TACD recommends that the US and EU exclude investor-state dispute resolution from any trade agreement (http://bit.ly/1eLB44i)

The European Commission's Public Consultation on Modalities for Investment Protection and ISDS in TTIP

Response of the Transatlantic Consumer Dialogue

Question 1: Scope of the substantive investment protection provisions

As explained throughout this response, investor-state dispute settlement (ISDS) should not be included in TTIP. For more information, see the above TACD statement advocating exclusion of ISDS.

Whether or not TTIP's substantive investor protections provisions are enforceable by ISDS, to avoid giving foreign investors superior rights to domestic investors, the definition that designates which investments and investors are subject to the substantive protections must be limited to forms of property and investors that would be granted similar substantive protections in both U.S. and EU member nation laws. However, the broad definition of an investment in the EU-Canada agreement (CETA) text provided with this questionnaire, as in past "free trade" agreements (FTAs) and bilateral investment treaties (BITs), would extend the substantive property rights protections to categories of activities and instruments that would not be provided the same substantive protections in domestic law. This broad definition risks granting foreign investors greater rights than domestic firms under the laws of EU member states. If ISDS were included, it would also invite a greater number of investor-state claims for compensation by allowing foreign firms to target a wider array of government actions as claimed violations of the treaty's expropriation or minimum standard of treatment provisions.

Of particular concern would be inclusion in the definition of an investment of vague concepts such as "assumption of risk" and "expectation of gain or profit" to be used as a basis of determining whether an investment exists. In contrast to definitions of investment that require the commitment of capital or acquisition of real property or other tangible assets, these highly subjective standards would grant investor-state or state-state tribunals excessive discretion in determining whether an actionable investment exists – in the form of a veritable investment. Investor-state tribunals have repeatedly used the discretion afforded by vague treaty terms both to continually expand the scope of covered investments and to create broad, unintended substantive obligations of States to foreign investors with respect to the ever-expanding categories of deemed investments. Increasingly, the use of such broad terms to define "investment" is enabling investor-state awards that order governments to compensate foreign firms that have not truly made a tangible investment in their countries.

The most comprehensive way to foreclose this risk would be to exclude ISDS from TTIP, since investor-state tribunals have proven much more willing than state-state tribunals to use inventive notions of "investment" to rule against governments. Whether or not ISDS is included, the definition of investment should be explicitly limited to the commitment of capital or the acquisition of real property, and language should be added to make clear that vague concepts such as "assumption of risk" or "expectation of gain or profit" are not to be used as a basis for determining whether an investment exists.

But a more general problem with attempting to define "investment" in an international treaty is the reality that the jurisprudence defining various property rights is a living doctrine. Even if a trade pact text were to include provisions that described the state of European property rights jurisprudence at any particular juncture, over time the pact could result in greater rights for foreign investors, as domestic jurisprudence continues to be refined. To resolve this problem, another potential way to improve the investment definition would be to directly link it to the domestic laws of the host country. Such a definition could read:

> "investment means property, property right or property interest as defined under the applicable law of the respondent state at the time the alleged injury occurred. For greater clarity, in instances where the respondent has substantially changed the definition of property, property rights or property interests from the time that the investment was initially made to the time of the alleged injury, a tribunal will find that the later definition applies, unless the claimant can show that the primary motivation for the substantial change was to specifically deprive an investor of rights under this Chapter."

Regarding the definition of an investor, requiring "substantial business activities" in the *host* country is a step in the right direction in trying to prevent foreign firms from setting up shell companies in a Party so as to launch an investor-state case (or to convince the home government to launch a state-state case) against the host government's policies or actions. However, "substantial" is not defined in the sample text, providing too much discretion for tribunals on a matter that should be made clear by the signatory Parties. To foreclose the risk of cases being allowed on behalf of a shell company, a footnote could be added to this effect:

> In order to claim benefits under this Chapter, an investor must have employed natural persons, and made purchases or sales within, the potential respondent Party's territory that are at least 20 percent the annual average per capita employment of natural persons, and purchases or sales of goods or services, realized in its primary market in the six years prior to the alleged injury.

The six year requirement references the conclusion by tribunalists Daniel Price and Piero Bernardini from the *Tokios Tokelés v. Ukraine* case brought under the Lithuania-Ukraine BIT. They argued that an enterprise incorporation six years prior to the attempt to access investor-state arbitration was evidence that the corporation was not engaging in "an abuse of legal personality."[1]

Moreover, denial of benefit provisions must be tightened to ensure a firm has substantial business activities in the *home* Party. Again, the term of art "substantial business activities" must be explicitly defined so to be premised on real-world, economic activity rather than merely reflecting legal artifices. It is critical that the definition eliminate the current wide discretion provided to tribunals. And, a relevant duration of such "substantial business activities" must be explicitly included, so as to avoid opportunistic "nationality planning" (for instance re-incorporations aimed at newly obtaining standing) in the lead-up to initiation of arbitral proceedings. A critical aspect of fixing these provisions relative to past pacts is ensuring that nationals of a given country are not challenging their own country's regulations using offshore subsidiaries and the TTIP.

In addition, the burden of proving that any TTIP investor protections apply must be borne by the investor (or the home Party in the case of a state-state dispute). That is, the claimant must prove the investor maintains (precisely defined) "substantial business activities" in the home country and that the ultimate beneficial owners of the investment are not actually located in the host Party or a non-Party. In contrast, investor-state arbitral tribunals have ruled that a respondent government must affirmatively invoke the denial of benefits provisions. In the *Plama v. Bulgaria* case under the Energy Charter Treaty, for instance, a tribunal ruled that governments must invoke denial of benefits before the investor even makes the investment. The tribunal noted that, if the negotiating governments wanted to allow for a later invocation of denial of benefits, they could have drawn from the precedent of other pacts. They cited NAFTA, which allows for a consultation period before denial of benefits, apparently even after the investment is made; and the ASEAN services agreement, which states simply that "the benefits of this Framework Agreement shall be denied to" shell corporations. Given that the issues surrounding ownership and control by shell companies are so complicated, it would behoove negotiators to come up with a better formulation. This would include providing arbitral panels direction on when and how deeply to "pierce the corporate veil" to determine ultimate beneficial ownership.

