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## Human rights compatibility of investor–State arbitration in international investment protection agreements

### Report<sup>1</sup>

Committee on Legal Affairs and Human Rights

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### Summary

Investor–State dispute settlement (ISDS) clauses in international investment agreements or bilateral investment treaties allow foreign investors to sue host States before private arbitration panels. ISDS has serious implications for human rights, the rule of law, democracy and national sovereignty. It raises issues as to fair trial, transparency, equal access to a tribunal, prohibition of discrimination and legal certainty, and the threat of litigation could result in “regulatory chill”.

The right to the protection of property also applies to foreign investors. Effective protection of foreign investments encourages long-term, sustainable investments which promote economic growth and create jobs.

The Investment Court System (ICS) proposed by the European Commission aims to correct the flaws of traditional ISDS mechanisms without leaving the protection of foreign investors exclusively to the courts of the host States.

The Committee on Legal Affairs and Human Rights therefore considers replacing ISDS clauses by a permanent, multilateral ICS as a reasonable compromise between the status quo consisting of multiple ISDS mechanisms and the full re-nationalisation of investment protection, and encourages its implementation by all interested parties, under certain conditions.

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1. Reference to committee: [Doc.13691](#), Reference 4115 of 6 March 2015.



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## A. Draft resolution<sup>2</sup>

1. The Parliamentary Assembly notes that investor–State dispute settlement (ISDS) clauses in international investment agreements or bilateral investment treaties allow foreign investors to sue host States before private arbitration panels set up by the parties whenever a dispute on the application of an international investment agreement arises. It stresses that ISDS has serious implications for human rights, the rule of law, democracy and national sovereignty, which the proposed Investment Court System (ICS) is intended to address:

1.1. ISDS/ICS raises issues regarding fair trial, transparency, equal access to a tribunal, prohibition of discrimination and legal certainty under Articles 6 and 14 of the European Convention on Human Rights (ETS No. 5, “the Convention”) and its Protocol No. 12 (ETS No. 177);

1.2. the threat of litigation before non-State dispute settlement mechanisms could discourage governments from taking necessary regulatory measures to uphold the rights of their citizens against foreign multinational companies, for example by strengthening the protection of the environment and social rights (“regulatory chill”);

1.3. democracy and national sovereignty are called into question when States are prevented by agreements concluded by previous governments from adapting their legislation and practice to changes in the factual situation or in political priorities.

2. The right to the protection of property (Article 1 of Protocol No. 1 to the Convention (ETS No. 9)) also applies to foreigners, including legal persons. Foreign investors can therefore not be denied legal protection on the pretext that they can take into account the risk of expropriation and other political risks in their investment and pricing decisions or that they merely exploit the host States.

3. The Assembly considers that effective protection of foreign investments encourages long-term, sustainable investments which promote economic growth and create jobs. This requires reliable, efficient and neutral dispute resolution mechanisms. The lack of effective legal protection for investments encourages short-term profit maximisation and informal self-protection strategies, including bribery and other forms of interference in the political process in the host countries.

4. It recognises that small and medium-sized businesses needing to defend themselves against discriminatory treatment by host States are at a disadvantage as they do not have a large company’s political clout in order to secure bilateral diplomatic protection by their home States.

5. The Assembly notes that:

5.1. European States have concluded thousands of international investment agreements/bilateral investment treaties with ISDS clauses with third countries and among themselves;

5.2. investment arbitration tribunals usually consist of one arbitrator selected by each party to the dispute and a third agreed on by the first two. Arbitrators are often drawn from business circles or specialised law offices. The parties’ submissions and the final rulings often remain confidential, which reduces the predictability of outcomes;

5.3. arbitration proceedings following the rules developed by the World Bank’s International Center for the Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC) have undergone a number of reforms aimed at, in particular, increasing transparency and the possibilities for third party intervention;

5.4. national courts dealing with investment disputes have been accused of bias against foreign investors, being generally reluctant to implement international agreements or too slow and inefficient for the purposes of international business transactions.

6. The Assembly further notes that:

6.1. the Investment Court System proposed by the European Commission is intended to correct the flaws of traditional ISDS mechanisms without entrusting the protection of foreign investors exclusively to the courts of host States. It would consist of a permanent first instance court and appeals court

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2. Draft resolution adopted unanimously by the committee on 13 December 2016.

staffed by judges appointed by participating States. The proposed ICS would follow transparent procedures, allow third-party interventions by representatives of civil society as a matter of right and be subjected to binding interpretations of the underlying agreement laid down by the States Parties;

6.2. proponents of ISDS fear that the future ICS will be too much under the influence of States and their interests, to the detriment of investors. Opponents of ISDS are dissatisfied with the fact that the proposed ICS would still grant foreign investors, as opposed to domestic ones, privileged access to a legal remedy outside the institutional framework of the host State.

7. In view of the above, the Assembly considers that replacing ISDS clauses by a permanent, multilateral ICS would be a reasonable compromise between the status quo, consisting of multiple ISDS mechanisms, and the full re-nationalisation of investment protection. It would eliminate the most important drawbacks of the existing ISDS mechanisms whilst ensuring that foreign investments, especially those by small and medium-sized companies, continue to enjoy adequate legal protection at the international level.

8. Investment protection is often included in bilateral trade and investment agreements. States can terminate the agreement if it no longer corresponds to their political objectives. In such a case, existing investments continue to benefit from protection for a transitional period. European Union member States are effectively prevented from exercising this option as such agreements are now concluded by the European Union. The Assembly considers that ways and means should be explored to enable European Union member States to choose whether or not to participate in investment protection agreements, for example by including investment protection rules in an optional protocol.

9. The Assembly therefore calls on the European Union to actively pursue, in their ongoing and future negotiations of international investment agreements, including the Transatlantic Trade and Investment Partnership (TTIP), the establishment of an ICS to gradually replace traditional ISDS mechanisms. It welcomes the inclusion of the ICS in the recently signed Comprehensive Economic and Trade Agreement (CETA) with Canada. The future ICS should be in line with human rights and the rule of law, and should in particular:

9.1. follow fair and transparent procedures, in line with Article 6 of the European Convention on Human Rights. In particular, the procedures should ensure that both sides of the dispute and any third parties having a legitimate interest are heard, that the parties' submissions and the holdings of the Court are made public and that the judges are impartial and independent;

9.2. apply the international investment agreement underlying each dispute in such a way as to avoid undue interference with the States' right to regulate. States should remain free to regulate economic activity in order to protect the environment, public health and safety and such human rights as the freedoms of association, expression and information, as well as the right to privacy, without discrimination between domestic or foreign companies;

9.3. duly take into account the States' obligations deriving from the Convention, in particular as regards the case law of the European Court of Human Rights on the distinction between the deprivation of possessions and the control of the use of property (Article 1 of Protocol No. 1 to the Convention);

9.4. interpret typical features of such international investment agreements as "fair and equal treatment" and "stabilisation" clauses and the protection of "legitimate expectations" in such a way that the State's right to regulate is not undercut; the interpretation of such clauses should encourage the use by prospective investors and States negotiating investment agreements of due diligence tools such as environmental and human rights impact assessments.

