

**The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic
Trade and Investment Partnership**

Study

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Table of Contents

Executive Summary	7
I. Introduction: purpose of study	11
A. IMPORTANCE OF THE TRANSATLANTIC ECONOMIC RELATIONSHIP	11
B. NEGOTIATIONS FOR A TRANSATLANTIC TRADE & INVESTMENT PARTNERSHIP (TTIP)	13
II. Background	15
A. HISTORY AND PURPOSE: INVESTMENT PROTECTION AND DISPUTE SETTLEMENT	15
1. <i>10th Century-18th Century: Merchant Concessions</i>	15
2. <i>18th Century: Development of FCNs</i>	16
3. <i>Post-1959: BITs</i>	20
B. HOW AND WHY ISDS BECAME THE PREFERRED DISPUTE SETTLEMENT MECHANISM	20
C. THE CURRENT ISDS LANDSCAPE	25
1. <i>Who are these claims against?</i>	25
2. <i>Who brings these claims?</i>	26
D. AUSTRALIAN INVESTMENT TREATY POLICY	26
III. Dutch (EU) – US international investment relations	29
A. INVESTMENT STATISTICS	29
1. <i>Current situation: EU-US FDI</i>	30
2. <i>Current situation: NL-US FDI</i>	31
3. <i>Possible effects of the TTIP</i>	32
B. GEOPOLITICAL DIMENSION	34
C. INTERNATIONAL INVESTMENT PROTECTION RULES	36
1. <i>US – EU/Netherlands BIT history</i>	36
2. <i>Continuing or breaking with treaty tradition?</i>	38
IV. Cost-benefit risk assessment	39
A. TREATY NEGOTIATING LEVERAGE	39
B. REGULATORY CHILL	39
1. <i>What is Regulatory Chill & How is it Measured?</i>	40
2. <i>Arguments Supporting Regulatory Chill</i>	42
3. <i>Arguments Against Regulatory Chill</i>	45
4. <i>Applied to the situation of The Netherlands</i>	48
C. THE RIGHT TO REGULATE	49
1. <i>Expropriation</i>	49

a. Character of the Government Measure and “Police Power”	51
b. Proportionality of the Measure	53
c. Degree of Interference with Property Rights.....	54
2. <i>Fair and Equitable Treatment</i>	57
3. <i>National Treatment</i>	58
4. <i>The Right to Regulate in a New Generation of BITs and IIAs</i>	60
a. Definitions of Specific Protections	60
b. General Exception Clauses	64
c. Preambular Language	66
D. IMPARTIALITY	68
E. EXPERTISE.....	68
F. DE-POLITICISATION OF DISPUTES.....	69
G. DOMESTIC LAW AND PROCEDURE.....	72
H. EXPENSES	74
I. COMPARATIVE ASSESSMENT OF THE NAFTA AND CAFTA EXPERIENCE	75
1. <i>Overall Trends from NAFTA & CAFTA Case Law</i>	76
2. <i>NAFTA & CAFTA Case Studies – Does ISDS Cause Regulatory Chill?</i>	78
a. Cases involving the environment.....	79
b. Cases involving natural resources.....	88
J. PRELIMINARY CONCLUSIONS	91
V. Risk mitigation.....	94
A. QUALIFYING PROCEDURAL ACCESS TO ISDS	94
1. <i>Exhaustion of local remedies</i>	94
2. <i>Fork in the road clause</i>	95
3. <i>Fivolous claims safeguards</i>	96
4. <i>Mandatory alternative to ISDS proceedings</i>	97
B. DELIMITING THE PROTECTION SCOPE OF INVESTMENT TREATIES	99
1. <i>Defining protected investors and investments</i>	99
a. Denial of benefits	99
b. Prudential and other carve outs.....	100
2. <i>Clarifying investment treaty standards</i>	101
3. <i>Excluding ‘umbrella clauses’</i>	101
4. <i>Excluding market access rights</i>	102
5. <i>Incorporating public policy protection into the investment treaty</i>	103
B. BUILDING SAFEGUARDS INTO THE PROCESS	105
1. <i>Transparency</i>	105
a. Publication of information about the dispute	106
b. Exceptions to transparency: confidential or protected information.....	107

c. When in doubt: discretionary powers and priority in case of conflict.....	109
2. Active role for States parties to the treaty and other stakeholders.....	110
a. States parties to the treaty	110
b. Other stakeholders.....	110
3. Code of conduct and roster of arbitrators.....	111
4. An appellate mechanism.....	112
a. Need for an appellate mechanism.....	112
b. Mechanism proposed by the European Commission.....	113
c. Appellate mechanisms in other FTAs/BITs	114
d. Comparison with the WTO Appellate Mechanism.....	115
e. ICSID annulment mechanism	117
VI. Regulation on financial responsibility	119
A. DRAFTING HISTORY AND BINDING NATURE.....	119
B. RESPONDENT STATUS.....	120
C. ATTRIBUTION OF CONDUCT	122
D. ALLOCATION OF FINANCIAL RESPONSIBILITY	123
E. SETTLEMENT	124
F. PRELIMINARY CONCLUSIONS	126
VII. Final comments	127
List of authorities.....	131

List of abbreviations

AB	Appellate Body
ABA	American Arbitration Association
BIT	Bilateral Investment Treaty
BOP	Balance of Payment
BRICS	Brazil, Russia, India, China, South Africa
CAFTA-DR	Dominican Republic-Central America Free Trade Agreement
CEPR	Centre for Economic Policy Research
CJEU	Court of Justice of the European Union
DG	Directorate-General
DNB	Dutch Central Bank
DSB	Dispute Settlement Body of the World Trade Organisation
DSU	Dispute Settlement Understanding
ECT	Energy Charter Treaty
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IBA	International Bar Association
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes

IIA	International Investment Agreement
ILO	International Labour Organization
ISDS	Investor-State Dispute Settlement
JAPEA	Japan-Australia Economic Partnership Agreement
KAFTA	Korea-Australia Free Trade Agreement
MFN	Most-Favoured Nation
NAFTA	North American Free Trade Agreement
NT	National Treatment
OECD	Organisation for Economic Co-operation and Development
PCA	Permanent Court of Arbitration
PPP	Purchasing Power Parity
SCC	Stockholm Chamber of Commerce
TEC	Transatlantic Economic Council
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organization

Executive Summary

The Transatlantic Trade and Investment Partnership (TTIP) agreement between the European Union and the United States has the potential to be the most ambitious trade and investment agreement between two developed economies. Most EU Member States do not currently maintain Free Trade Agreements (FTAs) or Bilateral Investment Treaties (BITs) with the United States, so the TTIP has the possibility of breathing new life into trade and investment flows as well as their corresponding protection on both sides of the Atlantic. Simultaneously, however, the TTIP's trade and investment protection standards and possible dispute settlement mechanisms have raised legitimate questions from governments, private industry, and civil society. Of particular concern is the inclusion of an investor-state dispute settlement (ISDS) mechanism, whereby individual foreign investors may bring claims against host state governments for breach of the TTIP's investment protection standards. This ISDS system is comparable to what has been included in agreements such as the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, the North American Free Trade Agreement (NAFTA), and the Central American Free Trade Agreement (CAFTA-DR).

Civil society and members of the Dutch Parliament have questioned the need for an investment chapter in the TTIP, raising a number of concerns regarding the necessity of ISDS given the maturity of legal remedies in the EU and the United States; the potential for "regulatory chill" in areas of Dutch public interest like health, the environment and natural resources; and the lack of transparency in current forms of ISDS. This study aims to address these concerns by focusing on the costs and benefits which the inclusion of an ISDS chapter in the TTIP may entail for the Dutch government, industry and society.

After reviewing overall trends in ISDS as well as their impact on the Dutch economy and legal system, we conclude that the risks of ISDS are overstated. This is not to say that the ISDS system is perfect or that legislators and negotiators should be satisfied with its adoption as currently established in other treaties. Instead, we conclude that risks posed by ISDS can be mitigated if not removed by careful and progressive drafting of the TTIP text. Instead of eliminating ISDS from the TTIP, the inclusion of more detailed provisions on substantive protections, exceptions and safeguards with respect to the functioning of an ISDS mechanism would strike a

better balance between the encouragement and protection of foreign investment on the one hand and the need to pursue legitimate public policy aims on the other. On balance, if the TTIP were to include investment protection and ISDS provisions along the lines of what has been incorporated in the new generation of investment agreements—such as CETA—the benefits of ISDS will outweigh the costs.

Our conclusions are based on the following observations:

- The purpose of ISDS is to provide foreign investors with a means of challenging a host state's actions outside of the politically-fraught and often inefficient system of diplomatic protection. ISDS is also intended to provide a forum for dispute settlement separate from the host state's domestic legal system.
- The Netherlands has not signed a BIT with the United States, but it has consistently included ISDS in the other investment agreements which it has concluded. What is more, Dutch investors increasingly rely on ISDS to vindicate their rights overseas as shown by the fact that Dutch investors have brought 10% of all ISDS claims worldwide.
- Including ISDS in an agreement with the United States could be particularly important since neither US federal nor state law fully protects foreign investors from discrimination. Investment cases such as *Loewen* suggest that US courts, and especially civil juries, may be biased against foreign investors.
- US and EU investors invest over a trillion dollars in each other's economies annually, with significant volume increases since 2008. Dutch investors have heavily invested in the US transportation sector while US investors have made significant investments in the Dutch professional and financial services sector. However, it is difficult to predict what effect, if any, the TTIP will have on Dutch-US FDI flows. It is equally difficult to predict whether ISDS provisions in the TTIP will have a discernable effect on FDI flows. We can only safely say that investment is important for both the US and Dutch economies, but neither economic costs nor benefits can be statistically linked to the TTIP given the paucity of statistics in this field.
- At the same time, we can assess the legal implications of the TTIP and of a potential ISDS chapter. Including ISDS in the TTIP may increase the Netherlands' negotiating leverage with the US since it becomes part of a larger EU strategy rather than an element in an individual BIT. Although international

arbitration expenses may be considerable – as are costs of proceedings before domestic courts – the ‘loser pays’ approach could ensure a more equitable outcome. ISDS may also serve to limit risks posed by resorting to diplomatic or domestic remedies by minimizing bias, increasing expertise in investment protection and de-politicising disputes.