Question 2: Non-discriminatory treatment for investors

The referenced CETA wording for the national treatment provision would allow tribunals to interpret the text as a prohibition of regulatory actions resulting in *de facto* discrimination even when there is no facial or intentional discrimination involved. This interpretation could result in tribunal orders to compensate foreign firms for environmental, health and other public interest policies that are facially neutral but that have an inadvertent, disproportionate impact on foreign investors. For example, a governmental measure restricting hydraulic fracturing ("fracking") in natural gas production could be interpreted by a tribunal as a national treatment violation if most domestic energy companies did not yet use fracking as a primary method of gas extraction while foreign investors depended significantly on fracking. To limit national treatment claims against such facially non-discriminatory policies, the national treatment text should be explicitly limited to instances in which a measure is enacted for a primarily discriminatory purpose.

Regarding the most-favored-nation (MFN) text, the attempt to prevent the "importation of standards" is prudent. However, to fully foreclose this possibility, more comprehensive

language is advisable. The clarification that MFN does not cover "investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements" satisfactorily limits the ability of foreign firms to import greater procedural rights from treaties signed with third Parties. However, it is not clear that any of the CETA reference language would bar foreign investors from importing the substantive rights afforded in such treaties. For example, the language would appear to allow tribunalists to grant a U.S. investor, upon its request, access to the definitions of indirect expropriation and "fair and equitable treatment" (FET) from an EU member state's earlier BITs, without the modifications to those terms included in the CETA reference text that the EC claims as significant improvements. By allowing firms to access these more expansive, earlier definitions of substantive foreign investor rights, the EU would expose itself to a broader array of investor-state or state-state challenges to domestic policies. The EC could close this loophole by adding language explicitly excluding from the definition of "treatment" the substantive rights afforded in other BITs and agreements, to parallel the text explicitly excluding ISDS.

The intention to provide an exception for environmental and other public interest measures in this section is laudable, but the language described would fail to meet this goal. First, the importation of GATT Article XX and GATS Article XIV replicates weaknesses of those texts. Only one of 40 attempts to use these exceptions at the WTO has ever succeeded due to legal hurdles contained within the exception that would be replicated under the CETA text.[2] To take advantage of the exception for policies "to protect human, animal or plant life or health," for example, a government would first have to prove that the policy was designed to fulfil one of those objectives. It would then need to prove that the policy was "necessary" for the fulfilment of the environmental objective. This requirement has been most responsible for failed attempts to invoke the general exception at the WTO, as tribunals can require high thresholds of necessity. An investor-state tribunal would have the discretion to even require the State to prove that no less trade restrictive alternative measure existed, placing the State in the unenviable position of proving a negative. Finally, the State would have to prove that the measure was not applied in a discriminatory manner or as a disguised restriction on investment. The EC should develop a more robust general exception that avoids these legal hurdles, particularly omitting any "necessity" test.

Second, the general exception in the CETA reference text is not actually generalized. The text states that the exception would not apply to the claims most frequently and most successfully used in investor-state claims: "fair and equitable treatment" and expropriation. Of the ISDS cases brought under U.S. FTAs and BITs in which the tribunal ruled in favor of the foreign investor, 74 percent of the claims were "successful" on the basis of "fair and equitable treatment" violations.[3] This includes a wide array of environmentally-focused cases in which the tribunal decided that a respondent government's environmental protection measure constituted an FET violation and ordered compensation to the investor. Halting anti-environmental tribunal rulings on the basis of such broad rights requires that public interest exceptions apply to those rights.

Question 3: Fair and equitable treatment

The EC is correct to attempt to narrow the FET obligation, given the wide discretion that tribunals have employed in interpreting vague FET provisions as expansive obligations for respondent States, including obligations to maintain a static regulatory environment and to respond to investors' unlawful behaviour in a manner that the tribunal deems proportional.

However, efforts to narrow the FET obligation could be of limited utility if ISDS is included in TTIP, given that investor-state tribunals have repeatedly ignored governments' past efforts to rein in tribunals' expansive FET interpretations. For example, in the U.S.-Central America Free Trade Agreement (CAFTA), the U.S. government and other CAFTA Parties inserted an annex that attempted to narrow the vague FET obligation by defining "fair and equitable treatment" as derived from customary international law as defined by the practice of States. But in *Railroad Development Corporation (RDC) v. Guatemala* – one of the first investor-state cases brought under CAFTA – the tribunal simply ignored the annex and the official submissions of four sovereign governments (including the U.S. government), each of which argued for the narrower definition.[4] The *RDC v. Guatemala* tribunal asserted that the States were in error in their interpretation of the FET standard. Instead, the tribunal cited yet another investor-state tribunal, imported its more expansive interpretation of "fair and equitable treatment" (including an obligation to honour investors' expectations), ruled that Guatemala had violated the expanded obligation, and ordered Guatemalan taxpayers to pay $18.6 million.[5] To foreclose the demonstrated risk of ISDS tribunals simply ignoring government attempts to narrow the FET obligation, ISDS should be excluded from TTIP.

Whether or not ISDS is included, the approach to FET should be neither that included in the CETA reference text (an ostensibly closed list of the substantive components of FET), nor that included in the 2012 U.S. Model BIT (an open-ended methodology for interpreting FET). Instead, a narrow methodology for interpreting FET should be clearly stated. The standard of proof for establishing an FET obligation should require *the claimant* to prove that the obligation is required by customary international law as demonstrated by State practice and *opinio juris*. That is, to prove the existence of an FET obligation, the claimant must perform a thorough analysis of State practice and *opinio juris* that clearly demonstrates the claimed obligation as an established component of the customary international law minimum standard of treatment. To use a more open-ended methodology, as seen in CAFTA and the 2012 U.S. Model BIT, would enable sweeping and unsubstantiated tribunal interpretations of FET, as demonstrated by the *RDC* case. But to use an ostensibly closed list, as seen in the reference text, risks explicitly expanding the FET obligation beyond the denial of justice standard embodied in customary international law.

Indeed, that is exactly what the list in the CETA reference text does. For example, the list defining FET includes "manifest arbitrariness" as a qualifying criterion. While the other criteria in the list are more precisely defined (e.g. "targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief), "manifest arbitrariness" is a more open-ended term that tribunals could interpret widely to rule against domestic measures taken in the public interest.