10. The Assembly calls on the member States of the Council of Europe to:

10.1. take an active part in the creation of an ICS and ensure that the above human rights and rule of law considerations are fully taken into account and that the final judgments of the ICS are promptly and fully implemented at the national level;

10.2. improve, if need be, their national courts' efficiency and actual and perceived impartiality in such a way as to encourage foreign investors to make use of them more frequently;

10.3. ensure that in existing ISDS cases, filings of notices, briefs, decisions and settlements are always public and available in an online repository;

10.4. lay down strict criteria on the domiciliation of foreign investors to determine their eligibility for ISDS/ICS remedies, in order to prevent "treaty shopping";

10.5. review all ISDS clauses in international investment agreements that they have entered into, assess their appropriateness and bring them into line with the best practices foreseen for the future ICS.

## B. Explanatory memorandum by Mr Pieter Omtzigt, rapporteur

### 1. Introduction: what is at stake in this debate?

1. The title of the motion underlying this rapporteur mandate sounds highly technical. But the issue at stake is in fact a highly political one. It gives rise to polemic, ideologically charged debates, in particular in the context of the negotiation process on the Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States and the Comprehensive Economic and Trade Agreement (CETA) between the European Union and Canada. For the opponents of TTIP and CETA, the proposed Investor–State Dispute Settlement (ISDS) clause (now: Investment Court System (ICS)) has been one of the most controversial issues. Others stress the opportunities for growth and job creation provided by TTIP and CETA in general and investment protection (including ISDS/ICS) in particular, from a market-liberal economic perspective.

2. The dramatic debates in the European Parliament and its relevant committees on a motion for a resolution aimed at giving guidance to the European Commission for the ongoing negotiations with the United States<sup>3</sup> shows how much is at stake. The vote in the European Parliament plenary was postponed at short notice in view of persisting strong disagreements, not least concerning ISDS.<sup>4</sup> Another indication for the size of the stakes is the overwhelming response to the European Commission's public call for submissions from civil society: more than 150 000 submissions were made, many of which represent powerful trade unions, business associations and non-governmental organisations (NGOs).<sup>5</sup> Most recently, the signature of CETA by Canadian Prime Minister Trudeau and the representatives of the European Union had to be postponed in dramatic circumstances because the leader of the Belgian region of Wallonia refused to authorise the central government to agree to the signature, not least because of objections to the ISDS/ICS clause included in CETA.<sup>6</sup>

3. In my view, and clearly also in that of the movers of the new motion on “Investor protection and human rights”<sup>7</sup> which I have been invited to take into account in this report, ISDS/ICS raises serious questions concerning the impact of these mechanisms on human rights (including social rights) and on the rule of law, which are the Council of Europe's core values. ISDS/ICS raises procedural concerns (Article 6 of the European Convention on Human Rights (ETS No. 5, “the Convention”)) such as the alleged lack of transparency, doubts about the impartiality of arbitrators and possible conflicts of interest. These mechanisms also raise substantive legal concerns. One of them is the risk of “regulatory chill”, when democratically elected governments fearing being sued before non-State tribunals empowered to award high amounts of damages against them may hesitate to take necessary regulatory measures to protect the environment, workers' rights or (other) human rights such as freedom of association, expression, information and the right to privacy. Another substantive concern is that for democracy and national sovereignty, when States are prevented by agreements entered into by previous governments from adapting their legislation and practice to changes in the factual situation or in political priorities.

4. This said, the protection of property is also a human right, protected in Article 1 of Protocol No. 1 to the Convention (ETS No. 177), and this right also applies to foreigners, including legal persons (corporations). In my view it is therefore inadmissible to argue, as did Mr Alfred de Zayas during the hearing at the committee meeting on 19 April 2016,<sup>8</sup> that foreign investors do not deserve or require legal protection because they merely exploit the host States and are free to take into account the risk of expropriation and other political risks in their investment and pricing decisions.

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3. European Parliament 2014-2019, Plenary sitting RR\1063482EN.doc PE549.135v02-00.

EN A8-0175/2015 dated 1 June 2015, [Report containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership \(TTIP\) \(2014/2228\(INI\)\)](#), Committee on International Trade, Rapporteur: Bernd Lange.

4. European Parliament Liaison Office with US Congress, Newsletter, TTIP vote in European Parliament postponed, 16 June 2015.

5. [European Commission document SWD\(2015\) 3 final \(13 January 2015\), Commission Staff Working Document, Report, Online public consultation on investment protection and investor-to-State dispute settlement \(ISDS\) in the Transatlantic Trade and Investment Partnership Agreement \(TTIP\)](#).

6. [http://ec.europa.eu/news/2016/10/20161030\\_en.htm](http://ec.europa.eu/news/2016/10/20161030_en.htm).

7. On 14 October 2016, the Bureau invited the committee to take into account in the preparation of the current report the motion for a resolution on “Investor protection and human rights” (Doc. 14109).

8. The text of his statement is available from the Secretariat. See also Report of the Independent Expert on the promotion of a democratic and equitable international order, Alfred-Maurice de Zayas, UNGA document A/HRC/30/44, 14 July 2015.

5. The political core issue is the balancing of interests between (foreign) investors and the host State and its stakeholders. In actual fact, these interests are not as far apart as the heated discussions in the public fore suggest. Investors need stability and predictability of the conditions determining whether the planned investment will be financially viable, whilst governments of host States want to remain free to adopt and enforce any regulations they deem in the public interest in areas such as the protection of the environment, labour rights, social protection etc., also vis-à-vis foreign companies. But governments also need to attract long-term foreign investments in order to promote sustainable economic growth, job creation and transfers of technology. Such investments will fail to materialise if the conditions investors require are not met. In unstable conditions, the only investments made will be “hit-and-run” operations where investors try to extract very high profits from a speculative investment during a short period of time for which they can foresee being safe from expropriation or destructive regulation. Also, in the absence of effective formal protection mechanisms, informal self-protection strategies are likely to spread, including bribery and other forms of interference in the political process in the host countries. So, really, it is in (almost) everyone’s interest that investment conditions are stable in the long term and that their evolution remains predictable.

6. The protection of foreign investments is thus not only required by the European Convention on Human Rights, but it also makes economic sense. Effective protection of foreign investments encourages long-term, sustainable investments which promote economic growth and create jobs. This requires reliable, efficient and neutral dispute resolution mechanisms, which also contribute to levelling the playing field between large corporations and small and medium-sized businesses. These need investment protection mechanisms most urgently as they do not have the political clout needed to secure bilateral diplomatic protection by their home State, nor the resources to engage in informal self-protection strategies in the host State.