- The risk of “regulatory chill” – which may cause governments to forgo the adoption of legitimate regulatory changes for the environment, health, or natural resources because of the threat of arbitration – can be avoided if the TTIP includes adequate definitions of investment protection standards, appropriate exception clauses, and fair procedural safeguards. First, the risk of “regulatory chill” or a threat to the Dutch government’s policy space is not supported by sufficient empirical evidence. We recognize that regulatory chill is difficult to prove or disprove, but a close examination of case law from NAFTA and CAFTA does not support this theory. Most investment claims do not challenge the government’s ability to legislate or regulate as such, but are administrative in character, challenging a government’s treatment of an individual investor in the context of a particular license, permit, or promise extended by government officials. So far under NAFTA, direct challenges to the government’s legislative or regulatory rights have never succeeded. Finally, modern BITs and IIAs, especially the model from CETA, include provisions to ensure the government’s “right to regulate”. These provisions, if included in the TTIP, would help protect against any possible regulatory chill while also ensuring that investors can raise legitimate claims.
- Based on the NAFTA, CAFTA and BIT case law examined, no conclusive evidence of an “American claim culture” – that is, the assumption that US investors are more litigious than others – could be found. In aggregate, investors from EU Member States have brought more claims in the past 30 years than investors from the United States.

The Commission’s intention to solidify its newly acquired investment policy is understandable, but the Netherlands, as well as the other Member States, may have concerns that the Commission’s actions could have important financial consequences. Under the amended version of the Regulation on Financial Responsibility arising from ISDS cases based on agreements to which the EU was a party, the unity of

external representation and the consistent interpretation of agreements are taken into consideration, but also the Member States' right of defence. Safeguards include the requirement of cooperation between the Commission and Member States as well as the provision of sufficient and rational justification for any Commission decision. The examination procedure of Regulation 182/2011 (which entails that any decision by the Commission is subject to the approval of a committee composed of representatives of all Member States) serves as a further safety measure.

We recommend that the TTIP include a number of risk mitigation strategies to filter potential ISDS claims and to ensure that the system works effectively. This can be done through limiting which claims proceed to arbitration through rules of access to arbitration, filtering frivolous and obviously unmeritorious claims, and laying down certain mandatory steps before one can resort to ISDS. The substantive provisions of the agreement itself could be carefully drafted through, for example: limitations on the definition of "investor" to exclude mailbox claimants; a prudential carve-out; more detailed definitions of "fair and equitable treatment," "national treatment," and "indirect expropriation"; the exclusion of "umbrella clauses" as well as automatic market access protection; and the inclusion of public policy exceptions. The TTIP, like CETA, can also mitigate risks by building procedural safeguards into its arbitration system through the inclusion of mandatory transparency requirements, increasing the role of third parties in the proceedings, and providing for a code of conduct and roster of arbitrators as well as an appellate mechanism. In sum, these are all viable options to make an investment chapter and ISDS, if included in the TTIP, work more efficiently, act more transparently, and better balance investor rights with the policy concerns and priorities of states.

The TTIP is expected to serve as a catalyst for the improvement of current international investment law regime. Given that either the EU or the US is the largest trade and investment partner for almost all other countries in the global economy, the TTIP may serve as a template for future bilateral negotiations and even set the ground for a multilateral breakthrough.

I. Introduction: purpose of study

A. Importance of the transatlantic economic relationship

1. Built on a common history and shared economic and political values, the transatlantic economic ties are among the strongest in the world as proven by several indicators. The US and EU together account for over 50% of global GDP, or 41% in PPP terms.¹ Moreover, bilateral economic relations directly account for the existence of 15 million jobs and generate USD 5.3 billion worth of commercial sales.² Another sign of the important economic linkages between the US and the EU is that 45 of the 50 states in the US exported more to the EU than they did to China (in 2012), mostly by a wide margin.³ While there is a clear downward trend in the economic importance of both regions on a global scale, the abovementioned statistics show that deeper economic integration will have global impacts due to the sheer size of their respective markets.

Another characteristic of the US-EU economic relationship is the high degree of interdependence as well as equality in these economic ties. One region is not more dependent on the other than *vice versa*, as is the case for EU-China economic ties for example. Not just goods trade accounts for this strong relationship; services, investments and shared commercial enterprises play a large role too. Economic ties between the Netherlands and the US are also robust, as illustrated by the significant investment flows between the two countries. Netherlands' outward investments amount to nearly 10% of all FDI in the US.⁴ In 2013, FDI stock with Dutch origins to the US reached a value of USD 240 billion⁵. Figures on cumulative FDI in the US by year-end 2012 indicate that the Netherlands ranked as the third single largest investor in the US – only surpassed by the United Kingdom

¹ D.S. Hamilton & J.P. Quinlan, *The Transatlantic Economy 2013: Annual Survey of Jobs, Trade and Investment*, Center for Transatlantic Relations Johns Hopkins University, Paul H. Nitze School of Advanced International Studies (2013), atv, available at: http://transatlantic.sais-jhu.edu/publications/books/Transatlantic_Economy_2013/TE2013%20volume%201.pdf

² *Id.*

³ *Id.*, at x

⁴ U.S. Department of State, Bureau of Economic and Business Affairs, '2013 Investment Climate Statement – Netherlands', available at: <http://www.state.gov/e/eb/rls/othr/ics/2013/204703.htm>

⁵ D.S. Hamilton & J.P. Quinlan, *The Transatlantic Economy 2013: Annual Survey of Jobs, Trade and Investment*, Center for Transatlantic Relations Johns Hopkins University, Paul H. Nitze School of Advanced International Studies (2013), at page viii, available at: http://transatlantic.sais-jhu.edu/publications/books/Transatlantic_Economy_2013/TE2013%20volume%201.pdf

and Japan – while the other two main EU investors, France and Germany, ranked fifth and eighth respectively.⁶

2. *Vice versa*, the Netherlands is the recipient of 8% of the entire FDI into the EU while being the largest single recipient of US investment at 14% of total US FDI abroad,⁷ (with US FDI in the Netherlands amounting to EUR 59.6 billion in 2013).⁸ Overall, a recent CBS study shows that approximately 720 companies in the Netherlands have US ownership,⁹ employing on average ca. 85 employees each. For the sake of comparison, at the end of 2010, US FDI stocks in the EU accounted for 41% (EUR 1.201,4 billion) of its total FDI inwards rendering the US as the major holder of FDI stocks in the EU.¹⁰ As of the end of 2011, among EU Member States, the Netherlands was the largest host to US FDI with USD 595 billion, followed by the United Kingdom (USD 549 billion), Luxembourg (USD 335 billion) and Ireland (USD 188 billion).¹¹
3. Likewise, bilateral trade between the US and the Netherlands is significant, with the former consistently featuring in the top-7 of most important Dutch trade partners. The US accounts for 4% of the Dutch exports and 7% of the Dutch imports.¹² Bilateral trade in goods in 2012 resulted in a Dutch trade deficit of slightly over EUR 6 billion, being EUR 26 billion worth of imports against EUR 20 billion worth of exports.¹³ Similarly, in 2012 the Netherlands had a trade deficit

⁶ Organization for International Investment, *Foreign Direct Investment in the United States*, 2013 Report, at 3, available at: https://www.ofii.org/sites/default/files/FDIUS_2013_Report.pdf

U.S. Department of State, Bureau of Economic and Business Affairs, '2013 Investment Climate Statement – Netherlands', available at: <http://www.state.gov/e/eb/rls/othr/ics/2013/204703.htm>

⁸ De Nederlandsche Bank, 'Balance of Payments and International Investment Position', Table T12.6.1, available at <http://www.statistics.dnb.nl/index.cgi?lang=uk&todo=Balans>.

⁹ Statistics Netherlands, *Werkgelegenheidseffecten van buitenlandse investeringen uit BRIC en niet BRIC landen, 2007–2010*, at p. 18, available at <http://www.cbs.nl/nl-NL/menu/themas/dossiers/globalisering/publicaties/publicaties/archief/2012/2012-werkgelegenheidseffecten-buitenlandse-bedrijven-art.htm>

¹⁰ European Commission, Eurostat, *International Trade and Foreign Direct Investment*, 2013 edition, Eurostat Pocketbooks, at 69, available at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-FO-12-001/EN/KS-FO-12-001-EN.PDF

¹¹ U.S. Department of State, Bureau of Economic and Business Affairs, '2013 Investment Climate Statement – European Union', available at: <http://www.state.gov/e/eb/rls/othr/ics/2013/204640.htm>

¹² Rijksoverheid, *Nederland Belangrijke Handelspartner voor alle EU-Landen*, available at <http://www.rijksoverheid.nl/nieuws/2012/08/02/nederland-belangrijke-handelspartner-voor-alle-eu-landen.html>

¹³ Statistics Netherlands, 'International Trade: In- and Export', available at <http://statline.cbs.nl/StatWeb/publication/?VW=T&DM=SLNL&PA=7137SHIH&D1=0-1&D2=0&D3=62&D4=220,223-232,234-236&HD=140617-1530&HDR=T,G2&STB=G1,G3>

of slightly less than EUR 5 billion in the services sector, with imports at EUR 14.7 billion and exports at EUR 9.9 billion.¹⁴

B. Negotiations for a Transatlantic Trade & Investment Partnership (TTIP)

4. As the EU and the US markets combined constitute the largest trading block in the world, a transatlantic trade and investment agreement would serve to strengthen this position. Both sides of the Atlantic see such treaty as a necessary step to counterbalance an emerging Asian market presence, thereby securing their position in the world economy.
5. Since the early 1990s many steps have been taken to facilitate transatlantic economic relations. Noteworthy attempts include the 1990 Transatlantic Declaration as a first Post-Cold War step towards enhanced cooperation between the European Community/Union and the US in the pursuit of their common goals.¹⁵ These include economic aims such as promoting market principles, rejecting protectionism and expanding a multilateral trading scheme as well as providing support for economic reforms in Eastern and Central European states. In 2005 a move was started towards more cooperation beyond trade and streamlining regulations. Two years later the Transatlantic Economic Council (TEC) was created.¹⁶
6. The TEC is a body that facilitates government-to-government cooperation in the fields of regulatory cooperation, intellectual property rights, secure trade, financial markets, innovation and technology and investments. Facilitating cooperation constitutes a rather difficult task, as both the US and EU political systems include multiple parties with varying decision-making powers regarding regulatory issues. In the US, not just the US Congress but also the US states themselves have regulatory competence in certain areas. Since the Treaty of Lisbon, the EU decision-making process has not been simplified. The Council, the Commission

¹⁴ Statistics Netherlands, 'International Trade: In- and Export in Services', available at <http://statline.cbs.nl/StatWeb/publication/?VW=T&DM=SLNL&PA=80414NED&D1=0&D2=0-1&D3=230&D4=49&HD=140617-1533&HDR=G3,G2,G1&STB=T>

¹⁵ European Union, Transatlantic Declaration on EC-US Relations 1990, available at http://eeas.europa.eu/us/docs/trans_declaration_90_en.pdf

¹⁶ European Commission, EU-USA Transatlantic Economic Council, available at http://ec.europa.eu/enterprise/policies/international/cooperating-governments/usa/transatlantic-economic-council/index_en.htm

and the European Parliament all share policy-setting powers, while many regulations are still decided and implemented at Member State level.