For example, in *S.D. Myers v. Canada*, brought under the North American Free Trade Agreement (NAFTA), the tribunal concluded that an FET violation was one in which "an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective."[6] On the basis of this definition, the tribunal ruled that Canada had violated S.D. Myers' right to "fair and equitable treatment" by banning the export of a hazardous waste called polychlorinated biphenyls (PCB) that is proven to be toxic to humans and the environment. Though the PCB export ban complied with a multilateral treaty encouraging domestic treatment of toxic waste, the tribunal deemed Canada's non-discriminatory ban as "arbitrary" and ordered the government to compensate S.D. Myers with $5.6 million.[7] Simply adding the qualifier "manifest" to "arbitrary" is not likely to rein in such overreaching tribunal interpretations. Instead, if a closed list approach is taken despite the risk of inviting overreaching tribunal interpretations of the substantive terms, "manifest arbitrariness" should be eliminated from the FET language.

Second, the CETA reference text's allowance for tribunals to consider an investor's "legitimate expectation" threatens to expose EU member countries to investor-state or state-state claims against policy reforms in the public interest. While the text ties the consideration of legitimate expectations to instances in which "a Party made a specific representation to an investor to induce a covered investment," this qualifier is not likely to be sufficient to foreclose the risk to progressive policymaking. Under the CETA language, a tribunal could conceivably find that a government's decision to respond to a financial crisis by restricting banks from dealing in risky derivatives, for example, frustrated a foreign bank's legitimate expectation, based on communications from an earlier administration under a more lax regulatory framework that the bank would be free to engage in derivative trading. A tribunal could well reason that this statement of permissiveness toward derivatives was one "upon which the investor relied in deciding to make or maintain" its investment, and that the subsequent restriction on derivatives "frustrated" that legitimate expectation. Similar logic could be envisioned for policy responses to climate crises, emerging food safety concerns, or other areas in which governments choose to alter policies, despite the fact that doing so contradicts earlier statements by government officials, in response to emergent crises or consumer demands. To not expose such responsive policymaking to foreign demands for compensation, no reference should be made to investors' expectations, regardless of the overall approach used for FET.

Question 4: Expropriation

While the annex clarifying the meaning of expropriation may be helpful in deterring the most far-fetched claims against domestic policies or actions, it still allows for a broad definition of indirect expropriation that invites tribunal decisions against regulatory policies on the mere basis that they adversely affected the value of an investment.

The combination of the right to compensation for such "indirect" expropriations and the opening for investor-state or state-state claims over "investments" that go far beyond real property would mean that States would be obliged to compensate foreign investors for regulatory actions that would not be subject to compensation for expropriation claims

under domestic law. While the domestic legal systems of many developed countries limit firms' ability to pursue claims of indirect expropriation for regulations affecting anything beyond real property,[8] the CETA language would enable foreign investors to claim indirect expropriations for regulations implicating copyrights, money or other forms of intangible property. Indeed, the definition is not even limited to measures directly affecting "property," but those affecting "the fundamental attributes of property" in a firm's investment "including the right to use, enjoy and dispose of its investment." Such an expansive definition invites tribunals to allow claims against regulations blamed for losses extending beyond traditional business assets (e.g. diminished market share, which can arguably be used, enjoyed and disposed of).

The definition of indirect expropriation also allows that government actions constitute acts of indirect expropriation for which foreign investors are entitled to compensation, even if there was no government appropriation of the asset in question. This contradicts the dominant legal standard used by States, which typically require government compensation only if there has been government acquisition or an action short of acquisition which extinguishes all value for all time of certain non-real-estate assets, not when a regulation merely diminishes an asset's value (no matter how "substantially").[9] Offering foreign investors "indirect expropriation" rights that go beyond the domestic takings laws of the EU member states would expose EU regulations to significant investor-state or state-state liability.

While the CETA reference text includes a seeming safeguard for "non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives," the language requires a respondent government to overcome several high legal hurdles to successfully use the safeguard. Based on the wording, a tribunal could require the government to prove that a given welfare objective is "legitimate," that the measure is designed to protect that objective, that the measure has been applied to protect that objective, and that the measure is non-discriminatory (likely in both intent and effect). Even if a given measure would clear this series of hurdles in the eyes of a tribunal, it could still constitute indirect expropriation in "rare circumstances[]." These legal obstacles significantly undercut the utility of the safeguard and should be excluded.

To avoid exposing a broad array of domestic measures, including public interest policies, to claims of indirect expropriation, the annex defining expropriation should be rewritten. It should clarify that an indirect expropriation occurs only when a host State acts indirectly to seize or transfer ownership of an investment, and not when the government merely acts in a manner that decreases the value or profitability of an investment. One option for codifying this approach would be to include language defining indirect expropriation as when "a Party acts indirectly, including through a series of actions, to seize, appropriate, or transfer ownership of a property right." This definition should be followed by a strenghtened safeguard: "Facially non-discriminatory regulatory actions by a Party that are designed and applied to protect public welfare objectives, such as public health, safety, environmental protection, and real estate price stabilization (through, for example, measures to improve the housing conditions for low-income households), do not constitute indirect expropriations."

Question 5: Ensuring the right to regulate and investment protection

The preamble of the CETA reference text states, "recognising the right of the Parties to take measures to achieve legitimate public policy objectives." However, such preambular language is merely hortatory and does not carry the same legal weight as the substantive rights afforded to investors above. As such, insofar as there are conflicts between an investor's binding rights and this non-binding recognition of the right to regulate, a tribunal would not limit the investor's explicit rights on the basis of the hortatory language in the preamble.

With respect to what is identified as prudential "carve-out" language, first, the provision is not a "carve-out." It is an exception that can be raised after a prudential measure has been challenged to try to convince a tribunal why, despite violating the agreement, it should nonetheless be allowed. A carve-out would state that the terms of the entire agreement simply are not applicable to prudential measures. Such a clause should be included, as it would forbid foreign investors or States from bringing claims against prudential measures. In contrast, under the CETA approach, investor-state or state-state claims could target prudential measures, and the respondent State would have to try to use the exception as its defence.