7. In this report, I will take a closer look at the advantages and drawbacks of ISDS mechanisms on the one hand and purely national remedies on the other. In assessing the concerns raised by ISDS, care must be taken to distinguish those problems which could really be caused by international arbitration mechanisms taking the place of national judicial remedies from those which result from the tenor of the substantive clauses of the investment protection treaty. As a matter of fairness and legal certainty, which is also part of the rule of law, if States make unreasonable promises in order to attract foreign investments, they should not enter into, or change such clauses and not count on making them inoperable because of the expected “national bias” of the State courts. As we will see, the proposed ICS may well turn out to be a valid compromise solution which can avoid most, if not all, the drawbacks of the two other options.

## 2. Current status of ISDS

8. ISDS clauses allow foreign investors to sue the host State before ad hoc tribunals set up by the parties to the agreement whenever a dispute on the application of the investment agreement arises. European States have concluded thousands of international investment agreements (IIAs)/bilateral investment treaties (BITs) with ISDS clauses with third countries and among themselves. ISDS is an almost-universal feature of the 3 268 IIAs in force as of 2014.<sup>9</sup> Whilst several States, in particular in Latin America, have denounced ISDS clauses, in particular following high-profile cases that went against them, a number of Western countries have concluded IIAs without ISDS, for instance:

- two free trade agreements by Australia immediately following an adverse ISDS ruling against Australia; but Australia has subsequently reverted to including ISDS in its investment agreements;<sup>10</sup>
- the EU–Ukraine Association Agreement; but this agreement anticipates adding investment protection at a later stage.

9. The European Union as a distinct entity only gained competence over investment agreements when the Treaty of Lisbon entered into force on 1 December 2009 (see below),<sup>11</sup> which is why its only agreements so far are with Ukraine and Canada (see below). None of the European Union’s agreements so far include standard ISDS clauses. However, EU member States have included ISDS clauses in 1 365 IIAs with non-EU States, plus about 190 among themselves.<sup>12</sup>

9. [IIA Issues Note](#), United Nations Conference on Trade and Development (UNCTAD), February 2015.

10. [China-Australia Free Trade Agreement, Fact-sheet Investor-State Dispute Settlement](#), 7 January 2016.

11. [Treaty of Lisbon enters into force – Implications for the EU’s trade policy](#), European Commission – Trade, 1 December 2009.

12. Elvire Fabry and Giorgio Garbasso, “ISDS in the TTIP: The Devil is in the Details”, Notre Europe, Jacques Delors Institute Policy Paper 122, 16 January 2015 (p. 9).

10. Although most treaty disputes are resolved bilaterally, between States, IIAs provide remedies to private investors who may be unable to enlist their home State's diplomatic apparatus in support. The creation of a neutral, efficient dispute settlement mechanism is intended to encourage foreign direct investment by reassuring investors who worry that the host State's courts may be biased against them or process their claim inefficiently.

11. IIAs differ in many aspects, although the investor and the respondent State are usually invited to select one arbitrator each, with a third chosen by agreement between the two. Otherwise, procedural rules vary widely though the World Bank's International Center for the Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC)'s rules on arbitration have set standards that are widely used in practice.

12. By 2014,<sup>13</sup> 608 ISDS claims were known to have been filed,<sup>14</sup> and 356 had been resolved. Of those arbitrations, 37% ruled for the State, 28% were settled, and 27% ruled for the investor (only 25% awarding monetary damages). As claims generate legal costs of US\$8 million on average,<sup>15</sup> it is likely that only the strongest claims enter the system at all.<sup>16</sup>

13. By 2014, 40% of claims were filed against developed States, continuing a trend of increasing claims against them. 80% of investors filing claims were from developed States (64% from the European Union). Many of these investors are multi-national companies, which are most frequently based in developed States.

14. ISDS opponents point out that developing countries are nonetheless most vulnerable to frivolous ISDS claims as they may be obliged to agree to expensive settlements in order to avoid litigation costs they cannot afford. NGOs such as the Corporate Europe Observatory<sup>17</sup> point out that industry insiders first lobby governments to enter into IIAs with unclear, overly broad investment protection provisions and ISDS clauses and then push investors to file numerous claims from which the same people benefit in turn as highly paid lawyers or arbitrators.

### 3. Rule of law and human rights concerns raised by ISDS

15. As indicated above (paragraph 3), concerns about ISDS include procedural and substantive issues. Regarding procedure, ISDS is considered as lacking transparency and, linked to this, predictability of outcomes. Arbitrators, typically industry insiders or lawyers recruited from a small circle of specialised firms, are considered as biased in favour of investors and lacking sensitivity with regard to the public interest of the host State, whose democratically legitimate political decisions they tend to set aside too readily.<sup>18</sup> Regarding substantive issues, opponents of ISDS point to the "regulatory chill" resulting from the threat of high damages awards based on overly broad interpretations of different types of investment protection clauses. The following reflections are based on the European Convention on Human Rights as interpreted by the European Court of Human Rights ("the Court").

#### 3.1. Rule of law issues raised by ISDS

16. The concept of the rule of law includes, *inter alia*, the right to a fair trial (Article 6 of the Convention), which in turn requires that disputes are resolved transparently, by an "independent and impartial tribunal". The rule of law also requires a minimum of legal certainty and predictability of outcomes and the respect of equality before the law, also in terms of access to justice. All of these issues come into play in the assessment of ISDS.

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13. ISDS claim statistics, unless indicated otherwise, are from UNCTAD's [IIA Issues Note](#) from February 2015.

14. Because some IIAs do not require publicity for claims or decisions, more have likely been filed and resolved.

15. David Gaukrodger and Kathryn Gordon, [Investor-State Dispute Settlement](#), OECD Publishing (2012) (see p. 58).

16. [Using Investor-State Mediation Rules to Promote Conflict Management: An Introductory Guide](#), Susan D. Franck, Washington & Lee Public Legal Studies Research Paper Series, 2 February 2014 (see p. 58).

17. "Profiting from injustice – How law firms, arbitrators and financiers are fuelling an investment arbitration boom", Corporate Europe Observatory and The Transnational Institute, Brussels, 2012.

18. See, for example, Joost Pauwelyn, ["Wto Panelists Are From Mars, Icsid Arbitrators Are From Venus – Why? And Does It Matter?"](#), draft of 13 April 2015.

### 3.1.1. Applicability of Article 6 of the Convention (right to a fair trial)

17. The Court has applied Article 6 (right to a fair trial) to civil disputes that mirror the claims brought by investors under ISDS, including refusal of a license (*Bentham v. the Netherlands*),<sup>19</sup> refusal to approve a property-sale contract (*Ringeisen v. Austria*),<sup>20</sup> expropriation of land (*Sporrong and Lönnroth v. Sweden*),<sup>21</sup> and land compensation proceedings (*Lithgow and others v. the United Kingdom*).<sup>22</sup> The specific character of the legislation, the parties' status (any "legal person" is protected, not just natural persons or citizens of the respondent State), and the type of judicial body adjudicating the claims do not matter, only that the body has the authority to settle the dispute (*Ringeisen*). In *Regent Company v. Ukraine*,<sup>23</sup> the Court found that an arbitration tribunal created by a voluntary contract remained subject to Article 6 requirements, and that the voluntary nature of the contract did not constitute a waiver of these rights enshrined in Article 6.