7. Cooperation was taken to the next level in 2013, when the EU and the US agreed to start negotiations with the intention to create a free trade area.¹⁷ While the issues with multiple decision-making actors that the TEC faces have not been overcome, the first five rounds of Transatlantic Trade & Investment Partnership (TTIP) negotiations had already taken place by the end of May 2014. As both the EU and the US have been involved in GATT/WTO negotiation rounds since the early 1950s, tariffs between the two economic blocks are relatively low. It is therefore assumed that most of the gains from TTIP would be in the context of removing bureaucratic hurdles and lowering costs involved with product standards differentials and other regulations. The key focus is on these four themes:¹⁸
 - Elimination of bureaucratic duplication
 - Greater regulatory alignment (though not harmonization)
 - Increased access to services markets
 - Increased access to public procurement markets
8. The negotiations for the TTIP mainly focuses on five groups of issues. The first issue is tariff and quota reform. In the second group are the horizontal themes, which are not sector-specific but relevant for a larger number of economic activities/sectors. Third are the vertical themes, which are related to specific sectors and to issues that have the priority of either party, or that possibly form a sensitive sector. Examples include the French film industry and GMO food. Fourth, trade facilitation measures are covered in the negotiations, not merely concerning movement of goods but also workers and services. Fifth, an EU-US agreement is likely to have an impact on the global trade environment.
9. Investment protection is one of the horizontal issues addressed in the TTIP. Investor-State Dispute Settlement (ISDS) which is envisaged to be included in the

¹⁷ European Union, Member States Endorse EU-US Trade and Investment Negotiations, available at http://europa.eu/rapid/press-release_MEMO-13-564_en.htm

¹⁸ European Commission, TTIP Explained, available at http://trade.ec.europa.eu/doclib/docs/2014/may/tradoc_152462.pdf

TTIP has figured prominently in the public debates on the TTIP. Several NGOs¹⁹ and parties²⁰ of the Dutch Parliament have questioned the need for including an investment protection chapter with ISDS rules in the TTIP. The purpose of this study is to obtain a solid understanding of the potential effects for the Netherlands of including ISDS in the TTIP.

II. Background

A. History and purpose: investment protection and dispute settlement

10. Over the course of centuries, with particularly rapid development in the past 60 years, investment protection and, in the last 30 years or so, accompanying dispute settlement mechanisms have created a complex multi-layered architecture now comprising some 3,000 Bilateral Investment Agreements (BITs) and investment chapters in Free Trade Agreements (FTAs). In order to gain a full picture of this investment protection structure, the below analysis considers the development of these protections over time. Historical preludes to the modern ISDS system can be divided into four general categories: (1) the era of merchant concessions beginning in the 10th Century; (2) development of Treaties of Friendship, Commerce and Navigation (FCNs) from the late 18th Century to mid-20th Century; (3) post-1959 BITs and the development of investor-state arbitration; and (4) a “new generation” of BITs and FTAs that are more specific about their protections and exceptions than ever before.

1. 10th Century-18th Century: Merchant Concessions

11. The beginning of investment protection instruments started much earlier than 25 November 1959 when the first BIT was signed. Some of the earliest protections that form the historical skeleton of modern investment protection emerged from trade concessions. A party’s interest in trading in a region can be associated with the modern activity of entering a country by making an investment. As economic

¹⁹ See, for example concerns of SOMO on <http://www.somo.nl/news-nl/klopt-juist-wel-gebrek-aan-democratie-bij-eu-vs-verdrag>

²⁰ See, for example, page 2 and 3 for concerns of the PvdA and SP. <http://www.tweedekamer.nl/downloads/document/index.jsp?id=0e724902-79e8-4040-aad2-63d0fc66d7a3&title=Verslag%20van%20een%20algemeen%20overleg,%20gehouden%20op%2013%20februari%202014,%20over%20de%20RBZ-Handelsraad%20.pdf>

interchange increased during this period, the associated need for protection of economic interests resulted in the creation of more clearly demarcated protections. Thus, as economic connections increased and grew, the protections evolved toward the protections currently included in BITs.

12. Some of the first appearances of investment protection are generally considered to have emerged in the 10th century.²¹ At this time, Venetian merchants were granted concessions to enter Byzantine Ports without paying duties.²² Genoese traders similarly negotiated concessions at the Byzantine Ports.²³ These same types of concessions were later used by English kings in the 12th century.²⁴ These concessions often allowed the traders to operate within the trading cities under the laws of their home jurisdiction.²⁵ Although these instruments were not investment protection agreements as such but were more accurately trade concessions, they provide an indication of the manner by which protection occurred in its earliest form. The earliest investment protection instruments were concessions granted by a sovereign to foreign traders, rather than a negotiation for reciprocal treatment between two sovereigns.²⁶ Many of these protections were procedurally limited even where substantive protections existed: an aggrieved party would need to petition his own sovereign when his interests had been injured in a foreign state.²⁷

2. 18th Century: Development of FCNs

13. The structure and value of inter-state investment and trade protection agreements changed significantly during the 17th and 18th centuries. With the emergence of the nation-state, commercial and trading rights were then negotiated between two sovereigns, modernizing in response to a world quickly developing into defined states.²⁸ These agreements were usually finalized in writing and acted as a way for the sovereign to control and regulate the state's economic activity.²⁹ This period of treaty drafting resulted in many bilateral agreements in Europe that recognized

²¹ J. Salacuse, *The Law of Investment Treaties* (2010) 80.

²² See generally R. Lillich, *The Human Rights of Aliens in Contemporary International Law* (1984) 7.

²³ *Id.*

²⁴ Salacuse, *op. cit.*, at 80; see also P. Fischer, *A Collection of International Concessions and Related Instruments* (1976).

²⁵ Lillich, *op. cit.*, at 7.

²⁶ Salacuse, *op. cit.*, at 80.

²⁷ Lillich, *op. cit.*, at 9.

²⁸ Salacuse, *op. cit.*, at 81.

²⁹ *Id.*

protections for foreign-owned property in a state – thus, the early emergence of investment protection.³⁰

14. With the changes during the end of the 18th Century in the international context, states without colonial holdings began to develop a new instrument to protect their economic interests abroad. In particular, in the early days of the United States, John Adams drafted a model treaty of alliance and commerce.³¹ The United States signed the first such agreement with France in 1778, the Treaty of Amity and Commerce.³² Later referred to as Treaties of Friendship, Commerce and Navigation (FCNs), these treaties included the idea of most-favoured nation standard of treatment between two state parties and further developed the idea in a way that closely resembles modern BIT language.³³ Treaties with Prussia, Morocco, England, and Spain also resulted from these efforts.³⁴ Although the earliest of these treaties were with European powers as a means to establish commercial relations, the United States began negotiating with Latin American, Asian and African states as the economies of these countries opened to commercial exchange.³⁵
15. One characteristic of these treaties in contrast to the earlier concession agreements was a greater balance in power between the two signatory states.³⁶ The treaties had a more reciprocal nature. FCN treaties are considered the true precursor to the modern BITs, providing relatively balanced protections to both parties to the

³⁰ *Id.*

³¹ K. Vandevelde, *Bilateral Investment Treaties: History, Policy and Interpretation* (2009) 19.

³² Salacuse, *op. cit.*, at 84; Treaty of Amity and Commerce between the United States and France (signed 6 February 1778) <http://avalon.law.yale.edu/18th_century/fr1788-1.asp>.

³³ A. Ziegler, 'Most-Favoured-Nation (MFN) Treatment', in *Standards of Investment Protection* edited by August Reinisch (2008) 59-86, 62; Vandevelde, *op. cit.*, at 19.

³⁴ A Treaty of Amity and Commerce between His Majesty the King of Prussia, and the United States of America (signed 10 September 1785), <http://avalon.law.yale.edu/18th_century/prus1785.asp>; Treaty of Peace and Friendship, Treaty with Morocco (28 June and 15 July 1786), <http://avalon.law.yale.edu/18th_century/bar1786t.asp>; Treaty of Amity Commerce and Navigation, between His Britannick Majesty and The United States of America, by Their President, with the advice and consent of Their Senate ("The Jay Treaty") (signed 19 November 1794), <http://avalon.law.yale.edu/18th_century/jay.asp>; Treaty of Friendship, Limits, and Navigation Between Spain and The United States (signed 27 October 1795), <http://avalon.law.yale.edu/18th_century/sp1795.asp>.

³⁵ See generally K. Vandevelde, 'U.S. Bilateral Investment Treaties: The Second Wave', *Michigan Journal of International Law* 14 (1993): 621, 623.