The prudential language described is also weakened by this stipulation: "These measures shall not be more burdensome than necessary to achieve their aim." This language offers foreign banks ample means of challenging (or requesting their government to challenge) prudential measures, as tribunals could require the respondent State to prove that there exists no less "burdensome" policy option that could have plausibly been pursued instead of the challenged measure. Since this high burden of proof (requiring the State to prove a negative) could well confound a government's attempt to defend a legitimate prudential measure, the "more burdensome than necessary" provision should be eliminated.

But even without this provision, the State would likely bear the burden of proving to the tribunal that a challenged measure qualified as "prudential" under the CETA reference language. To truly safeguard measures taken to ensure financial stability, it should be the claimant that bears the burden of proving that a measure argued by the State to be prudential does not qualify. Such protection could be achieved by adding this text:

> "For greater certainty, if a Party invokes this provision, the exception shall apply unless the party initiating the claim can demonstrate that the measure is not intended to protect investors, depositors, policy-holders or persons to whom a fiduciary duty is owed by a financial service supplier, or is not intended to ensure the integrity and stability of the financial system."

The "Safeguard measures" and "Balance of Payments" provisions in the CETA reference text indicate that the EC intends to replicate the terms in the investment chapter of prior agreements that generally prohibit a Party from restricting transfers (e.g., from a draft of the CETA text: "Each Party shall permit all transfers relating to a covered investment to be made without restriction or delay and in a freely convertible currency."). This provision acts

as a ban on capital controls, which the International Monetary Fund has officially endorsed as a legitimate policy tool to mitigate or prevent financial crises in certain instances.[10] The ban on capital controls contradicts a growing academic consensus – many mainstream economists have vouched for capital controls as a common sense measure with a proven track record of stemming the damage from destabilizing flows of speculative capital.[11] Indeed, the EU itself used intra-EU capital controls to stem the fallout of the recent Eurozone crisis. The standard transfers language, written before the global financial crisis of 2007-2009, also conflicts with financial transaction taxes, which 11 EU member nations are slated to implement. The CETA reference text under the "Safeguard" and "Balance of Payments" sections offer some narrow limitations on this anachronistic ban on capital controls, though they do not provide a sufficient safeguard. Meanwhile, they do nothing to protect a State's prerogative to enact financial transaction taxes.

The "Safeguard" language is limited to narrow uses of capital controls and exposes any such uses to a series of high legal hurdles. Capital controls can be employed for numerous legitimate policy objectives: ensuring economic stability in the face of balance-of-payment (BOP) crises, maintaining effective monetary policies in the face of procyclical flows, avoiding currency appreciation, eliminating rent-seeking activities, preventing asset bubbles, and ensuring a stable climate for long-term domestic investment. Of these six objectives, this exception could only plausibly cover the first three, as policies falling under the exception must address "difficulties for the operation of…the economic and monetary union" rather than other domestic difficulties created by speculative capital flows.

But the availability of this exception for even these three policy objectives is severely hampered by the requirement that the capital control measure must last no longer than six months. The threat of a BOP crisis, spurred or exacerbated by capital flows, can certainly outlast a six-month window, while capital flows' threats to an independent monetary policy and currency stability can be of an indefinite duration. The requirement for capital controls to be temporary prohibits their valid usage, specifically with respect to avoiding floods of speculative inflows, which is critical as a preventative tool to stop crises *before* they start.

Even if a capital control measure would fit within the narrow confines of this exception, a defence of the measure would face high legal hurdles in the event of an investor-state or state-state challenge. The language names at least three such hurdles: the circumstances in which the measure is used must be "exceptional," the difficulties caused must be "serious," and the measure itself must be "strictly necessary." The last hurdle creates another burdensome "necessity" test, for which a tribunal could require a respondent State to prove that no other less trade restrictive measure exists.

Meanwhile, the CETA balance-of-payments provision replicates many of the weaknesses of the balance of payments exception found in GATS Article XII. First, the exception only applies to capital controls used to address balance-of-payments problems. As discussed above, this language excludes an array of other legitimate policy objectives for which capital controls could be used. Second, any BOP-focused capital control must be temporary according to the text, barring the usage of capital controls as an ongoing measure to prevent rather than respond to crises. Third, the exception poses another series of hurdles for a government wishing to use it to fend off a challenge to a capital control measure,

including that the measure "avoid unnecessary damage to the commercial, economic or financial interests of the other Party." The threshold for "damage" is not specified, allowing a tribunal to determine that the exception does not apply in an instance of an iota of "unnecessary damage."

Rectifying the weaknesses of these safeguards requires the creation of new language that makes explicit that any included transfers provisions do not apply to financial transaction taxes or capital controls, including capital controls that are not temporary and whose purpose extends beyond addressing BOP and monetary concerns. While anti-abuse language could be added to ensure that the primary intent of a given measure is not to cause economic harm to an investor, the burden of proof should lie with the claimant to convince the tribunal that the challenged measure is in fact intended to cause harm. And if any language is added regarding the necessity of the capital control or financial transaction tax measure, it should be the respondent government rather than the tribunal that is authorized to determine when such a measure is necessary.

Question 6: Transparency in ISDS

Transparency in any TTIP dispute settlement system is necessary, but it is not sufficient to foreclose the threat that ISDS poses to consumer protections or governments' right to regulate. As investor-state documents have become more publicly available, tribunals have not indicated greater hesitance to use overreaching interpretations of investors' rights to rule against public interest policies. Documents were generally made available, for example, in the recent *Occidental v. Ecuador* case brought under the U.S.-Ecuador BIT. That includes the publicly-available 2012 award in which the tribunalists concocted a new obligation for Ecuador to respond proportionally to Occidental's breach of the law, deemed themselves the arbiters of proportionality, and ordered the government to pay $2.3 billion for violating the creative obligation.[12] Preventing the threats posed by ISDS requires not a more transparent investor-state system but abstention from said system.