18. Article 6 requires an "independent and impartial tribunal established by law". ISDS tribunals generally seem to meet these three standards. The State's ratification of the underlying IIA establishes the tribunal by law. Since both the investor and the respondent State participate in the selection of arbitrators, these can be expected to be independent of the government and, also based on the process of selection by the parties, could be expected to be impartial. By contrast, foes of ISDS claim that arbitrators (including those appointed by governments) tend to be generally biased in favour of investors, as they are selected from a small pool of industry insiders, in particular high-powered law firms, who have a vested interest in stimulating more such profitable litigation by generously accommodating investors' claims.<sup>24</sup> But others point to empirical studies showing that arbitrators have diverse backgrounds, including as national judges and civil servants.<sup>25</sup>

19. Most Article 6 rights can be waived, but the waiver must be freely entered into, on the basis of adequate information; and it must be unequivocal and not violate public order or an important public interest.<sup>26</sup> The procedure for arbitration is spelled out in IIAs, so the investor is knowledgeable about the process and its limitations. Because investors can as a rule also pursue their claim in the host State's courts (unlike the compulsory arbitration in *Regent Company*), they have valid alternatives and make a free choice to use the ISDS protocol.

### 3.1.2. In particular: ISDS and transparency

20. Transparency of arbitration proceedings is the greatest procedural concern with ISDS tribunals. While the rules laid down in IIAs differ, many do not require any publication of decisions or documents submitted during the proceedings. In some cases it is not even required to notify non-parties that a claim has been filed or is being arbitrated. The International Chamber of Commerce's Arbitration Rules allow a tribunal to make the entire arbitration process confidential "upon the request of any party".<sup>27</sup> Such secrecy can indeed be an obstacle to the protection of Article 6 rights and also stand in the way of developing a "case law" guiding the interpretation of substantive rules, to the detriment of legal certainty and the predictability of outcomes.

21. Under Article 6 of the European Convention on Human Rights, judgments must contain sufficient reasoning to address each party's factual and legal arguments (e.g. *Ruiz Torija v. Spain*).<sup>28</sup> This cannot be verified if the judgment and even the filings and briefs are kept away from the public eye and the courts. According to the European Court of Human Rights, judgments should also be made available to the public (e.g. *Ryakib Biryukov v. Russia*),<sup>29</sup> which is expressly forbidden by the confidentiality agreements in some ISDS proceedings.

22. In response to these valid concerns, there has been a trend towards more transparency in ISDS proceedings. For example, the 2013 version of UNCITRAL's Arbitration Rules that IIAs frequently refer to when defining ISDS procedures, has incorporated a set of "Rules on Transparency" that requires public filing

19. Judgment of 23 October 1985, Application No. 8848/80.

20. Judgment of 16 July 1971, Application No. 2614/65.

21. Judgment of 18 December 1984, Application No. 7151/75.

22. Judgment of 8 July 1968, Applications Nos. 9006/80, 9262/81, 9263/81, 9265/81, 9266/81, 9313/81 and 9405/81.

23. Judgment of 3 April 2008, Application No. 773/03, paragraphs 54-56.

24. "Profiting from injustice", op. cit., pp. 18-33.

25. See reference in note 18; [European Federation for Investment Law and Arbitration \(EFILA\), A response to the criticism against ISDS](#), 17 May 2015, p. 21.

26. See, for example, *Håkansson and Sturesson v. Sweden* (judgment of 21 February 1990, Application No. 11855/85), paragraph 66.

27. Article 22.3, [2014 Arbitration Rules](#), International Chamber of Commerce.

28. Judgment of 9 December 1994, Application No. 18390/91, paragraphs 29-30.

29. Judgment of 17 January 2008, Application No. 14810/02, paragraphs 30-37.

of notices, briefs, and decisions/settlements in an online repository.<sup>30</sup> The Rules declare that “the arbitral tribunal shall ensure that [transparency] objectives prevail”,<sup>31</sup> but nevertheless allows treaties or even arbitrators in individual cases the discretion to permit exceptions.<sup>32</sup> This clearly gives rise to concern. Also, the new rules in principle apply only to IIAs that invoke UNCITRAL’s Arbitration Rules after 1 April 2014 (either being ratified after that date or both parties agreeing after that date to apply the Rules on Transparency). The United Nations Convention on Transparency in Treaty-based Investor–State Arbitration (Mauritius Convention on Transparency), which was opened for signature on 17 March 2015 could and should speed up this process.<sup>33</sup>

### 3.1.3. ISDS as a threat to legal certainty

23. Legal certainty, the principle that those subject to a law must know how to regulate their conduct in order to comply with the law, may also be jeopardised by ISDS. Ad hoc tribunals are still not required to even consider prior decisions, and the above-mentioned transparency problems mean that unpublished or unelaborated/unargued decisions leave future tribunals without any guidance allowing them to rule consistently.

24. The European Court of Human Rights has recently found violations of Article 6 because of “uncertainty – be it legislative, administrative or arising from practices applied by the authorities”.<sup>34</sup> This has been the case whether a single entity produced inconsistent rulings,<sup>35</sup> or different entities within the State persisted in producing irreconcilable rulings (*Ștefănică and others v. Romania*).<sup>36</sup> The current shroud of secrecy over ISDS arbitrations prevents any assessment of whether a State or an investor is treated consistently enough to provide legal certainty.

### 3.1.4. ISDS as a threat to equality before the law and equal access to justice

25. ISDS is a legal remedy that is only available to foreign investors, not local investors, nor States, nor individuals claiming to be victims of the foreign investor’s business activities. Local competitors must content themselves with local courts, though in Europe they can also apply to the European Court of Human Rights if they have exhausted all locally available remedies and consider that their human rights have been violated. Governments (and local citizens) cannot seize ISDS tribunals in order to hold foreign investors to account, for example for the pollution of the environment or the violation of social rights.

26. But such differences in treatment are only discriminatory and therefore violations of the equality principle or the principle of equal access to courts if they are not justified by objective reasons. In this regard, the State has the whole panoply of sovereign prerogatives at its disposal: it can pass laws to promote the public interest and enforce them using all instruments of public power. The State can take unilateral action directly, and it is up to the investor to defend himself if he believes that this action violates any protected rights.

27. By contrast, a local investor is also at the receiving end of the State’s unilateral measures, in the same way as a foreign investor. Why grant his foreign competitor an additional remedy before an international tribunal? This differential treatment is seen by some as an unjustified privilege for foreign investors.<sup>37</sup> It can only be justified if foreign companies are indeed at a disadvantage compared to local investors when it comes to the impartiality of national courts. Numerous examples of “national bias” have been presented by proponents of ISDS. They concern not only the “usual suspects” (developing or other countries with known weaknesses of the justice system), but also developed countries with generally strong courts such as the United States.<sup>38</sup> Such cases are the very reason why industry strongly lobbies in favour of ISDS, including in IIAs between developed countries (such as TTIP and CETA).