³⁶ Salacuse, *op. cit.*, at 82. See, e.g., Treaty of Friendship, Commerce and Navigation Between Argentina and the United States (signed 27 July 1853), <http://avalon.law.yale.edu/19th_century/argen02.asp>; Brazil-US, Treaty of Amity, Commerce, and Navigation (signed 12 December 1828), <http://avalon.law.yale.edu/19th_century/brazil01.asp>.

agreement: national treatment was provided for and the foreign traders had the right to use domestic courts to protect their interests.³⁷ The combination of procedural and substantive benefits was essential to ensuring the equality between the parties, most notably demonstrated by the principle of “fair and equitable treatment” which later became an element of these FCNs.³⁸ The standard of treatment provisions later included “most-favoured nation” and “national treatment.”³⁹

16. From the procedural perspective, it was the Treaty of Amity, Commerce and Navigation between Britain and the United States of 1794,⁴⁰ known as the Jay Treaty, that signaled a new era of dispute resolution. The Jay Treaty created three mixed Anglo-American arbitration commissions to resolve disputes ranging from boundary disputes to claims by British and American citizens whose property had been damaged or seized during the war. The treaty was the first of its kind to provide for mixed commissions for the resolution of disputes. The commissions had jurisdiction to decide both state to state disputes and disputes between states and individuals. The Jay Treaty thus provided an important blueprint for international investment treaties and the investor-state arbitration system in place today.
17. The Jay Treaty also led to an important renewed interest in state-to-state arbitration. In the hundred years after the first award under the Jay Treaty, there were more than one hundred inter/state arbitrations.⁴¹ Indeed, the late nineteenth century saw a similar boon in inter-state-arbitrations spurred on by claims commissions formed to settle multiple disputes. On example is the United States-Mexican Mixed Claims, which heard over 2,000 claims between 1871 and 1876 on topics ranging from cattle theft to denial of justice.⁴²
18. The trend of FCN treaties and state-to-state dispute settlement persisted until the mid-20th Century. Following World War I, the United States concluded FCN

³⁷ D. Blumenwitz, *Treaties of Friendship, Commerce and Navigation*, in Rudolf Bernhardt (Ed.), *Encyclopaedia of Public International Law* Volume IV (2000) 954-955.

³⁸ Blumenwitz, *op. cit.*, at 955; A. Bjorklund, *National Treatment*, in August Reinisch (Ed.) *Standards of Investment Protection* (2008) 29-58, 31.

³⁹ Salacuse, *op. cit.*, at 85.

⁴⁰ The Jay Treaty, *op. cit.*, Art. 6.

⁴¹ D. Rivkin, ‘The Impact of International Arbitration on the Rule of Law’, transcript of the 2012 Clayton Utz Syney University International Arbitration Lecture (2012), at 7 (citing James Brown Scott, *The Hague Peace Conferences of 1899 and 1907* Volume I (1909) 226).

⁴² *Id.*

treaties intended to protect U.S. nationals and businesses abroad from arbitrary and discriminatory governmental actions.⁴³ These treaties also included procedural protections in regard to expropriation and demonstrated agreements on processes for settling disputes. Despite the signing of these FCN treaties, the actual level of U.S. investment abroad was relatively small and Europe was not investing outside of former colonial holdings to a great enough extent to warrant negotiation of further investment protection instruments. However, despite the limited benefits to be gained, both the United States and various European countries expanded their FCN treaty programs during the post-war period. In particular, the United States drafted a model FCN treaty, which included a uniform clause on the protection of investments. Property taken by expropriation was to be protected by “due process of law” and “just compensation.”⁴⁴

19. The international economic climate, however, changed drastically after World War II, especially with the development of the international trade regime. With the creation of global monetary and economic institutions after the war, namely the International Bank for Reconstruction and Development, the International Monetary Fund, and the General Agreement on Tariffs and Trade (GATT), other institutions also served the goal of promoting trade and tariff reduction.⁴⁵ GATT in particular largely eliminated the need for bilateral FCNs; thus, investment protection became the primary goal of bilateral treaty negotiations.⁴⁶
20. These pre-1959 treaties provide the architecture for what followed in the next fifty years. From the earliest treaties where foreign concessions were first offered to the FCNs where additional specific protections were offered for foreign investors, the protections provided became more detailed and developed in a way to facilitate changing economic relationships, providing more efficient means for resolution of disputes and treatment protections in line with global needs. This evolution not only marks the increasing economic integration of a world ever becoming more global, but also demonstrates an evolving view towards the advantages of investment protection. In the FCN programs, the treaties served broader purposes and allowed the countries to maintain friendly relations. The protections after 1959

⁴³ Salacuse, *op. cit.*, at 86.

⁴⁴ K. Vandeveld, *United States Investment Treaties* (2010) 50-51.

⁴⁵ Salacuse, *op. cit.*, at 86-87.

⁴⁶ Vandeveld (2009), *op. cit.*, at 22.

serve similar purposes yet more fully developed the specific area of investor-state relationships. A wide range of protections, substantive and procedural, were incorporated into the treaties.

3. Post-1959: BITs

21. The development of BITs over the next fifty years will be broken down into four general stages. The first stage considers the BITs signed between 1959 and the mid-1970s – generally at the point of the rejection of the Hull Doctrine by the New International Economic Order (NIEO). The second stage runs through the mid-1980s. The third stage is divided by the entry of the United States into the development of a BIT program and active treaty negotiation with foreign states. The final stage, representing the latest BITs concluded and several updates of earlier BITs, reveals a movement away from reliance on traditional procedural dispute resolution mechanisms.
22. There were advantages to the use of BITs over the use of FCNs. These documents more successfully achieved the goal of specific investment protections than the broader FCN treaties that had previously offered protections in this area among others. The specificity of the BITs was advantageous for ensuring protection. Without international mechanisms for dispute resolution in place, the treaties required a more detailed explanation of procedural aspects of dispute resolution.
23. The push for the early BITs was centralized in European states. Between 1959 and 1972, Germany concluded 46 BITs and Switzerland concluded 27. The Netherlands concluded 105 BITs since signing its first one in 1963. During the same period, the United States concluded two modern FCNs. Despite its earlier widespread FCN treaty program, the United States was relatively slow in following the strong European lead in developing bilateral treaties.

B. How and Why ISDS Became the Preferred Dispute Settlement Mechanism

24. Arbitration has been considered the most favourable dispute resolution technique for much of the recent life of investment protection instruments. By providing a forum outside the home courts, issues of lack of impartiality or immunity could generally be avoided.

25. The early treaties, enacted prior to the establishment of ICSID, utilized the International Court of Justice (ICJ) in the process of settling disputes. The first generation of treaties, for example the Germany-Pakistan treaty of 1959, provided that when disputes arose concerning the interpretation or application of the treaty, such disputes would be taken to the ICJ for settlement if agreed by both parties. The process, however, was to begin with consultation between the state parties in order to find a solution “in the spirit of friendship.” Where the parties could not agree on a settlement at the ICJ, the treaty provided that disputes could be resolved by arbitration. This arbitration would be resolved by three arbitrators, chosen in the usual mixed commission manner. If the parties failed to appoint an arbitrator, then the President of the ICJ, or Vice President, if a conflict arose, would appoint instead. If the dispute was to be settled by an arbitral tribunal, the tribunal could determine its own rules of procedure. This allowance of choosing procedure filled the gap as no widely accepted investment arbitration rules were yet in place.
26. Beginning in the mid-20th Century, however, BITs supplemented state-to-state dispute settlement by allowing investors to directly bring claims against host states. In the past, when a government’s violation of international law hurt an investment, an investor’s options for remedy were usually limited to one of the following: (1) negotiating directly with the host government; (2) suing the host government in the sovereign’s own courts where defences of sovereign immunity may be readily available; (3) requesting the home government to negotiate diplomatically with the host government; or (4) requesting the home government to espouse a claim on their behalf before the International Court of Justice, provided the ICJ had jurisdiction.⁴⁷ While some of these options may have provided useful opportunities to solve disputes, they were often ineffectual and investors were unable to redress their grievances satisfactorily. For example, the United Nations identified 875 acts of government takings in sixty-two countries in the fourteen years prior to the promulgation of BITs for which there was no effective remedy.⁴⁸ Finally, even when a home country litigated on an investor’s behalf, it was uncertain if the

⁴⁷ See S. D. Franck, *Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law*, 19 *Global Business & Development Law Journal* 337, 343 (2007).

⁴⁸ J. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *International Law* 655, 659 (1990).

- investor would receive the financial compensation for its damages.⁴⁹
27. The real innovation of BITs was the creation of procedural rights giving investors a mechanism to directly enforce substantive rights. Instead of relying on the unpredictable political or diplomatic process, investment treaties began to provide a reliable forum for investors to enforce specific protection articulated in a treaty. Indeed, the ICSID Convention specifically provides in Article 27 that it is meant to replace the traditional system of diplomatic protection. Ibrahim Shihata, the former Secretary General of ICSID, has noted that ICSID, by provided a forum and rules for investment dispute settlement, has helped to “depoliticize” the settlement of investment disputes.⁵⁰ Thus, ISDS was a solution to two evident problems: first, unreliable and disjointed reliance on diplomatic protection; and second, biased or ineffective domestic remedies.
28. The third stage of BITs, beginning in the early 1990s, included more comprehensive arbitration clauses and growing conformity in the substantive protections offered to investors, including fair and equitable treatment, national treatment as well as most-favoured nation treatment and expropriation protections.⁵¹ The 1992 Australia-Hungary BIT⁵² exemplifies the level of specificity that was included in the dispute settlement clauses during this stage. The BIT provides for a detailed analysis of the procedure for resolving a dispute, including time limits and procedures for those instances when parties cannot agree on the method of resolution.
29. There was also a limiting of the scope of application of the treaties during this period. Exception clauses, addressing issues such as the environment, national security, as well as taxes were more frequently used. This period marks the emergence of non-investment issues being incorporated in the BITs, as further discussed below. The BITs also provided that the scope was limited to investor-state disputes.⁵³
30. This period further marks the proliferation of treaties between developed

⁴⁹ See Franck (2007), *op. cit.*, at 343.

⁵⁰ I. Shihata, *Towards a Greater Depoliticization of Investment Disputes*, 1 ICSID Rev. 1, 4 (1986).

⁵¹ UNCTAD, “Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking” (2007) <http://www.unctad.org/en/docs/iteia20065_en.pdf>.

⁵² Agreement between Australia and the Republic of Hungary on the Reciprocal Promotion and Protection of Investments (signed 15 August 1991)

<http://www.unctad.org/sections/dite/ia/docs/bits/australia_hungary.pdf>.