If ISDS were included in TTIP despite the threats, the CETA reference language to make public most ISDS documents and hold public hearings (with limited exceptions) is welcome. However, doing so in accordance with the new transparency rules of the United Nations Commission on International Trade Law (UNCITRAL), as envisioned in the reference text, would be problematic. The importation of UNCITRAL rules would mean the incorporation of a provision empowering the tribunal to block information that would "jeopardize the integrity of the arbitral process" (Article 7:7).[13] The text lists several reasonable instances in which this exception could be invoked: when the information would "hamper the collection or production of evidence, lead to the intimidation of witnesses, lawyers acting for disputing parties or members of the arbitral tribunal." But it also includes this catch-all: "or in comparably exceptional circumstances," giving the tribunal wide discretion for determining that a given document or hearing should not be public due to suspicion that it could interfere with the arbitral process. If, for example, a controversial ISDS case spurred public demonstrations against the investor's claim, the tribunal would seem to have ample room to use the demonstrations as a pretext for not making documents or hearings public, even in the likely scenario that the demonstrations posed no actual threat to witnesses, lawyers,

parties, or tribunal members. This tribunal discretion should be narrowed by adding an exception to the importation of UNCITRAL rules that negates the "comparably exceptional circumstances" basis for not making documents public.

Question 7: Multiple claims and relationship to domestic courts

If ISDS were to be included in TTIP, investors should indeed be prevented from simultaneously pursuing the same claim in domestic courts and via the ISDS mechanism, as the reference CETA text proposes, to make sure that investors are not doubly compensated. However, this limitation does nothing to counter the much more fundamental problem that would be created if ISDS were to be included in TTIP: the empowerment of foreign investors to circumvent domestic laws and courts and directly pursue claims before three-person extrajudicial tribunals, undermining the validity of U.S. and EU domestic legal systems.

ISDS is an extraordinary mechanism in that it elevates individual investors to equal standing with an agreement's signatory governments, empowering firms to privately enforce the terms of the public treaty. Its inclusion in TTIP would grant foreign investors greater procedural rights than domestic investors who do not have access to this parallel, extrajudicial legal track. Moreover, the EU and United States have some of the most respected domestic legal systems and most robust property rights protections in the world. What is the need for extrajudicial enforcement when investors have access to such trustworthy domestic judicial systems?

Given its overreach and its unnecessary nature, investor-state dispute settlement should be replaced with a state-to-state mechanism for settling investment disputes in TTIP. In addition to not giving foreign firms greater rights than domestic firms or undermining domestic rule of law, state-to-state dispute settlement has proven to be an effective enforcement mechanism in fora such as the World Trade Organization.

If ISDS is still included in TTIP despite its clear dangers and unclear benefits, investors should at least be required to exhaust domestic remedies before proceeding to international tribunals. The exhaustion requirement is a fundamental principle of international law.[14] There is no reason for foreign investors to skirt a nation's judicial system in pursuing claims against that nation, unless it is an attempt to obtain greater rights than those provided under national law. Under international law, the exhaustion requirement does not apply when attempts to use domestic legal remedies would be futile. This would allow investors to proceed to international tribunals if, for example, domestic remedies caused undue delay[15] or if domestic courts lacked jurisdiction to provide relief.[16] Even if the domestic courts lacked jurisdiction to hear international law claims, the exhaustion requirement could be satisfied by raising the substance of the claim under domestic law.[17]

Question 8: Arbitrator ethics, conduct and qualifications

While the CETA reference text regarding arbitrator independence is an improvement over the scant conflict-of-interest rules relied upon in many investor-state cases, it fails to address

more fundamental, structural conflicts of interest inherent in the ISDS regime. Even if a tribunalist has no connection to the corporation bringing a given claim, by interpreting that corporation's rights broadly and ordering government compensation for violation of those rights, the tribunalist boosts the utility of ISDS for corporations, thereby increasing the number of firms interested in launching new cases. Since firms are permitted to pick one of the arbitrators under standard ISDS rules, tribunalists that have proven most favourable to corporations in the past are likely to be popular picks for firms launching ISDS claims. (This helps explain why just 15 lawyers are repeatedly picked as arbitrators, covering 55 percent of all investment treaty disputes between them.)[18] In this way, tribunalists are incentivized to create expansive rights for foreign investors and to find government violations of those rights to boost the number of firms interested in serving as ISDS clients. To avoid this structural conflict of interest, in addition to providing a more fulsome fix for the narrower conflicts of interest that the CETA text addresses, TTIP should exclude ISDS.

Whether or not ISDS is included, the method for picking arbitrators envisioned in the CETA reference text should be replaced with an approach that would prove more effective in ensuring arbitrator impartiality. Rather than having the disputing parties choose arbiters, all tribunalists should be randomly assigned from a roster of arbitrators in each dispute. This method would diminish conflicts of interest by not allowing parties to pick arbitrators biased toward their interests, while removing the incentive for arbitrators to rule in favor of the party that selected them so as to invite further selections. The criteria for appointment to the roster would need to be publicly accountable and include comprehensive conflict-of-interest rules.

If ISDS were to be included in TTIP, the CETA conflict of interest rules should also be strengthened to better ensure the impartiality of arbitrators. Core rules must include a prohibition against representing corporations in ISDS challenges for those who seek to serve as tribunalists; a requirement for tribunalists to publicly disclose any indirect association with any party – State, investor or other tribunalists – in the case; and a judicial process for removal of tribunalists for conflicts and qualifications.

While the CETA text states that tribunalists shall "not be affiliated with or take instructions from any disputing party or the government of a Party with regard to trade and investment matters," it does not bar selection of arbitrators affiliated with the foreign investor in ways unrelated to trade and investment matters. Nor would it appear to prevent the appointment of arbitrators who are no longer formally affiliated with a disputing party, but who used to be affiliated (even in a capacity related to trade and investment matters). Thus, the text would appear not to bar the disputing firm from selecting as a tribunalist its own former employee, its current Board member (so long as she was not responsible for trade and investment matters) or its close (but not trade-related) business partner. The text should be revised to close these loopholes.

Such appointments would ostensibly violate, however, the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration, which are invoked by the CETA text and which define a conflict of interest as one in which "a reasonable and informed third party would reach the conclusion that there was a likelihood that the arbitrator may be influenced by factors other than the merits of the case."[19] The relevant

question though is how, under the CETA reference text, arbitrators could be removed after the identification of such conflicts of interest.