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30. [UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration](#), UNCITRAL, January 2014.

31. *Ibid.*, Article 1.6.

32. *Ibid.*, Articles 1.3, 1.7, 7.2(b)-(c), 7.3.

33. Stephan Schill, “The Mauritius Convention on Transparency: A Model for Investment Law Reform?”, 8 April 2015, at: [www.ejiltalk.org](http://www.ejiltalk.org); the Convention was signed on 17 March 2015 by, *inter alia*, Canada, Finland, France, Germany, Sweden and the United Kingdom and the United States.

34. *Tudor Tudor v. Romania*, judgment of 24 March 2009, Application No. 21911/03, paragraph 26.

35. *Ibid.*, paragraphs 26-32.

36. Judgment of 2 November 2010, Application No. 38155/02, paragraphs 31-40.

37. For example, Alfred de Zayas during the hearing before the committee on 19 April 2016; Joseph E. Stieglitz, “[The Secret corporate takeover](#)”, 13 May 2015.

28. But this “compensatory privilege” (compensating, in the view of proponents of ISDS, the alleged “national bias” of national courts) must of course not be abused by domestic companies posing as foreign ones by the use of creative ownership structures, as is reportedly frequently the case. In order to avoid such “forum shopping”, clear and simple criteria such as the majority of the capital being held by foreigners and the corporate headquarters being located abroad must be strictly adhered to.

### 3.2. ISDS as an obstacle to the implementation of human rights

29. The existence of investment protection treaties enforced by ISDS can deter States from implementing progressive public policies aimed at improving the protection of the environment, workers’ rights or simply increasing State revenue – to be used for improving the living conditions of the local population (“regulatory chill”). This is the main concern of the movers of the new motion on “Investor protection and human rights”, which I was invited to take into account in the present report.<sup>39</sup> This is primarily a question of the content of the investment protection treaties and not of the nature of the enforcement mechanism available. But the nature of the enforcement mechanism and the procedure followed can influence substantive outcomes, which is why it will be necessary to examine some of the most widely criticised clauses in IIAs from this angle.

#### 3.2.1. Non-discrimination clauses

30. A primary goal of IIAs is to protect foreign investors from government discrimination relative to other investors, in particular local competitors. Article 1 of Protocol No. 1 to the Convention recognises the human right to peaceful enjoyment of property, and Article 14 requires that rights guaranteed by the Convention must be secured without discrimination on many grounds, including nationality. Even without an IIA, the Convention signatories would therefore be required to afford the property rights of foreign investors the same respect as those of local investors.

31. IIAs, however, prefer to explicitly define this treatment in standard clauses that appear in almost every agreement. A “national treatment” clause guarantees foreign investors the same treatment as local investors. A “most favoured nation” clause guarantees that foreign investors under an agreement will be treated by a State no less favourably than that State treats foreign investors under any other agreement.

32. However, such “most favourable” treatment may turn out to be asymmetrical. Foreign investors are guaranteed minimum treatment at the level of local investors and other foreign investors, so their treatment must be as good as anyone else’s. Local investors do not benefit from such protections under an IIA, but in States Parties to the Convention they would enjoy protection against discrimination under Article 14 of the Convention in conjunction with Article 1 of Protocol No. 1. The procedural inequality residing in the fact that they must content themselves with the national courts (with subsidiary protection from the European Court of Human Rights) has been discussed above.

#### 3.2.2. “Fair and Equitable Treatment” clauses

33. Numerous IIAs include “Fair and Equitable Treatment” (FET) clauses. The North American Free Trade Agreement (NAFTA) provides in Article 1105 (“Minimum Standard of Treatment”) that “[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment ...”. But NAFTA offers no additional guidance as to the meaning of “fair and equitable”, so arbitrators have had to make their own assessments.

34. In the events leading to *Metalclad Corporation v. The United Mexican States*,<sup>40</sup> the American corporation Metalclad bought the Mexican corporation Coterin, in part to develop a hazardous waste landfill in Mexico. Metalclad obtained federal and State permits, and started construction believing it had all necessary approvals. The municipality of Guadalcazar, however, had turned down similar applications made by Coterin in the previous five years, and also did not approve Metalclad’s application, thus preventing the operation of the facility. The arbitral tribunal, because Metalclad claimed to have relied on the federal government’s assurance that it had obtained all the necessary permits, found that “Mexico failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment [,which] demonstrates a lack of

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38. For example, the case of *Loewen Group v. the United States*, where a Canadian funeral company, sued by a local quasi-monopolist, was practically denied justice by the courts of Mississippi, see Francesco Francioni, “Access to Justice, Denial of Justice and International Investment Law”, in: EJIL (2009), Vol. 20 Nr. 3, 729-747 (732-733), with further examples, at: [www.ejil.org/article.php?article=1862&issue=92](http://www.ejil.org/article.php?article=1862&issue=92).

39. See note 3 above.

40. Case No. ARB(AF)/97/1, International Centre for Settlement of Investment Disputes (ICSID).

orderly process”, and awarded Metalclad US\$15.6 million in damages. Metalclad thus used the “fair and equitable treatment” clause to elevate NAFTA protection beyond basic non-discrimination and opening of markets to the guarantee of a quality level of administrative services that the federal government must provide, covering State agencies at all levels. A local investor’s application had been refused in the same way, so there was clearly no discrimination. The decision found the assurances given by the Mexican Government to be “a failure on the part of Mexico to ensure the transparency required by NAFTA”.<sup>41</sup> A third denial of the same application by the same legal person (Coterin and Metalclad as its direct legal successor) should have been the normal outcome of transparent and predictable proceedings, but the arbitrators chose to interpret “fair and equitable treatment” as requiring that the burden of due diligence be placed squarely on the State.