⁵³ UNCTAD, “Bilateral Investment Treaties” (2007), *op. cit.*, at 99.

economies and the former communist countries of Eastern Europe. Treaties were concluded in particularly high numbers with Hungary, Poland, the Czech Republic, and the Slovak Republic. Poland, for example, signed 62 BITs this period. Similarly, the 79 Czech treaties were mostly signed during this decade. This proliferation of treaties by former communist countries in Europe may largely explain the general surge in the number of BITs worldwide.⁵⁴

31. The fourth stage of investment protection has emerged relatively recently. There is a continued use of Model BITs by parties entering into negotiations to conclude the treaties, but the most notable change is the inclusion of investment chapters in FTAs. This period can be particularly characterized by changes in the use of arbitration to resolve disputes between parties. This “new generation” of BITs and IIAs can be characterized by three trends: (1) express inclusion of social welfare concerns into the agreements; (2) new analytical devices for arbitrators such as more clearly defined terms; and (3) refined and streamlined procedural mechanisms to increase transparency and accountability.
32. The 2007 UNCTAD Report assessing trends and emerging issues among investment agreements noted that one of the recent trends in the development of BIT protection is the extension of the protection from merely traditional investment protection to assurances in regards to health and safety, the environment, labor and security. Some of these additional protections are part of broader human rights standards now being incorporated into BITs, arising from concerns that these basic protections have been neglected for the broader goal of investment protection. Environmental protections, in particular, have gained widespread acceptance in BITs and FTAs in the past decade.⁵⁵ At times these additional issues are included in the preambles, such as the US-Uruguay BIT which includes the protection of “health, safety, and the environment, and the promotion of consumer protection and internationally recognized labor rights” as an equal objective to promoting and protecting investment. A number of recent agreements also contain preamble language on the promotion of sustainable development as a goal.⁵⁶ The US Model

⁵⁴ See generally UNCTAD, “International Investment Arrangements: Trends and Emerging Issues” (2014), at 1.

⁵⁵ K. Gordon and J. Pohl, ‘Environmental concerns in international investment agreements: A Survey’, OECD Working Papers on International Investment, No 2011/1, OECD Investment Division, <www.oecd.org/daf/investment>.

⁵⁶ E.g., U.S.-Colombia FTA (2012).

BIT, beginning with the 1994 version, includes language in the preamble that directly addresses concerns for health as well as the environment: “Agreeing that these objectives can be achieved without relaxing health, safety and environmental measures of general application.” The US 2004 Model BIT notes the “effective utilization of economic resources” as well as the “protection of health, safety, and the environment, and the promotion of internationally recognized labor rights.” There is also a growing trend to expressly include certain protections in independent substantive articles.⁵⁷ These approaches to incorporating non-investment priorities into investment agreements are further examined below in the section analyzing the “right to regulate.”

33. These concepts such as human rights, the environment, health, and sustainable development are becoming more prevalent in BITs – certainly in part because of the increasingly recognized importance put on these factors as protections within public international law. Although the core purpose of an investment protection agreement is the protection and promotion of foreign investment, the interrelated nature of economics and human rights cannot be ignored. Of particular importance in this respect is the incorporation of environmental protection as an inter-related aspect of investment protection. The close interconnection between these extra-investment protections suggests that these issues are beginning to be seen as essential elements of investment protection. Thus, the protection of investments cannot be separated from these additional issues, and certainly the trend leads more in the direction of such relationship.
34. Two final trends among modern BITs and IIAs are examined in greater detail in the following sections. The first includes new analytical devices for arbitration panels such as more clearly defined terms and greater explanation of protections such as fair and equitable treatment, national treatment, and limits on expropriation. The last trend encompasses efforts to make investment arbitration more transparent, consistent, and accountable.

⁵⁷ Gordon and Pohl note an increasing trend for environmental protections to be included in the body of the treaty. See Gordon and Pohl, *op. cit.*, at 14.

C. The Current ISDS Landscape

35. ISDS has advanced greatly since its meagre beginnings in the mid-20th Century. Today, both states and investors are familiar with the system, as it has become a common tool for investors to use in order to enforce their rights against host states. The OECD estimates that 93% of all existing BITs contain ISDS provisions.⁵⁸ According to UNCTAD's most recent April 2014 review of ISDS development, by the end of 2013, 98 states had responded to a total of 568 treaty-based claims since ISDS's inception.⁵⁹ This trend, however, is not unique to investment arbitration. For example, from 1 January 1995 until beginning of May 2014, a total of 478 trade cases have been brought before the WTO for dispute resolution.⁶⁰ These numbers also pale in comparison to the amount of cases brought before the European Court of Human Rights for example, which received 65.900 applications *in the year 2013 alone*.⁶¹
36. Overall, 274 ISDS claims have been concluded, meaning they have been adjudicated on their merits or dismissed. 43% of cases historically have been decided in favour of the state, while 31% have been decided in favour of the investor and another 26% were settled. The number of claims has increased over time; however, 2013 saw a drop in the number of ISDS claims filed. The majority of these cases have also been brought under three particular international agreements: NAFTA accounts for 51 claims, the Energy Charter Treaty for 42, and the Argentina-U.S. BIT for 17. As well, 72 total arbitrations have been brought pursuant to so called *intra*-EU BITs, i.e. BITs concluded between Member States of the EU.⁶²

1. Who are these claims against?

37. In 2013, 46% of all claims were brought against European countries, followed by 25% against Asian countries. However, of the 24 cases brought against EU Member States, most were initiated by investors from other EU states pursuant to

⁵⁸ OECD, "Investor-State Dispute Settlement", Public Consultation Document (2012), at 8.

⁵⁹ UNCTAD, "Recent Developments in Investor-State Dispute Settlement (ISDS)," *IIA Issues Note*, No. 1 (April 2014), at 1.

⁶⁰ For details see <http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm>.

⁶¹ European Court of Human Rights, "Statistics 2013", http://www.echr.coe.int/Documents/Stats_annual_2013_ENG.pdf.

⁶² OECD (2012), *op. cit.*, at 68.

individual BITs or the Energy Charter Treaty. In total, intra-EU cases account for 15% of all claims brought worldwide.⁶³

2. Who brings these claims?

38. The majority of ISDS claims are brought by investors from developed countries. In 2013, for instance, investors from The Netherlands, Germany, Luxembourg, and the United States brought the most claims. This also corresponds with overall trends through the history of ISDS. By the end of 2013, United States investors had brought 125 claims against states, followed by The Netherlands (61), United Kingdom (42), and Germany (39).⁶⁴ At first blush, this may support the concept of an “American claim culture”—that is, that American investors are more litigious than other investors. However, comparing U.S. investor claims to all EU investor claims helps put this hypothesis in perspective. Six of the top ten home states for investors are Member States of the European Union, raising a total of 225 claims. In aggregate, investors from EU Member States have brought more claims in the past 30 years than investors from the United States.
39. Moreover, ISDS claims are not always the tools of large corporations. An OECD survey concluded that 22% of all ISDS claims are brought by individuals or “very small corporations.”⁶⁵ Meanwhile, medium and large multinational companies account for 50% of claims.⁶⁶ The rest of the cases (28%) were brought by investors about which there is little or no public information.⁶⁷

D. Australian investment treaty policy

40. Often, the impression is created that once a State starts concluding International Investment Agreements (IIAs)⁶⁸ which provide for ISDS, it is impossible to reverse such policy. This is not entirely correct as shown by the Australian investment treaty experience, but such policy switch could entail significant legal uncertainty

⁶³ UNCTAD (2014), *op. cit.*, at 3.

⁶⁴ *Id.* at 9.

⁶⁵ OECD (2012), *op. cit.*, at 16.

⁶⁶ *Id.*

⁶⁷ *Id.*

⁶⁸ The term ‘IIAs’ refers to ‘freestanding’ bilateral investment agreements (BITs), but also any other bilateral or multilateral treaty which regulates international investment, such as Free Trade Agreements (FTAs) with an investment chapter.

and instability. Before 2004, Australian IIAs commonly provided for ISDS.⁶⁹ Although the 2004 US-Australia FTA still protects foreign investment, it does not include an ISDS mechanism. The Australian government based this choice on the grounds that “*both countries have robust, developed legal systems for resolving disputes between foreign investors and government*”.⁷⁰

41. In 2011, the Australian government released a Trade Policy Statement opposing ISDS in future FTAs to be concluded by Australia. According to the statement:

Some countries have sought to insert investor-state dispute resolution clauses into trade agreements. Typically these clauses empower businesses from one country to take international legal action against the government of another country for alleged breaches of the agreement, such as for policies that allegedly discriminate against those businesses and in favour of the country’s domestic businesses.

The Gillard Government supports the principle of national treatment – that foreign and domestic businesses are treated equally under the law. However, the Government does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses. Nor will the Government support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses. The Government has not and will not accept provisions that limit its capacity to put health warnings or plain packaging requirements on tobacco products or its ability to continue the Pharmaceutical Benefits Scheme.

*In the past, Australian Governments have sought the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice. If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries.*⁷¹

⁶⁹ See UNCTAD Database of Bilateral Investment Treaties, available at: http://www.unctadxi.org/templates/DocSearch_779.aspx

⁷⁰ Australian Government, Department of Foreign Affairs and Trade, ‘Australia-United States Free Trade Agreement: Fact Sheets – Investment’, available at: http://www.dfat.gov.au/fta/ausfta/outcomes/09_investment.html

⁷¹ Australian Government, Department of Foreign Affairs and Trade, ‘Gillard Government Trade Policy Statement: Trading our way to More Jobs and Prosperity’, Apr. 2011, at 14, available at:

42. This position was nuanced afterwards so that, as far as the Australia's governmental position on ISDS in current FTA negotiations is concerned, according to the governmental site:

The Government will consider ISDS provisions in FTAs on a case-by-case basis.