Though the CETA text stipulates that a party in the dispute can contest the other party's arbitrator selection as a violation of conflict-of-interest rules, the contested tribunalist would not be removed unless the other party agrees, the arbiter removes herself, or the Secretary General of the International Centre for Settlement of Investment Disputes (ICSID) decides she should be removed. The first scenario seems unlikely – a party should not be expected to dismiss the arbiter they had picked, particularly if that person's conflict-of-interest bends in their favour. The second scenario has rarely played out – challenged arbitrators in investor-state cases have generally not proven willing to leave the arbitration on their own volition.

The third scenario, delegating the decision over challenged arbitrators to the Secretary General of ICSID, does not inspire confidence that conflict-of-interest rules will be effectively enforced. Though the ICSID Convention contains a rule against conflicts of interest,[20] only four attempts to disqualify arbitrators have ever been successful in ICSID's 50-year history, while 37 attempts have failed.[21] While the CETA conflict-of-interest language is stronger than that of ICSID, by delegating the ultimate decision over challenged arbitrators to the Secretary General of ICSID rather than an independent judge, it is not clear that we should expect a change from ICSID's pattern of failed attempts to remove compromised arbitrators. Further, the reference text grants wide discretion to the Secretary General to make a unilateral decision – the rules neither stipulate criteria that shall guide the Secretary General's decision nor require disclosure of the criteria actually used.

As a more sensible and effective means of determining whether contested tribunalists are unbiased (and of removing those that are not), a judicial process should be established to adjudicate challenges to tribunalists' impartiality. Such a process would establish a clear, public set of decisionmaking criteria, require judges to enforce that criteria and require disclosure of the rationale behind each decision. Using such a process would avoid relying on the consent of parties who are inherently not inclined to give their consent for removal of a tribunalist (e.g. the party that picked the tribunalist or the tribunalist herself). And it would afford greater predictability and accountability than the CETA text's proposal to empower the Secretary General of ICSID to issue decisions as she/he sees fit.

And while the CETA proposal to have the Committee on Services and Investment create a code of conduct for arbitrators represents an iterative improvement over past FTAs and BITs, it is not clear how effective the proposal would be. First, the development of the code depends on the agreement of both Parties, which "shall make best efforts" to create a code within two years of the agreement's implementation. This aspirational language allows for the possibility that creation of a code of conduct could be long (or indefinitely) delayed. Assuming the code is actually created, its prospective contents remain unknown – the text only states that it "may address topics" such as disclosure, independence and confidentiality. Assuming that the code is developed with robust rules against conflicts of interest on tribunals, it is not clear what mechanism, if any, would ensure enforcement of the code. If developed as a set of hortatory guidelines rather than binding rules, the code would be ill-equipped to rein in the bias of tribunalists.

Question 9: Reducing the risk of frivolous and unfounded cases

The attempt to limit the expenditure of State resources on claims that are frivolous or legally unfounded is a welcome one. However, the CETA reference provisions are not likely to have prevented the recent surge in investor-state challenges to public interest policies, nor tribunals' decisions against many of these policies, given that most of the claims could not have been accurately described as "manifestly without legal merit" or "unfounded as a matter of law."

The problem is that many investor-state claims do in fact fall within the wide ambit of investor rights enshrined in most FTAs and BITs. The increase in investor-state claims owes not to the ability of investors to pursue claims outside of investor-state protections, but their ability to pursue an increasingly broad array of claims that are indeed covered by those protections. This is due to existing treaties' expansive definitions of "investment" and "investor," the vague substantive rights granted to investors, and the ample discretion of ISDS tribunals to interpret those definitions and rights ever more broadly. To avoid exposing domestic laws and government decisions to this expanding liability, TTIP should exclude ISDS while narrowing substantive investor rights and definitions of "investment" and "investor." Until States' wide obligations to investors are reined in, language to prevent "frivolous" claims not falling under those obligations will have limited impact in preventing challenges and rulings against public interest measures.

Question 10: Allowing claims to proceed (filter)

If ISDS were to be included in TAFTA, the CETA text's addition of a filter in which regulators from both Parties may offer binding judgments on whether claims should be dropped for prudential reasons marks a significant improvement over standard U.S. and EU pacts that contain no such provision. It would be critical that this filter step take place early in the investor-state process so that resources are not needlessly expended in cases where claims are dismissed for prudential reasons.

While this would be a welcome addition, a more effective means of filtering out undeserving claims would be to use an ex-ante regulatory and diplomatic screen. Under such a provision, investors would be required, before mounting an investor-state claim, to present their case to a panel of regulators and other officials from their own government. The panel would determine whether to allow the claim to proceed as an investor-state challenge to the other Party's measures. Such panels would help diminish the extent to which investor-state proceedings impinge on governments' right to regulate. Regulators in the investor's home country would have the incentive to not allow cases to proceed if they were likely to infringe on the other government's regulatory prerogatives, given a desire to not have to respond to similarly overreaching cases from the other country's investors. (The presence of foreign affairs officials on these screening panels would further help in vetting the merits of prospective investor-state cases, as they would be hesitant to incur the diplomatic costs of investor-state challenges launched against other governments if the claims were particularly spurious.) In addition, establishing this screen before the launch of a new investor-state case (as opposed to afterwards, as in the CETA filter provision) would

prevent both parties from expending money for tribunal costs and legal fees for claims deemed unfit to proceed.

The benefits in reduced costs and increased regulatory autonomy of this screening process would be amplified if it were not limited to claims affecting prudential financial measures, but instead applied to all investor-state claims. (Regulators serving on the screening panel would be selected based on the type of regulation at issue in the claim.) If ISDS is included, the EC should consider developing an ex-ante regulatory and diplomatic screening process for all ISDS claims in place of the CETA filter mechanism, providing a more effective check on unwarranted investor-state challenges.

If, instead, the CETA filter language is kept (and ISDS is included), then the EC should expand the range of measures covered to those beyond financial regulations. The Parties could use such a filter, for example, to examine cases in which the general exception (hopefully a strengthened version of it) is invoked as a defence for challenged environmental, health and other public interest measures. A regulatory check would be just as important in such cases as in those implicating financial stability.