35. Fair and equitable treatment clauses can also warp the application of other laws. Occidental Petroleum Corporation broke a contract with Ecuador by selling 40% of its rights under the contract although the contract stipulated that any unauthorised transfer of rights would terminate the contract.<sup>42</sup> The State’s interest in deterring other contracting partners from breaking contracts and Occidental’s breach of contract were considered by the arbitration tribunal as insufficient to justify enforcing the forfeiture clause in this contract leading to the loss of Occidental’s investment. Contracts normally do not require justification for enforcement, just the parties’ prior voluntary agreement, but the tribunal found that the US–Ecuador Bilateral Investment Treaty’s fair and equitable treatment clause outweighed general contract law, leading to an award of US \$769 625 000 against Ecuador.<sup>43</sup>

36. Such huge awards constitute hefty price tags for regulation in the public interest. The long-term impact may well be a “regulatory chill” that will make most States Parties to IIAs less likely to enforce its legal regulations in the future, no matter how strong the public interest involved. For example, when Germany established new rules restricting the discharge of cooling water from nuclear power plants, it had to lower relevant standards to settle a claim brought by Swedish conglomerate Vattenfall under the Energy Charter Treaty.<sup>44</sup>

37. As States see more of their legitimate police powers being usurped by “fair and equitable treatment” claims, there are some efforts to clarify and restrict the interpretation of this vague phrase. The US–Chile Free Trade Agreement limits it to the minimum standard of treatment of aliens required by customary international law,<sup>45</sup> which is generally limited to a denial of fair judicial proceedings and outright expropriation of property.<sup>46</sup> The United States, Canada and Mexico issued a joint interpretative note in 1999 applying the same limitation to NAFTA.<sup>47</sup>

38. However, sometimes such protections are undercut in the same agreement. For example, the [Japan-Switzerland Free Trade Agreement](#) (FTA) incorporates Article XIV of the World Trade Organization’s [General Agreement on Trade in Services](#) (GATS) in its own Article 95.1. Article XIV provides that an agreement will not prevent measures by a State to, *inter alia*, “protect human, animal or plant life or health”, “protection of the privacy of individuals”, or ensure safety. However Article 95.3 of the FTA explicitly prevents Article XIV from applying to the “fair and equitable treatment” standard promulgated in Article 86 of the FTA.

39. Of course, any non-enforcement of regulations required by IIAs will only apply to foreign investors – local firms have to follow regulations and take responsibility for their own due diligence.

### 3.2.3. Stabilisation clauses

40. Stabilisation clauses are clauses in private contracts between investors and host States dealing with changes in the host State’s law during the life of the project.<sup>48</sup> Some such clauses “freeze” the law of the host State with respect to the investment project over its intended lifespan, thus exempting the investor from any new laws; others (“economic equilibrium clauses”) accept that the investor shall comply with new laws but require the host State to compensate the investor for the cost of compliance.

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41. *Ibid.*, paragraph 88.

42. *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, Case No. ARB/06/11, ICSID.

43. In a further mathematical twist, the tribunal calculated the award based on 100% of Occidental’s holdings, not the 60% it still held, so a later annulment reduced it to only US\$1 061 775 000. See [Decision on Annulment of the Award](#), Case No. ARB/06/11, ICSID.

44. Case No. ARB/09/6, ICSID.

45. Article 10.4.2, [United States-Chile Free Trade Agreement](#).

46. Tolga Yalkin, [The International Minimum Standard and Investment Law: The Proof is in the Pudding](#), EJIL: Talk!, Blog of the *European Journal of International Law*.

47. *Ibid.*

41. Such clauses have been criticised as obstacles in the path of necessary measures by host States to improve, for example, the protection of the environment or the rights of workers. At the same time, a certain degree of stability and predictability is needed in order to make long-term investments “bankable”, especially when large investments, for example in infrastructures, are required before an investment becomes profitable.

42. The public debate about the investment agreements between BP and Azerbaijan and Turkey concerning a major cross-border pipeline project led BP to supplement the investment contracts with a “Human Rights Undertaking” designed to avoid the potential negative impact of the stabilisation clauses on the protection of human rights in the host States.<sup>49</sup> Such “human rights undertakings”, following a dialogue involving all stake-holders could indeed help minimise the negative impact of such clauses on human rights whilst safeguarding their role in making large-scale, long-term investments economically viable.

### 3.2.4. “Legitimate expectations”

43. Many tribunals will also award claims based on the “legitimate expectations” of the investors regarding the States’ investment environment. These expectations were first addressed in a 2003 case, *Tecmed v. United Mexican States*:

*“The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations ... The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities.”<sup>50</sup>*

44. IIAs do not usually include the term “legitimate expectations”, and in *Tecmed* there was no explicit legal basis for the sweeping promise that the State will never change anything that could have a negative impact on an investment. Since then, many decisions have invoked expectations by merely citing precedent. One concurring opinion in a 2005 arbitration suggested “that ‘legitimate expectation’ has become for tribunals a preferred way of providing protection to claimants in situations where the tests for a ‘regulatory taking’ appear too difficult, complex and too easily assailable for reliance on a measure of subjective judgment”.<sup>51</sup>

45. The definition of “legitimate expectations” in *Tecmed* is very broad and deprives the State of the ability to change any regulations no matter how urgent the public interest, for example in improved health or safety. Later decisions have recognised that traders “cannot have a legitimate expectation that an existing situation which is capable of being altered by ... institutions in the exercise of their discretionary power will be maintained”.<sup>52</sup> Tribunals currently tend to hold that expectations are legitimate only when States make a specific representation to an investor or include a contract clause that promises the stability of particular policies or regulatory frameworks. Without such a specific promise, a State cannot be “legitimately expected” to abdicate its responsibilities to its citizens.

46. Acknowledging that most tribunals will recognise some form of legitimate expectations, IIAs should proactively and explicitly define the expectations of the parties. A current trend is to specifically exempt a State’s purpose of promoting environmental protection and public health and safety from an investor’s expectations.<sup>53</sup> The Australia-Japan Free Trade Agreement is a good example. Its Article 14.15 guarantees each party the right to adopt measures to pursue similar public interests to the previously mentioned Article XIV of the GATS.<sup>54</sup> Importantly, no other clauses limit this protection (contrary to the Japan-Switzerland FTA). Article 14.15 also protects the investors’ interests in that it requires that such measures shall not be framed as disguised restrictions on investment or as discriminations against investors from a particular State.

48. “Stabilization Clauses and Human Rights, a research project conducted for IFC and the UN Special Representative of the Secretary-General on Business and Human Rights”, 27 May 2009.

49. *Ibid.*, pp. viii and 1-2.

50. *Técnicas Medioambientales Tecmed S.A. v. The United Mexican States* at paragraph 154, Case No. ARB (AF)/00/2, ICSID.

51. *International Thunderbird v. United Mexican States* (No. 10), paragraph 37, *Separate Opinion of Thomas Wälde*, UNCITRAL.

52. *Kyowa Hakko v. Commission* (No. 35), paragraph 39, Case T-223/00, Court of Justice of the European Union.

53. *IIA Issues Note*, *op. cit.*

54. See paragraph 38 above.

47. Expectations regarding the parties' human rights obligations can also be set in advance with due diligence work targeting these concerns directly. Human rights impact assessments and human rights audits could offer the parties useful data when they negotiate an investment protection treaty (between States) or an investment contract (between the host State and an individual investor).

48. Some trade negotiations now include a "social impact assessment" that determines the impact an agreement would have across society in the States concerned. The European Union is conducting a similar "sustainability impact assessment" as part of its negotiations on TTIP.<sup>55</sup> Similarly a "human rights impact assessment" can be carried out in order to anticipate an agreement's effect on human rights.<sup>56</sup> Adding such steps to the standard due diligence requirements in the preparation of international trade and investment agreements and individual investment contracts would contribute to identifying potential problems in advance and allow the parties to draft their agreements in such a way as to prevent negative consequences on human rights, the environment, the social situation, etc.