The Australian Government, however, is opposed to signing up to international agreements that would restrict Australia's capacity to govern in the public interest — including in areas such as public health, the environment or any other area of the economy.⁷²

43. In 2013, Australia again provided for ISDS in the Korea-Australia Free Trade Agreement (KAFTA). To explain this new change of policy, the Australian government highlighted that it had reserved its policy space in order not to be prevented from regulating in the public interest, while noting the prominent place of the treaty's procedural safeguards regarding frivolous claims.⁷³ In the same vein, it stated that:

KAFTA ISDS is a modern, balanced mechanism with explicit safeguards for legitimate public welfare regulation

- *Investment obligations can be enforced directly by Australian investors (and by Korean investors) through an ISDS mechanism. An ISDS claim can only be made on the basis of a breach of an investment obligation or commitment. It cannot be based on a breach of an obligation in other parts of KAFTA such as the intellectual property or environment chapters.*
- *The KAFTA Investment Chapter and ISDS provisions include explicit safeguards to protect legitimate public welfare regulation, including in areas such as public health, and the environment. These include: safeguards built into the Investment Chapter obligations; 'reservations' which allow Australia to reserve policy space in sensitive areas; general exceptions; and procedural safeguards built into the ISDS mechanism.*

<http://www.acci.asn.au/getattachment/b9d3cfae-fc0c-4c2a-a3df-3f58228daf6d/Gillard-Government-Trade-Policy-Statement.aspx>

⁷² Australian Government, Department of Foreign Affairs and Trade, 'Frequently Asked Questions on Investor-State Dispute Settlement (ISDS)', available at:

<https://www.dfat.gov.au/fta/isds-faq.html>

⁷³ Australian Government, Department of Foreign Affairs and Trade, 'Fact Sheet: Investor-State Dispute Settlement (ISDS)', available at:

<http://www.dfat.gov.au/fta/kafta/guides/fact-sheet-isds.html>

- *ISDS does not apply to decisions made concerning investments which are subject to review under Australia's foreign investment policy.*⁷⁴
44. The latest FTA between Australia and Japan again does not include ISDS. Yet, that omission has to be considered in the light of the Trans-Pacific Partnership (TPP): given that ISDS is planned to be included in the TPP, the inclusion of ISDS in the Australia-Japan FTA could be seen as pleonastic. However, the difficulty would be that a number of protection standards which are now provided via the FTA, will have to be read into the TPP in order to be enforceable. To solve this problem, one option on the table is that once the TPP (with ISDS) is in force, all obligations under the former FTAs/BITs (with or without ISDS) between TPP Members would be incorporated into the TPP and these FTAs/BITs themselves will terminate.
45. We are reliably informed that the new Australian Government which took office in September 2013 is not in principle opposed to ISDS, but that matters will continue to be addressed on a case-by-case basis, including in pending negotiations.

III. Dutch (EU) – US international investment relations

A. Investment statistics

46. As indicated in the introduction (section I), the US has always played a prominent role in Foreign Direct Investment (FDI) inflows to the Netherlands, and *vice versa*. It is interesting to consider the sectoral composition of the FDI stock from the EU and the Netherlands in the US and *vice versa*. The underlying notion is that possibly the risk of ISDS cases is positively correlated with the size of FDI stocks in the respective economies. Other factors that could also contribute to the risk of the Netherlands facing ISDS cases are the characteristics of investments, i.e. their size and whether they consist of (im)mobile assets. With respect to the size of investments, one could expect that if investments of a specific company are very large, there may be a higher chance for investment disputes compared to a situation where many companies make only small investments. The (im)mobility of assets

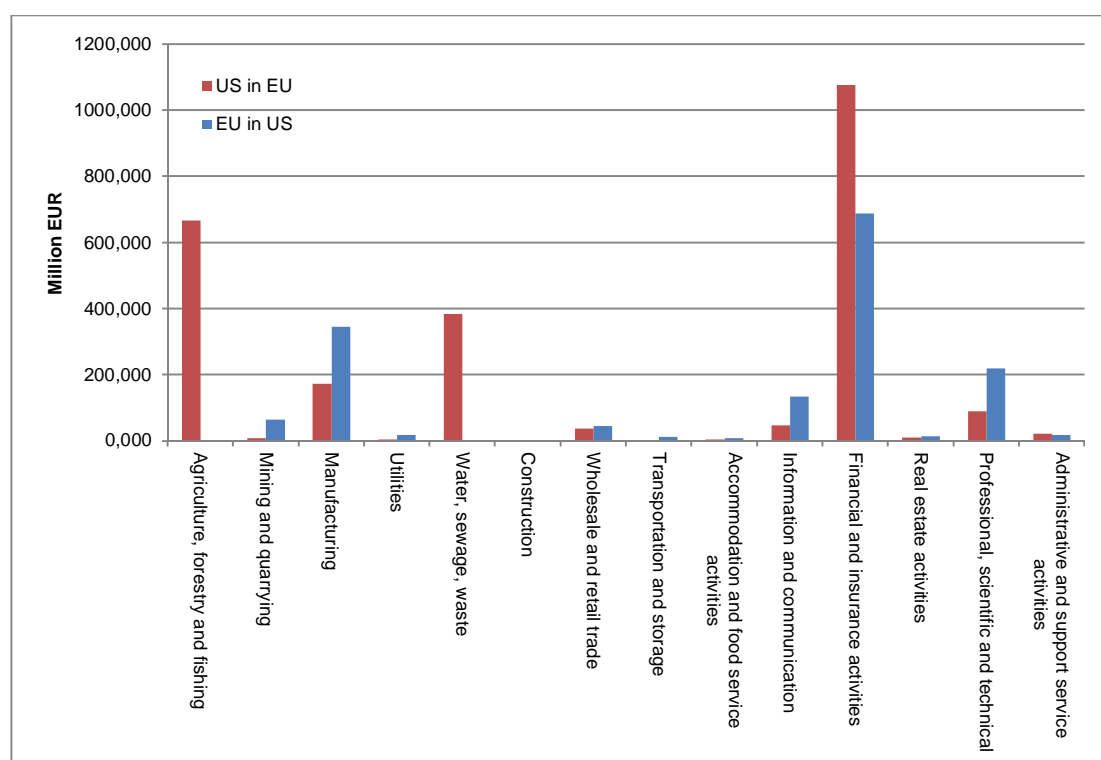
⁷⁴ Australian Government, Department of Foreign Affairs and Trade, 'Quick Guide: Key Investment & Investor-State Dispute Settlement (ISDS) Outcomes', available at: <http://www.dfat.gov.au/fta/kafta/guides/quick-guide-key-investment-and-isds-outcomes.html>

refers to the ease with which companies can either transfer assets to either another owner or another location. If assets are more mobile (e.g. in sectors like business services), companies may prefer to move their assets rather than to start an investment dispute, contrary to a situation where assets are more immobile (e.g. in sectors like mining).

47. International sectoral FDI statistics are not streamlined, i.e. data collection methods as well as definitions might differ per country. For example, collection methods range from the balance of payment approach (BOP approach), the administrative approach (e.g. based on the approval of investment projects), to the survey approach. While it is clear that surveys do not capture every company that invests, the main problem with the administrative and BOP approaches is that both do not take into account retained earnings and depreciation. As such, FDI statistics have to be interpreted with caution. However, we do not expect that problems related to FDI data and their reliability affect certain sectors (or EU countries for that matter) more than others.

1. Current situation: EU-US FDI

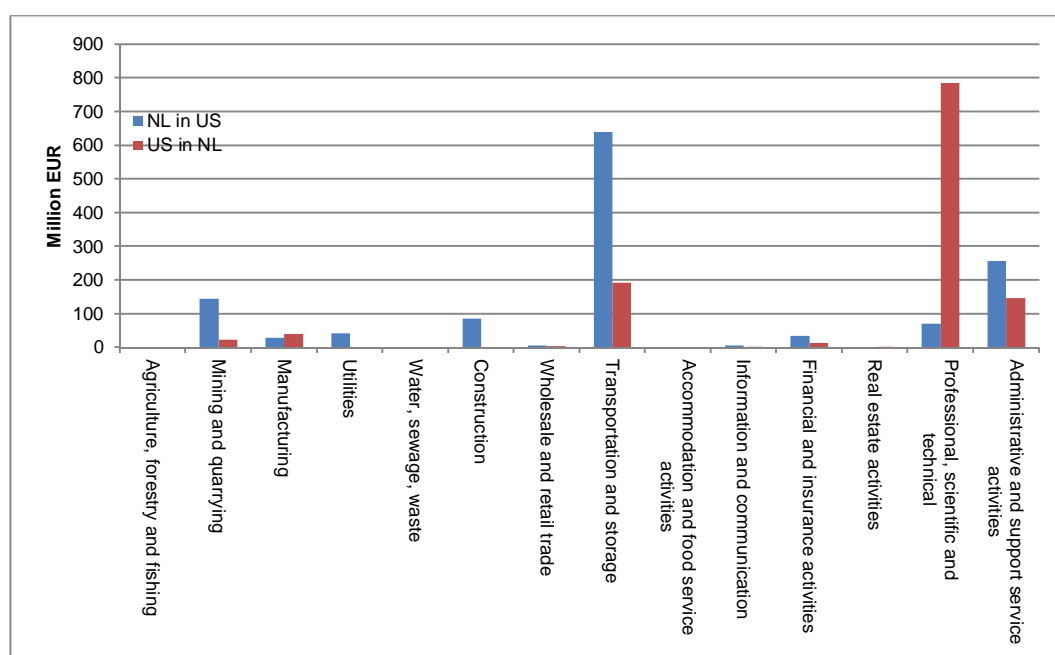
48. Figure 1 shows the total foreign direct investments (FDI stocks) between the EU and US in 2011. While the EU mainly holds investments in the manufacturing, finance and insurance, as well as professional services sectors, US companies mostly invest in agricultural, water, and finance and insurance sectors. For US investments in the EU, manufacturing is smaller but still significant, mainly in food products and (petro)chemicals in the EU. According to Eurostat, the US's total investments in the EU are worth ca. EUR 1.5 trillion, and *vice versa*. This bilateral balance in investment position has not changed significantly since 2008. However, what has changed are investment volumes, which have increased by more than 50% compared to 2008.

Figure 1 Investment stocks EU-US, 2011⁷⁵

2. Current situation: NL-US FDI

49. Comparing the sectoral profile of US investment in the EU to that of US investment in the Netherlands (see Figure 2) it becomes clear that they differ greatly. The largest investment positions are held in professional, administrative, and transport and storage (logistics) services. While particularly Dutch transportation companies invest in the US, most American investments in the Netherlands are in the professional services sector. In the latter sector investments are majorly driven by activities of headquarters.

⁷⁵ Eurostat. (2014). EU direct investment positions, breakdown by country and economic activity . In Eurostat, European Commission. Retrieved 2014, from http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=bop_fdi_pos_r2&lang=en.

Figure 2 Investment stocks NL-US, 2011⁷⁶

50. Due to the data differences described above we have tried to match Eurostat data with data provided by the Dutch Central Bank (DNB).⁷⁷ While an exact match was not possible due to a lack of information on the sectoral classification and corresponding aggregation, we can say that figures from DNB in banking and insurance services, as well as in processed foods are comparable to data retrieved from Eurostat. DNB estimates have relatively lower figures for services FDI from the US, while within manufacturing processed foods are more important than suggested by Eurostat data.

3. Possible effects of the TTIP

51. The size and sectoral composition of the EU and US economies may be affected in the future by the TTIP itself. It is therefore interesting to analyse which changes the TTIP could entail concerning FDI. It is important to note that the impact assessment studies of the TTIP for the European Commission (DG Trade) and for the Dutch government do not analyse the effects of the TTIP on investment flows at the sectoral level. As such, we will use trade flow changes and current levels of

⁷⁶ Eurostat. (2014). EU direct investment positions, breakdown by country and economic activity . In Eurostat, European Commission. Retrieved 2014, from http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=bop_fdi_pos_r2&lang=en.