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

Were ISDS to be included in TTIP, non-disputing Parties in investor-state cases should indeed have the opportunity to inform tribunals how they believe the investor rights and other provisions of the pact should be interpreted, as provided for in the CETA reference text. However, recent investor-state cases have shown that when not forced to heed such governmental input, tribunals have few qualms with ignoring it. For example, in the *RDC v. Guatemala* case brought under CAFTA, as mentioned above, three sovereign governments submitted comments to the tribunal as non-disputing Parties (in addition to Guatemala's submission). Each argued that the substantive investor right at issue – "fair and equitable treatment" – should be interpreted narrowly as derived from State practice. But the tribunal simply rejected this input from the States, asserting that the States were in error in their interpretation of customary international law, and instead imported a much broader interpretation of "fair and equitable treatment" from another investor-state tribunal's award.[22]

The most effective way to rein in such runaway tribunal interpretations would be to exclude ISDS from TTIP. The CETA provision intends to limit tribunal discretion by allowing the Parties to the agreement to provide a new interpretation of the pact's terms. However, while the CETA text states that such an interpretation would be "binding" on tribunals, it is unclear what enforcement mechanism would make the revised terms any more "binding" than the original terms that failed to bind the tribunal. That is, if the Parties feel the need to provide a reinterpretation of the pact's provisions because of "serious concerns as regards matters of interpretation," as provided for in the CETA text, then it is likely that those concerns were sparked by tribunal interpretations that overstepped the intended bounds of the original written terms. What then would keep tribunals from simply overstepping the newly-defined bounds?

Indeed, in the *RDC v. Guatemala* case, the Parties to CAFTA had included an annex in the pact that tried to narrow the "fair and equitable treatment" obligation, given serious concerns that tribunals had been interpreting the provision too broadly. The insertion of that annex did not stop the *RDC* tribunal from once again using a broader interpretation, paying little heed to the added language.[23]

The proven difficulty in limiting tribunals' ability to defy the opinions of States and the revisions of a pact's terms indicate once again the fundamental dangers of ISDS. While some textual reforms, such as narrowing the scope of covered "investments" and narrowing substantive investor rights, could help somewhat in reining in the wide discretion of tribunals, they are unlikely to foreclose tribunals' overreaching rulings against public interest policies. To more effectively preserve the right to regulate, ISDS should be replaced with state-to-state dispute settlement, as discussed above. Barring this change, requiring domestic exhaustion and establishing an effective appeal mechanism would be perhaps the best means of curtailing tribunals' threats to regulatory autonomy.

Question 12: Appellate Mechanism and consistency of rulings

As explained throughout this response, ISDS should be replaced with state-to-state enforcement. But if ISDS would be included in TTIP despite likely costs to consumers, the environment, taxpayers and the rule of law, a robust appellate mechanism would provide one of the better hopes of tempering the expansive decisions of tribunals that threaten the right to regulate. To be effective, it would be critical that the mechanism allow appeals on the legal merits of the tribunal's decisions, not merely attempts to correct factual errors or to contest major procedural miscarriages (as provided for in the extremely limited annulment mechanism).

It also would be critical that the appeals mechanism be established by the pact itself, rather than being included as language promising the future creation of such a mechanism. Certainly the non-binding language from the CETA text would be insufficient. That text does not even require the future creation of an appellate mechanism, but only requires a "forum" for the EU and U.S. governments to consult on the question of whether to create such a mechanism.

But even when pacts have included binding language to create an ISDS appellate mechanism in the future, the promised mechanism has failed to materialize. For example, CAFTA stated, "Within three months of the date of entry into force of this Agreement, the Commission shall establish a Negotiating Group to develop an appellate body or similar mechanism to review awards rendered by tribunals under this Chapter…The Commission shall direct the Negotiating Group to provide to the Commission, within one year of establishment of the Negotiating Group, a draft amendment to the Agreement that establishes an appellate body or similar mechanism."[24] Nearly eight years have passed since CAFTA took effect in most participating countries, and no such amendment has been produced. In order for an appeals process to become a reality under TTIP, it would need to be created by TTIP itself.

ENDNOTES

1 *Tokios Tokelés v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (April 29, 2004), at para. 56.

2 *See* Public Citizen, "Replicating the WTO Exception Construct Will Not Provide for an Effective TPP General Exception," PC memo, 2014. Available at: https://www.citizen.org/documents/general-exception.pdf.

3 *See* Lori Wallach, "Fair and Equitable Treatment" and Investors' Reasonable Expectations: Rulings in U.S. FTAs & BITs Demonstrate FET Definition Must be Narrowed," Public Citizen memo, September 5, 2012. Available at: http://www.citizen.org/documents/MST-Memo.pdf.

4 The U.S. government attempted to make clear the narrowness of the "fair and equitable treatment" standard in its official submission in the RDC case, stating, "These provisions [in the CAFTA annex] demonstrate the CAFTA-DR Parties' express intent to incorporate the minimum standard of treatment required by customary international law as the standard for treatment in CAFTA-DR Article 10.5. Furthermore, they express an intent to guide the interpretation of that Article by the Parties' understanding of customary international law, i.e., the law that develops from the practice and *opinio juris* of States themselves, rather than by interpretations of similar but differently worded treaty provisions. The burden is on the claimant to establish the existence and applicability of a relevant obligation under customary international law that meets these requirements." Railroad Development Corporation v. Republic of Guatemala, ICSID Case No. ARB/07/23, Submission of the United States of America (January 31, 2012), at para. 3. Available at: http://italaw.com/sites/default/files/case-documents/ita0709_0.pdf.

5 *See* Lori Wallach and Ben Beachy, "CAFTA Investor-State Ruling: Annex on Minimum Standard of Treatment, Proposed for TPP, Proves Insufficient as Tribunal Ignores Customary International Law Standard, Applies MST Definition from Past NAFTA Award to Rule against Guatemala," PC memo, July 19, 2012. Available at: http://www.citizen.org/documents/RDC-vs-Guatemala-Memo.pdf. And *see* Lori Wallach and Ben Beachy, "Rebutting Misleading Claims Made by Industry with Respect to RDC v. Guatemala Award: CAFTA Tribunal Rejected CAFTA Parties' and CAFTA Annex 10-B's Definition of CIL Based on State Practice, Imported Past Tribunal's MST Standard," PC memo, November 17, 2012. Available at: http://www.citizen.org/documents/rdc-v-guatemala-rebuttal.pdf.