49. Investors negotiating an investment contract under an IIA can also set their expectations more accurately by using a human rights audit, in addition to an assessment of the social impact of investment rules. Such an audit would explore a host State's human rights obligations. This information would allow the investor to forecast and account for future changes that might be needed to accommodate those obligations (i.e. a commitment to paying "living wages" or limiting pollution of natural resources).<sup>57</sup> To avoid wasteful inefficiency, a State could centrally document such information to provide to investors upon request. A State's provision of false or out-dated information could then be seen as a misrepresentation that would rightly be "actionable" – through ISDS or in the State's courts – as violating legitimate expectations.

### **3.3. Investment protection and the right to protection of property (Article 1 of Protocol No. 1)**

50. The property rights protected by IIAs are in principle covered by Article 1 of Protocol No. 1 to the Convention, which has been signed and ratified by every signatory to the Convention. A key issue is the definition of the line between "expropriation" (which is only possible under certain conditions and even then gives rise to pecuniary compensation) and merely "controlling the use of property in accordance with the general interest" (Article 1.2 of Protocol No. 1). There is ample case law not only of the European Court of Human Rights interpreting Article 1 of Protocol No. 1, but also of national constitutional courts interpreting similar protections of the right to property in national constitutions.<sup>58</sup> This case law should also serve as guidance to arbitration panels when they interpret investment protection clauses in IIAs.

51. It should be noted that the European Court of Human Rights has held that the Convention should be interpreted in harmony with a State's other international engagements as far as possible, but also that the Convention could override incompatible agreements (see *Fogarty v. the United Kingdom*).<sup>59</sup> This means that clauses in IIAs which would prevent the implementation of human rights obligations under the Convention shall be interpreted narrowly or even overruled.

## **4. ISDS as a challenge to State sovereignty**

52. As with most treaties, IIAs usually allow parties to end the agreement either by an expiration date ("sunset clause") or a specific withdrawal mechanism. 80% of investment treaties have an "anytime termination stage" during which either party can cancel the agreement after the initial term of the treaty.<sup>60</sup> Investments made prior to the treaty's termination must still be protected for a certain period, but otherwise the parties are free from the treaty's requirements.

53. But EU agreements do not allow its member States to withdraw individually. The purpose of the European Union negotiating these agreements instead of individual member States is to leverage the volume and legal homogeneity of the common market, which requires in principle that every member State participates. The Commission argues that States surrendered this aspect of their sovereignty when they ratified the Lisbon Treaty. But if the European Union agrees to include ISDS or ICS in TTIP, CETA or any

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55. [www.trade-sia.com/ttip/](http://www.trade-sia.com/ttip/).

56. James Harrison, Human Rights Impact Assessments of Trade Agreements (23-24 June 2010).

57. Bruno Simma, "Foreign Investment Arbitration: A Place for Human Rights?", 60(3), *International and Comparative Law Quarterly* (2011), 573-596.

58. For example Article 14 paragraphs 2 and 3 of the German Basic Law (*Grundgesetz*).

59. Judgment of 21 November 2001, Application No. 37112/97, paragraphs 32-39.

60. Arjan Lejour and Maria Salfi, *The Regional Impact of Bilateral Investment Treaties on Foreign Direct Investment*, CPB Netherlands Bureau for Economic Policy Analysis, January 2015, p. 5.

other future agreement, States could find themselves facing restrictions also regarding other competences that have not been fully transferred to the European Union, such as the right to regulate on public health and safety issues (see below).

54. EU agreements with third States concerning both EU competences and national competences (so-called mixed treaties) require the signature and ratification of all EU member States. This would give the States protection against any agreement that would unacceptably infringe on their sovereignty. But according to the European Commission, the Lisbon Treaty grants the European Union exclusive competence for the conclusion of trade and investment protection agreements, basing itself on, in particular, Articles 3 and 207.5 of the Treaty on the Functioning of the European Union.<sup>61</sup> The approval by the European Parliament then takes the place of the ratification by national parliaments. But in view of their potential impact on public policy areas that remain within the competence of member States, it is presently highly disputed whether agreements such as TTIP and CETA require ratification by member States, too. Significantly, in July 2016, the European Commission proposed the signature of CETA by Canada, the European Union and all EU member States as a “mixed agreement” – without prejudice to its legal position currently litigated before the European Court of Justice according to which such agreements fall within the exclusive competence of the European Union.<sup>62</sup> In my view a solution must be found to allow individual EU member States to opt out of an ISDS/ICS clause if and when it turns out that interpretations of the agreement given by the tribunal have a negative impact on national policies for which the competence has remained in the national domain. As we have seen, States can terminate bilateral investment agreements if they no longer correspond to their political objectives, even if existing investments continue to benefit from protection for a transitional period. But EU member States are effectively prevented from exercising this option as such agreements are now concluded by the European Union. Ways and means should therefore be explored to enable EU member States to choose whether or not to participate in investment protection agreements, for example by including investment protection rules in an optional protocol.

55. Another sovereignty issue is raised by the provisional application of mixed agreements prior to ratification. The EU–Ukraine Association Agreement, for example, which is subject to ratification by all member States, was provisionally applied across the European Union as of 1 November 2014 (regarding the “political” provisions) and 1 January 2016 (regarding the trade-related provisions).<sup>63</sup> The provisional application is in principle indefinite, unless terminated by a unanimous decision of the European Council.<sup>64</sup> If future agreements contain similar provisional clauses, the national ratification requirement may lose part of its relevance as a protection for State sovereignty.<sup>65</sup> In my view, this is unacceptable. The above-mentioned opt-out for individual member States in case of conflict with national policies in the areas remaining in the national competence must also (and even more so) be available during the period of provision application. Such provisional application should in any case be limited in time (for instance two years) and ideally should only apply to those parts of the treaty which are within the competence of the European Union.

## 5. Is ISDS/ICS even necessary?

56. Supporters claim ISDS (or ICS) is required because many countries’ courts insufficiently protect foreign investors. This can be a result of the poor quality (or perceived poor quality) of national courts. It should be recalled that one quarter of EU member States have courts perceived by their own public as below average in both independence and efficiency.<sup>66</sup> Other courts generally considered as satisfactory tend to resist enforcing international agreements, for example the United States doctrine following which its courts only enforce international treaties that are explicitly self-executing upon ratification or accompanied by domestic legislation.<sup>67</sup>

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61. <http://trade.ec.europa.eu/doclib/press/index.cfm?id=493>.

62. “European Commission proposes signature and conclusion of EU-Canada trade deal”, Strasbourg, 5 July 2016.

63. EU–Ukraine Association Agreement at 2, European Union.

64. “The Dutch Referendum on the EU–Ukraine Association Agreement: Legal options for navigating a tricky and awkward situation”, CEPS, 8 April 2016.

65. House of Commons Library briefing paper CBP 7192 dated 28 March 2016, “EU external agreements, EU and UK procedures” pointing out the danger of “competence creep” in those cases where it is not clear which parts of an agreement are under EU competence.

66. *The Global Information Technology Report 2015*, World Economic Forum; EFILA (note 25), pp. 34-35, with references to evaluations of the performance of countries in implementing the rule of law by the World Justice Project (<http://worldjusticeproject.org>).

67. See, for example, *Medellin v. Texas*, 552 U.S. 491 (25 March 2008) concerning the non-implementation of a treaty-based duty to provide consular protection for foreign nationals threatened by the death penalty.

57. ISDS tribunals as well as the proposed ICS create a “dual court system” where (privileged) foreign investors can make legal claims for a binding judgment outside of a State’s courts. The German Magistrates’ Association (*Deutscher Richterbund*) opposed such a dual system in an opinion published in February 2016,<sup>68</sup> finding it both unnecessary and lacking a sound legal basis in EU law. It is perhaps unsurprising that national magistrates have more confidence in national courts. Their States nevertheless conclude IIAs with ISDS clauses – which seems to indicate that they trust each other’s courts less than their own. In the past, high-income countries rarely signed IIAs with ISDS clauses between themselves, as their investors usually trust their well-developed, independent judicial systems.<sup>69</sup> But more recent IIAs (such as the above-mentioned ones between Switzerland and Japan and between Australia and Japan, and the agreements recently signed with Canada (CETA) or under negotiation with the United States (TTIP) have such clauses, as do most IIAs among EU member States.

58. The German magistrates, among others, propose that the best solution when national courts are ineffective is to improve these courts, not to circumvent them. Improvement of national courts would indeed be the ideal resolution. But this is a long-term project, which is not immune from setbacks for different (political, budgetary) reasons. Meanwhile, IIAs with ISDS/ICS clauses can encourage foreign investment for their signatories, which increases pressure on developing economies to participate in such agreements.<sup>70</sup> This said, IIAs have only a limited impact in terms of foreign direct investment. Countries in central and eastern Europe appear to benefit spectacularly from IIAs, but States in sub-Saharan Africa and central and South America do not register a significant increase in foreign direct investment.<sup>71</sup> Factors beyond the presence and structure of IIAs must be influencing these regional variations, and there is no data on whether those factors would similarly promote and channel investment in the absence of an IIA. The data in these studies (1985-2011 for the primary study cited here) has come from an era of significant global economic growth, and the IIAs could just be further aiding the natural flow of capital. ISDS/ICS would appear to be most useful when a State’s government is effective enough to live up to a contractual partnership whilst regulating business in the interest of society as a whole, but not yet reliably enforcing the rule of law. In sum, ISDS/ICS may well make it easier under those conditions to attract foreign investment through trade agreements.

## 6. Deep reform of ISDS procedures or creation of an Investment Court System?

59. The EU–Canada Comprehensive Economic and Trade Agreement addresses many of the criticisms levelled against ISDS, as presented above. For example, CETA:

- in its preamble, stresses the States’ “right to regulate” in order to achieve legitimate policy objectives, such as public health, safety, environment, public morals, social or consumer protection and the promotion and protection of cultural diversity;
- provides clear, closed (and fairly restrictive) definitions of investment protection standards such as “fair and equitable treatment” and “indirect expropriation”. A “fair and equitable treatment” violation can only arise when there is denial of justice, a fundamental breach of due process, manifest arbitrariness, targeted discrimination on manifestly wrongful grounds, or abuse treatment of investors, such as coercion, duress and harassment. An “indirect expropriation” can only occur when the investor is “substantially deprived of the fundamental attributes of property, such as the right to use, enjoy and dispose of its investment”;<sup>72</sup>
- empowers the Parties to adopt binding interpretations to control the interpretation of the agreement and correct possible errors by the tribunals;
- incorporates the progressive UNCITRAL transparency rules (see paragraph 22 above);
- gives the tribunals discretion to allow amicus curiae third-party interventions;
- prevents forum shopping by excluding claims made by companies carrying out an investment or a business re-organisation for the purpose of bringing a case, or by “mailbox companies” having no real business operations in the territory of one of the Parties;

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68. “Opinion on the establishment of an investment tribunal in TTIP – the proposal from the European Commission on 16.09.2015 and 11.12.2015”.

69. Arjan Lejour and Maria Salfi, *op. cit.*, p. 7.

70. *Ibid.*, pp. 20-21.

71. *Ibid.*, pp. 21-22.

72. European Commission, “Investment provisions in the EU–Canada free trade agreement (CETA)”.

- is the first IIA including a code of conduct for arbitrators, ensuring high ethical and professional standards and requiring disclosure of any situation that could give rise to conflicts of interest. Improvements enhancing the role of States are also made with regard to the selection of arbitrators in individual cases;
- facilitates the early dismissal of unfounded or frivolous claims;
- introduces (for the first time in an IIA) the “loser pays principle”, meaning that the investor must pay the litigation costs of the State he has challenged;
- prohibits parallel proceedings before arbitration tribunals and domestic courts, to avoid double compensation and divergent verdicts.<sup>73</sup>

60. These advances are impressive, compared to the existing situation dominated by some 3 000 IIAs with “classic” ISDS mechanisms, the drawbacks of which we have seen above. More progress in reforming ISDS is possible step by step, for example by giving stakeholders a right to intervene (rather than the tribunal the discretion whether or not to accept such interventions). But the existing system is very slow to reform, as numerous existing IIAs would need to be replaced by more progressive ones. As a reaction to growing criticism of ISDS in the political sphere, the European Commission adopted a more radical approach, namely to promote the creation of a wholly new Investment Court System, including a first-instance investment tribunal and an appellate tribunal.<sup>74</sup>

61. Such an institutionalised system, whilst remaining a fully international mechanism not exposed to the risk of national bias, would arguably combine the advantages of (reformed) ISDS with those of classic courts: it would enable permanent members of the tribunal appointed by the States on the basis of strict criteria of professionalism and ethics to accumulate experience and build a body of case law to interpret the relevant investment provisions in a way that fully respects the States’ right to regulate for legitimate policy purposes whilst protecting foreign investments against arbitrary and discriminatory treatment.

62. To build such an Investment Court System would require a high degree of international consensus in order to supplant the existing mechanisms within a reasonable period of time. I suggest that the Council of Europe make a modest contribution to building such a consensus by stressing the shortcomings of the existing ISDS mechanisms from a human rights and rule of law perspective and encouraging its member States to play an active part in the establishment of the future ICS.

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73. European Commission Concept Paper “Investment in TTIP and beyond – the path for reform, Enhancing the right to regulate and moving from current ad hoc arbitration towards an Investment Court”.

74. [Investment Provisions in CETA](#), European Commission, February 2016.