⁷⁷ For an overview, see: <http://www.statistics.dnb.nl/betalingsbalans-en-extern-vermogen/index.jsp>

investment related barriers per sector as proxies for likely investment flow changes.

52. Table 1 shows the expected trade flow changes based on the modelling work done for the official TTIP scoping study conducted by CEPR for the European Commission.⁷⁸ According to this study, especially manufacturing sectors are expected to experience significant growth in trade flows. This concerns, for example, processed foods, chemicals, and motor vehicles trade. It is to be noted that these projections are benchmarked to 2027. Given these results it might be that the risk for ISDS cases increases in sectors that experience a sharp increase in trade. This however depends on the substitutability or complementarity of FDI and trade in a given sector, i.e. whether FDI *follows* trade flows, or whether FDI *replaces* trade flows.

Table 1 Expected change in EU-US exports as a result of TTIP (%)⁷⁹

	EU to US		US to EU	
	Ambitious agreement	US to EU	EU to US	US to EU
	Ambitious agreement		less ambitious agreement	
Agr forestry fisheries	15.10	21.80	16.30	20.50
Other primary sectors	0.60	0.40	0.50	0.50
Processed foods	45.50	74.80	26.10	56.50
Chemicals	36.20	34.20	20.00	23.00
Electrical machinery	35.00	44.10	18.30	21.90
Motor vehicles	148.70	346.80	71.00	207.40
Other transport equipment	25.50	27.80	13.20	17.30
Other machinery	6.60	16.70	7.60	14.40
Metals and metal products	68.20	88.10	42.40	52.70
Wood and paper products	19.90	42.50	10.80	21.70
Other manufactures	22.80	16.70	23.00	16.30
Water transport	6.80	7.10	3.50	3.40
Air transport	1.60	2.20	0.90	1.00
Finance	8.50	4.90	4.30	2.40
Insurance	8.30	7.40	4.20	3.50
Business services	2.30	5.40	1.40	2.50
Communications	0.90	10.50	0.60	5.00
Construction	3.10	6.60	1.80	3.10
Personal services	2.30	13.80	1.40	6.40
Other services	-1.00	1.50	-0.40	0.60
Total	28.03	36.57	16.16	23.20

⁷⁸ Centre for Economic Policy Research (CEPR), *Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment*, Report prepared for the European Commission, DG Trade (2013), available at: http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150737.pdf

⁷⁹ *Id.*

53. The literature provides guidance as to the nature of the relationship between trade and investment, i.e. whether trade and FDI are complementary or whether they substitute one another (see Annex A). The general view put forward in the existing literature is that trade and FDI are indeed complementary to each other. More FDI leads to larger trade volumes, either through trade in intermediate goods or through stronger commercial connections more generally. If one looks at the product level, however, the opposite trend is apparent. If a firm decides to produce final goods overseas, there is a drop in export volumes of that final good. At the aggregate level though trade in intermediate goods or other goods altogether more than compensates for that decrease.
54. The CEPR study also looks at existing levels of investment-related barriers in the EU. These are relatively high in the sectors of aerospace, automotives, textile, clothing & footwear, chemicals, electronics and processed foods. In services, they are relatively high in information and communications technology, consumer services and transport services. As these barriers are likely to be at least partly reduced under the TTIP, FDI in these sectors may be expected to increase.
55. The analysis above has shown that there is no easy answer to the question to what extent the structure of FDI stocks may be affected by the TTIP. The results suggest that there may be effects on FDI flows notably in the automotives, chemicals, electronics, and transport sectors, but the size of these effects is difficult to predict.

B. Geopolitical dimension

56. An argument for including an investment chapter in the TTIP is related to geopolitical considerations. If the EU and the US would manage to agree on regulatory harmonisation, they could set a world standard for trade-related rules, given their still dominant role in global trade and investment.⁸⁰ This would strengthen the bargaining power of the EU and the US in negotiations with emerging economies like the BRICs, which are considered less similar to the EU than the US in terms of economic principles and political values. Although this argument is often made with respect to trade-related standards (e.g. in the area of

⁸⁰ See e.g. P. van Ham, *TTIP and the Renaissance of Transatlanticism: Regulatory Power in the Age of Rising Regions*, Clingendael Report (2014).

food safety),⁸¹ it can also be put forward in the context of ISDS. It is claimed that ISDS in the TTIP could create a model for investment protection to be employed as a standard in the future. A state of the art ISDS could create transparency and predictability for investors, especially if this standard would eventually also be agreed at a multilateral level (e.g. in the WTO). An additional argument is that if ISDS is not included in the TTIP, it would be much harder to conclude FTAs including ISDS with other countries. Since FDI towards emerging economies is increasing but not all of these countries have transparent and well-developed legal systems, investment protection is important for foreign investors in these countries.

57. To what extent an agreement on ISDS in the TTIP would indeed lead to a better bargaining position with countries like China is difficult to predict. First, it is unlikely that China will not agree to include ISDS in a future potential trade and investment agreement with the EU if it is not included in the TTIP. China has a large and growing FDI stock abroad, and is therefore increasingly interested in investor protection itself. It has concluded over a 100 BITs, at least part of them including ISDS provisions.⁸² Secondly, ISDS in TTIP may not be the only reference point for negotiations with other countries. The US is for example also negotiating aiming to negotiate ISDS provisions in negotiations for the TPP, which would create another large trading block with bargaining power towards third countries. Especially for China, TPP may be a more relevant reference point than TTIP given that TPP also covers many of its regional trade partners. In addition, whether the TTIP ISDS provisions will be considered as a model will also depend on the extent to which the EU and US will use it as a model themselves when negotiating other trade agreements. Although large deviations may not be likely, if they feel they need or can achieve a better or more tailored ISDS mechanism with other countries and therefore not use the ISDS in TTIP as a standard, the bargaining power created by TTIP may also be reduced. Finally, while in terms of common products standards or regulation in areas like intellectual property rights

⁸¹ E.g. common standards can mean that products can be produced and controlled in the same way for both the EU and US market. This can create economies of scale in production and/or less costs in checking the compliance with standards.

⁸² Berger, Axel, "China's new bilateral investment treaty programme: Substance, rationale and implications for international investment law making", Paper prepared for the American Society of International Law International Economic Law Interest Group (ASIL IELIG) 2008 biennial conference "The Politics of International Economic Law: The Next Four Years", Washington, D.C., November 14-15, 2008 (2008) <http://80.237.152.15/uploads/media/Berger_ChineseBITs.pdf>

there would be clear economic gains for third countries to adhere to such standards, as it has a direct effect on production and distribution processes leading to increased efficiencies, this is less obvious for ISDS. Although the geopolitical argument for the TTIP may be valid, for ISDS specifically this argument is less strong.

C. International investment protection rules

1. US – EU/Netherlands BIT history

58. Despite the large capital flows between the Netherlands and the US, the two countries have never concluded a BIT to regulate their investments. However, the Netherlands has maintained a treaty of Friendship, Commerce and Navigation with the US⁸³ since 1956 that provides for national treatment (NT) and free entry for foreign investors, with certain exceptions⁸⁴ and without providing for ISDS. Likewise, the majority of the ‘old’ EU Member States (i.e., those that formed the EU prior to the major enlargement of 2004 and that are economically similar to the Netherlands)⁸⁵ have not concluded a BIT with the US. In fact, less than one third of the 28 EU Member States (namely, 9) have BITs with the US.⁸⁶
59. Since the inception of its BIT programme in 1963, the Netherlands has concluded 98 BITs, thus belonging to the group of countries with the largest BIT networks globally.⁸⁷ These treaties have been almost exclusively concluded with developing and transition economies.⁸⁸ The BITs concluded between the Netherlands and

⁸³ Treaty of Friendship, Commerce and Navigation between the United States of America and the Kingdom of the Netherlands (1956), available at: <https://treaties.un.org/doc/Publication/UNTS/Volume%20285/v285.pdf>

⁸⁴ For example, according to Article VII, despite the national treatment afforded to foreign investors with respect to engaging in business activities, each Party reserves the right to limit the extent to which aliens establish, acquire interests in, or carry on enterprises engaged in communications, air or water transport, banking involving depository or fiduciary functions, or the exploitation of land or other natural resources.

⁸⁵ See GDP figures, available at: http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/2-12122013-BP/EN/2-12122013-BP-EN.PDF

⁸⁶ These States are Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, Slovakia.

⁸⁷ Other countries which have concluded numerous BITs include Germany (147 BITs), Switzerland (127 BITs), France (103 BITs) and the United Kingdom (102 BITs); in contrast the US has concluded 48 BITs; See *ICSID Database of Bilateral Investment Treaties*, available at: <https://icsid.worldbank.org/ICSID/FrontServlet>

⁸⁸ Albania (1994), Algeria (2007), Argentina (1992), Armenia (2005), Bahrain (2007), Bangladesh (1994), Belarus (1995), Belize (2002), Benin (2001), Bolivia (1992), Bosnia and Herzegovina

other States largely follow the Dutch Model Agreement on Encouragement and Reciprocal Protection of Investments of 2004 (hereafter the 2004 Dutch Model BIT).⁸⁹ Like other EU Member States' BITs concluded prior to the entry into force of the Treaty of Lisbon, the 2004 Dutch Model BIT contains broadly formulated definitions and protection standards.