6 *S.D. Myers, Inc. v. Government of Canada*, Second Partial Award, Ad hoc—UNCITRAL Arbitration Rules (2002), at para.263.

7 For more information, *see* Public Citizen, "Table of Foreign Investor-State Cases and Claims under NAFTA and Other U.S. 'Trade' Deals," PC chart, February 2014. Available at: http://www.citizen.org/documents/investor-state-chart.pdf.

8 *See* Eduardo Moisès Peñalver, Is Land Special? 31 Ecology L.Q. 227, 231 (2004) ("it is almost beyond dispute that . . . the [Supreme] Court has focused overwhelmingly on regulations affecting land and that landowners bringing regulatory takings claims stand a greater chance of prevailing in the Supreme Court than the owners of other sorts of property"); Molly S. McUsic, The Ghost of Lochner: Modern Takings Doctrine and Its Impact on Economic Legislation, 76 B.U. L. Rev. 605, 647, 655 (1996) ("Economic interests, such as personal property, trade secrets, copyright, and money, are all recognized by the Court as 'property' under the Fifth Amendment, but receive little protection against government regulation.") J. Peter Byrne, Ten Arguments for the Abolition of Regulatory Takings Doctrine, 22 Ecology L.Q. 89, 127 (1995) ("the Supreme Court has shown absolutely no interest in applying the regulatory takings doctrine to assets other than land").

9 *See* A.J. Van der Walt, Constitutional Property Clauses: A Comparative Analysis (1999) at 17 ("the distinction between police-power regulation of property and eminent-domain expropriation of property is fundamental to all [constitutional] property clauses, because only the latter is compensated as a rule. Normally, the will be no provision for compensation for deprivations or losses caused by police-power regulation of property.") United States law is an exception in this regard, and under certain circumstances – most notably in the "rare circumstance" when a regulatory measure destroys all value of real property – requires compensation even when there has been no appropriation of the property by the government. See Lucas v. South Carolina Coastal Comm'n, 505 U.S. 1003 (1992).

10 International Monetary Fund, "The Liberalization and Management of Capital Flows: An Institutional View," November 14, 2012. Available at: http://www.imf.org/external/np/pp/eng/2012/111412.pdf.

11 Global Development and Environment Institute, "Economists Issue Statement on Capital Controls and Trade Treaties," January 31, 2011. Available at: http://www.ase.tufts.edu/gdae/policy_research/CapCtrlsLetter.html.

12 *See* Lori Wallach and Ben Beachy, "Occidental v. Ecuador Award Spotlights Perils of Investor-State System: Tribunal Fabricated a Proportionality Test to Further Extend the FET Obligation and Used "Egregious" Damages Logic to Hit Ecuador with $2.4 Billion Penalty in Largest Ever ICSID Award," PC memo, November 21, 2012. Available at: http://www.citizen.org/documents/oxy-v-ecuador-memo.pdf.

13 UNCITRAL, "Rules on Transparency in Treaty-based Investor-State Arbitration," United Nations, 2014. Available at: http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf.

14 Interhandel Case (Switz. v. U.S.), 1959 I.C.J. Rep. 5, 27 (Mar. 21).

15 *See*, e.g., El Oro Mining and Railway Co. Case (Gr. Brit. v. Mex.), 5 Int'l Arb. Awards 191, 198 (Perm. Ct. Arb. 1931).

16 *See*, e.g., Panevezys-Saldutiskis Railway (Est. v. Lith.), 1939 P.C.I.J. (ser. A/B) No. 76, at 18 (Feb. 28) ("There can be no need to resort to the municipal courts if those courts have no jurisdiction to afford relief . . .") See also generally The Finnish Ships Case (Finland v. U.K.), 3 R. Int'l Arb. Awards 1484 (1934) (domestic judicial appeal not required where it would not afford a basis for reversing determination of British Admiralty Transport Arbitration Board that the British government had not requisitioned certain Finnish ships).

17 Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy), 1989 I.C.J. 15, 45-46 (July 20) (exhaustion requirement satisfied where "the substance of the claim" brought in domestic court "is essentially the same" as the international claim).

18 Pia Eberhardt and Cecilia Olivet, "Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom," Corporate Europe Observatory and the Transnational Institute, November 2012, at 38. Available at: http://www.tni.org/sites/www.tni.org/files/download/profitingfrominjustice.pdf.

19 International Bar Association, "IBA Guidelines on Conflicts of Interest in International Arbitration," May 22, 2004, at 8. Available at: http://www.ibanet.org/Document/Default.aspx?DocumentUid=e2fe5e72-eb14-4bba-b10d-d33dafee8918.

20 ICSID, "ICSID Convention, Regulations and Rules," April 2006, at Art. 14. https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf.

21 Luke Eric Peterson, "Analysis: The Scope for ICSID Arbitrators to Agree to Hand on to ICSID the Task of Resolving Challenges to Colleagues," Investment Arbitration Reporter, March 18, 2014. Available at: http://www.iareporter.com/articles/20140319_1.

22 For more information, *see* Lori Wallach and Ben Beachy, "CAFTA Investor-State Ruling: Annex on Minimum Standard of Treatment, Proposed for TPP, Proves Insufficient as Tribunal Ignores Customary International Law Standard, Applies MST Definition from Past NAFTA Award to Rule against Guatemala," Public Citizen memo, July 19, 2012. Available at: http://www.citizen.org/documents/RDC-vs-Guatemala-Memo.pdf.

23 For more information, *see* Lori Wallach and Ben Beachy, "Rebutting Misleading Claims Made by Industry with Respect to RDC v. Guatemala Award: CAFTA Tribunal Rejected CAFTA Parties' and CAFTA Annex 10-B's Definition

of CIL Based on State Practice, Imported Past Tribunal's MST Standard," Public Citizen memo, November 17, 2012. Available at: http://www.citizen.org/documents/rdc-v-guatemala-rebuttal.pdf.

24 The Dominican Republic – Central America – United States Free Trade Agreement, ch. 10, Annex 10-F, August 5, 2004, 43 I.L.M. 514. Available at: http://www.ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf.