le droit des marchés  
et des investissements internationaux  
Faculty of Law  
Université de Bourgogne  
Dijon

Claire Cutler  
Professor of International Law and Relations  
Political Science Department  
University of Victoria

Dan Danielsen  
Professor of Law  
Northeastern University School of Law  
Boston

Simon Deakin  
Professor of Law  
Faculty of Law  
University of Cambridge

Gráinne de Búrca  
Florence Ellinwood Allen Professor of Law  
Director, Jean Monnet Center for International  
and Regional Economic Law & Justice  
NYU Law School  
New York University

Sionaidh Douglas-Scott  
Professor of European and Human Rights Law  
Lady Margaret Hall  
University of Oxford

Michelle Everson  
Professor of Law  
School of Law  
Birkbeck, University of London

Julio Faundez  
Professor of Law  
School of Law  
University of Warwick

Tomaso Ferrando  
Fellow  
Institute for Global Law and Policy  
Harvard Law School  
Harvard University

Sean Flynn  
Professorial Lecturer  
Washington College of Law  
American University

William E. Forbath  
Associate Dean of Research  
Lloyd M. Bentsen Chair in Law  
School of Law  
University of Texas at Austin

Günter Frankenberg  
Professor of Public Law  
Law Department  
Goethe-University Frankfurt am Main

Daniele Gallo  
Assistant Professor in Law  
LUISS Guido Carli University  
Rome

Carola Glinski  
Researcher  
Centre for European Law and Politics  
University of Bremen

Anna Grear  
Reader in Law  
Cardiff Law School  
Cardiff University  
Director, Global Network for the Study of  
Human Rights and the Environment

Ricardo Grinspun  
Associate Professor of Economics  
Department of Economics  
York University  
Toronto

Edward Guntrip  
Lecturer in Law  
School of Law, Politics and Sociology  
University of Sussex

Vanja Hamzić  
Lecturer in Law  
School of Law  
SOAS, University of London

Xiuli Han  
Associate Professor of International Law  
School of Law  
Xiamen University

Martin Hedemann-Robinson  
Senior Lecturer in Law  
Kent Law School  
University of Kent

Martijn Hesselink  
Professor of European Private Law  
Faculty of Law  
University of Amsterdam

Raymond Hinnebusch  
Professor of International Relations  
School of International Relations  
University of St. Andrews

Kristen Hopewell  
Assistant Professor  
Department of Sociology  
University of British Columbia

Balázs Horváthy  
Research Fellow  
Centre for Social Sciences  
Hungarian Academy of Sciences  
Budapest

Jo Hunt  
Reader in European Union Law  
Cardiff Law School  
Cardiff University

Christophe Jamin  
Professor of Law and Dean  
Law School  
SciencesPo Paris

Christian Joerges  
Professor of Law & Society  
Hertie School of Governance and  
Professor of Law  
Law Department  
University of Bremen

Ioannis Kalpouzos  
Lecturer in Law  
City Law School  
City University London

Jane Kelsey  
Professor of Law  
Faculty of Law  
University of Auckland

David Kennedy  
Manley O. Hudson Professor of Law and  
Faculty Director, Institute for Global Law and  
Policy  
Harvard Law School  
Harvard University

Urfan Khaliq  
Professor of Public International and European  
Laws  
Cardiff Law School  
Cardiff University

Jonathan Klaaren  
Professor of Law  
Oliver Schreiner School of Law  
University of Witwatersrand  
Johannesburg

Jan Klabbers  
Professor of International Law  
Law Department  
University of Helsinki

Martti Koskeniemi  
Professor of International Law  
Law Department  
University of Helsinki

Markus Krajewski  
Professor of Law  
Law Department  
Universität Erlangen-Nürnberg  
Nico Krisch  
ICREA Research Professor  
Institut Barcelona d'Estudis Internacionals  
(IBEI)  
Barcelona

Stéphanie Laulhé-Shaelou  
Assistant Professor of Law  
Law School  
University of Central Lancashire (Cyprus)

Claudio Lentini  
Profesor Comercio Exterior y Economía  
Internacional  
Profesor Macroeconomía y Política Económica  
Universidad Nacional de Lanús

Laura Lorello  
Professor of Constitutional Law  
Law Department  
University of Palermo

Audrey Macklin  
Professor & Chair in Human Rights Law  
Faculty of Law  
University of Toronto

Chantal Mak  
Associate Professor in Private Law  
Law Faculty  
University of Amsterdam

Maria Rosaria Marella  
Professor of Private Law  
Law Department  
University of Perugia

Antonio Marzal Yetano  
Max Weber Research Fellow  
European University Institute  
Florence

Ugo Mattei  
Professor of Law  
Law Department  
University of Torino

Petros Mavroidis  
Professor of Regional and Global Economic  
Law  
Law Department  
European University Institute  
Florence

Mario Mendez  
Senior Lecturer  
School of Law  
Queen Mary University of London

Agustín José Menéndez  
Professor of Law  
Law Department  
University of León

Ralf Michaels  
Arthur Larson Professor of Law  
Duke University School of Law  
Durham

Hans-W. Micklitz  
Professor of Economic Law  
Law Department  
European University Institute  
Florence

Lucinda Miller  
Lecturer in Law  
Faculty of Law  
University College London

Pier Giuseppe Monateri  
Professor of Law  
Law Department  
University of Torino

Miguel Moura e Silva  
Professor of Law  
Faculty of Law  
University of Lisbon

Paul O'Connell  
Reader in Law  
School of Law  
SOAS, University of London

Gbenga Oduntan  
Senior Lecturer in International Law  
Kent Law School  
University of Kent

Obiora Chinedu Okafor  
Associate Professor  
Osgoode Hall Law School  
York University  
Toronto

Anne Orford  
Michael D Kirby Professor of International Law  
Australian Research Council Future Fellow  
Melbourne Law School  
University of Melbourne

Yoriko Otomo  
Lecturer in Law  
School of Law  
SOAS, University of London

William Outhwaite  
Professor of Sociology  
School of Geography, Politics and Sociology  
Newcastle University

Leo Panitch  
Canada Research Chair in Comparative  
Political Economy  
Department of Political Science  
York University  
Toronto

Eva Paus  
Professor of Economics  
Mc Culloch Center for Global Initiatives and  
Department of Economics  
Mount Holyoke College  
South Hadley, Mass.

Jeremy Perelman  
Assistant Professor  
School of Law  
Sciences Po Paris

Amanda Perry-Kessaris  
Professor of Law  
Kent Law School  
University of Kent

Sol Picciotto  
Emeritus Professor of Law  
Law School  
University of Lancaster

Cesare Pinelli  
Professor of Public Law  
Law Department  
Sapienza University of Rome

Nikolas Rajkovic  
Lecturer in International Law  
Kent Law School  
University of Kent

Francesco Rimoli  
Professor of Public Law  
Faculty of Law  
University of Teramo

Florian Rödl  
Cluster of Excellence on Normative Orders  
Goethe-University  
Frankfurt am Main

Stefano Rodotà  
Emeritus Professor of Law  
Law Department  
Sapienza University of Rome

Derek Roebuck  
Senior Associate Research Fellow  
Institute of Advanced Legal Studies  
University of London

Isobel Roele,  
Lecturer in Law  
Cardiff Law School  
Cardiff University

Alfredo Saad Filho  
Professor of Political Economy  
Department of Development Studies  
SOAS, University of London

Saskia Sassen  
Robert S. Lynd Professor of Sociology  
Department of Sociology and  
Co-Chair, Committee on Global Thought  
Columbia University  
New York

Robert Schütze  
Professor of European Law  
Durham Law School  
Durham University

Iain Scobbie  
Professor of Public International Law  
School of Law  
University of Manchester

Joanne Scott  
Professor of European Law  
Faculty of Laws  
University College London

Jo Shaw  
Salvesen Chair of European Institutions  
Edinburgh Law School  
University of Edinburgh

Stijn Smismans  
Professor of European Law and Governance  
Director, Centre for European Law and  
Governance  
Cardiff Jean Monnet Centre of Excellence  
Cardiff University

M Sornarajah  
CJ Koh Professor of Law  
Faculty of Law  
National University of Singapore

Celine Tan  
Associate Professor  
School of Law  
University of Warwick

Lawan Thanadsillapakul  
Professor of Law  
School of Law  
Sukhothai Thammathirat Open University  
Bangkok

Chantal Thomas  
Professor of Law  
Cornell Law School  
Ithaca

Kyla Tienhaara  
Research Fellow  
Regulatory Institutions Network  
Australian National University  
Canberra

Neus Torbisco Casals  
Professor of Law  
Law Department  
Universitat Pompeu Fabra  
Barcelona

William Twining  
Quain Professor of Jurisprudence Emeritus  
Faculty of Laws  
University College London

Marton Varju  
Senior Research Fellow  
Centre for Social Sciences  
Hungarian Academy of Sciences  
Budapest

Georgij Velyaminov  
Professor of Law  
Institute of State and Law  
Russian Academy of Sciences

Ingo Venzke  
Associate Professor  
Amsterdam Center for International Law  
University of Amsterdam

Simone Vezzani  
Assistant Professor in International Law  
Law Department  
University of Perugia

Sophie Vigneron  
Lecturer in Law  
Kent Law School  
University of Kent

Maria Weimer  
Assistant Professor in EU Law  
Law Faculty  
University of Amsterdam

Lynn Welchman  
Professor of Law  
School of Law  
SOAS, University of London

Toni Williams  
Professor of Law  
Kent Law School  
University of Kent

Bruno de Witte  
Professor of European Law  
Maastricht University and  
European University Institute  
Florence

Stepan Wood  
Professor of Law  
Osgoode Hall Law School  
York University

Mikhail Xifaras  
Professor of Law  
School of Law  
Sciences Po Paris