60. The US Model BIT (updated version of 2012)⁹⁰ on the other hand, employs far more detailed language delimiting and qualifying the protection scope and standards of treatment available under the treaty. According to a recent study,⁹¹ the latter model text is expected to be the template for US negotiators in the course of the Transatlantic Trade and Investment Partnership (TTIP) negotiations. This more detailed model has also been followed in the large majority of other recently concluded FTAs with investment provisions between the United States and third countries.⁹²

(1998), Brazil (1998), Bulgaria (1999), Burkina Faso (2000), Burundi (2007), Cabo Verde (1991), Cambodia (2003), Cameroon (1965), Chile (1998), China (2001), Costa Rica (1999), Côte d'Ivoire (1965), Croatia (1998), Cuba (1999), Czech Republic (1991), Dominican Republic (2006), Ecuador (1999), Arab Republic of Egypt (1996), El Salvador (1999), Eritrea (2003), Estonia (1992), Ethiopia (2003), Gambia (2002), Georgia (1998), Ghana (1989), Guatemala (2001), Honduras (2001), Hong Kong (1992), Hungary (1987), India (1995), Indonesia (1994), Jamaica (1991), Jordan (1997), Kazakhstan (2002), Kenya (1970), Republic of Korea (2003), Kuwait (2001), Lao People's Democratic Republic (2003), Latvia (1994), Lebanon (2002), Macao (2008), Lithuania (1994), Former Yugoslav Republic of Macedonia (1998), Malawi (2003), Malaysia (1971), Mali (2003), Malta (1984), Mexico (1998), Moldova (1995), Mongolia (1995), Montenegro (2002), Morocco (1971), Mozambique (2001), Namibia (2002), Nicaragua (2000), Nigeria (1992), Oman (1987), Pakistan (1988), Panama (2000), Paraguay (1992), Peru (1994), Philippines (1985), Poland (1992), Romania (1994), Russian Federation (1989), Senegal (1979), Singapore (1972), Slovak Republic (1991), Slovenia (1996), South Africa (1995), Sri Lanka (1984), Sudan (1970), Suriname (2005), Tajikistan (2002), Tanzania (2001), Thailand (1972), Tunisia (1998), Turkey (1986), Uganda (2000), United Arab Emirates (2013), Ukraine (1994), Uruguay (1988), Uzbekistan (1996), Venezuela (1991), Vietnam (1994), Republic of Yemen (1985), Zambia (2003), Zimbabwe (1996); See Official Journal of the European Union, 'List of the bilateral investment agreements referred to in Article 4(1) of Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries' (2014/ C 169/01), available at: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:JOC_2014_169_R_0001&from=NL; *ICSID Database of Bilateral Investment Treaties*, available at: <https://icsid.worldbank.org/ICSID/FrontServlet>

⁸⁹ Dutch Model BIT (2004), available at: <http://www.rijksoverheid.nl/onderwerpen/internationaal-ondernemen/documenten-en-publicaties/convenanten/2004/08/27/ibo-modelovereenkomst.html>

⁹⁰ U.S. Model Bilateral Investment Treaty (2012), available at: <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>

⁹¹ L.N Skovgaard Poulsen, J. Bonnitca & J. Webb Yackee, *Costs and Benefits of an EU-USA Investment Protection Treaty*, LSE Enterprise, Apr. 2013, at 6, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/260380/bis-13-1284-costs-and-benefits-of-an-eu-usa-investment-protection-treaty.pdf

⁹² See, for example, United States-Chile FTA, United States-Singapore FTA, Dominican Republic-Central America-United States FTA, United States-Peru FTA, United States-Korea FTA.

2. Continuing or breaking with treaty tradition?

61. The conclusion of the TTIP (including an investor protection and ISDS chapter) would imply a transition for the Netherlands from a regime without a BIT with the US, directly to an FTA with a detailed investment chapter, without the intermediary step of a generic BIT. The implications of this should not be overstated; rather the main difference is the regulation of investments between the Netherlands and the US partly at an international level as compared to their current regulation wholly under domestic law, regardless of whether the former is enacted in a BIT or an FTA with an investment chapter.
62. When developing its international investment policy before the entry into force of the Treaty of Lisbon, the Netherlands did not conclude BITs with developed countries. The conclusion of the TTIP containing an investor protection chapter (with or without ISDS) would constitute a departure from this policy. Yet, in the treaties that the Netherlands did conclude, ISDS was commonly provided. Furthermore, the Netherlands has been a long-standing supporter of ISDS, as shown by the explanatory memorandum to the Dutch ratification of the International Centre for Settlement of Investment Disputes (ICSID) Convention.⁹³ Concluding an international agreement protecting investment without providing ISDS would hence be a major change of policy.
63. In addition and as already indicated, figures show that Dutch investors relatively often rely on the ISDS mechanism.⁹⁴ Out of the 568 treaty-based ISDS cases known to have been initiated by 2013, Dutch investors have brought about 10% (61 cases).⁹⁵ The overall number of ISDS claims brought by EU investors accounts for 53% (299 cases) while 22% of ISDS claims have been initiated by US investors (127 cases).⁹⁶ These statistics, considered in light of the different market size of the

⁹³ N. Schrijver & V. Prislán, *The Netherlands*, in C. Brown (Ed.), *Commentaries on Selected Model Investment Treaties* 535 at 580, ft. 198 (2013); In the explanatory memorandum, the Dutch government held that the 'new institution has to get a chance. As so many other legal institutions, arbitration between a State and an individual must also gradually be built up on a basis, which is acceptable to everyone involved. In every aspect, the acceptance of this convention means that arbitration has become firmly rooted in modern international law': *Memorie van Toelichting* (Tweede Kamer der Staten-Generaal, Parliamentary Year 1965-1966, 8610, nr 3), at 3.

⁹⁴ UNCTAD IIA Issues Note, *Recent Developments in Investor-State-Dispute Settlement (ISDS)*, Apr 2014, at 3-4, available at: http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf

⁹⁵ *Id.*, at 7, 8.

⁹⁶ *Id.*, at 8, 9.

Dutch and the US economy, indicate that ISDS has been a comparatively popular mechanism for Dutch investors.

64. Opposition to the inclusion of ISDS in the TTIP would also be at odds with the negotiating mandate granted to the Commission.⁹⁷ But questions may arise about the rationale of including an ISDS chapter in an FTA between developed countries with strong legal systems⁹⁸ – given that the initial *raison d'être* of ISDS was the protection of foreign investors in developing countries with less sophisticated legal and court systems.⁹⁹ For this purpose a cost-benefit risk assessment for the Netherlands is required.

IV. Cost-benefit risk assessment

A. Treaty negotiating leverage

65. In the present negotiations with the US, the Netherlands could benefit from ‘economies-of-scale’ leverage. Under the EU umbrella, the Netherlands has a stronger negotiating position – due to the EU overall economic weight – compared with its potential leverage in bilateral negotiations with the US. Such a bargaining power is essential, especially given that US investors invest in many sectors of the Dutch economy which are considered a government priority, such as agri-food, horticulture and propagation materials, high tech, energy, logistics, the creative industry, life sciences, chemicals and water.¹⁰⁰

B. Regulatory chill

66. Although investor-state dispute settlement mechanisms have existed for decades—now included in over 3,000 individual agreements—ISDS as a concept faces a new

⁹⁷ European Commission Memo, ‘Member States Endorse EU-US Trade and Investment Negotiations’, 14 Jun 2013, available at: http://europa.eu/rapid/press-release_MEMO-13-564_en.htm

⁹⁸ Note Germany’s veto on the inclusion of an ISDS mechanism in the TTIP. For Australia’s oscillating position see Section II.D. above.

⁹⁹ See J. Kleinheisterkamp, *Is there a Need for Investor-State Arbitration in the Transatlantic Trade and Investment Partnership (TTIP)?*, LSE Department of Law, at 1 (2014), available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2410188

¹⁰⁰ Government of the Netherlands, ‘Investing in top sectors’, available at: <http://www.government.nl/issues/entrepreneurship-and-innovation/investing-in-top-sectors>.

crisis of legitimacy.¹⁰¹ Over the past two years, ISDS criticism has reached new levels and new institutional stakeholders. The most common criticism levied against investor-state arbitration is regulatory chill, the argument that governments will refrain from or alter legitimate legislation and regulation for fear of costly investment arbitration. According to proponents of the regulatory chill theory, ISDS prevents governments from exercising their sovereignty by restraining policy space associated with the environment, health, natural resources, and human rights, among other policy areas. This hypothesis, however, is inherently difficult to test.¹⁰² The following section attempts to shed light on the regulatory chill debate in three ways: first, defining a workable, and testable, definition of regulatory chill; second, assessing the arguments and cases in support of the theory; and third, assessing the arguments and cases against it.

1. What is Regulatory Chill & How is it Measured?

67. Even though “regulatory chill” is not new to law, international law, or even international investment law, the trouble is defining the concept in a meaningful way. Political scientists, legal scholars, and non-academics have applied the concept inconsistently.¹⁰³ Admittedly, the definition lies somewhere between two extremes. Certainly, no one implies that regulators would “cease to adopt any new regulations and that the entire environmental regulatory framework [would grind] to a halt.”¹⁰⁴ Similarly, it is highly unlikely than any ISDS critic would argue that because of regulatory chill governments should be permitted to unduly discriminate against foreign investors.
68. For the purposes of this study, we define regulatory chill as follows: a State actor will fail to enact or enforce *bona fide* regulatory measures because of a perceived or actual threat of investment arbitration. The most important part of this definition is the limitation to “bona fide” measures. Although this term is potentially subjective and will vary among states, investors, arbitrators, and civil

¹⁰¹ See, e.g., C. Brower and S. Schill, “Is Arbitration a Threat of a Boon to the Legitimacy of International Investment Law?”, 9 *Chicago Journal of International Law* 472 (2009).

¹⁰² K. Tienhaara, *Regulatory chill and the threat of arbitration: A view from political science*, in Chester Brown & Kate Miles (Eds.) *Evolution in Investment Treaty Law and Arbitration* (2011) 607.

¹⁰³ J. Soloway, *NAFTA’s Chapter 11: Investment Protection, Integration and the Public Interest*, 9 *Choices* 1, 18 (2003) 18.

¹⁰⁴ *Id.*

society observers, this restriction is nonetheless important because some measures are meant to be “chilled.” Indeed, the purpose of investment law is to “chill” the promulgation of measures designed with discrimination and protectionism in mind.¹⁰⁵

69. Regulatory chill can be grouped into three categories, or kinds of “chill.” First is what we call **anticipatory chill**, where policy-makers take into account potential disputes with foreign investors *before* they begin drafting regulatory or legislative changes for the public interest. This kind of chill is concerned with the overall phenomenon whereby the regulatory process is hampered by all areas impacted by foreign investors. This is a serious concern, but is also the most difficult kind of regulatory chill to identify and measure. It would be difficult to first identify a particular public regulation the state would have regulated and then secondly pinpoint ISDS as the cause for the failure to regulate. It would therefore be nearly impossible to find enough of these individual cases to prove any overall pattern of regulatory chill.
70. The second kind of regulatory chill, on the other hand, is more tangible and will be the focus of this section. We term this kind of chill **specific response chill**: chilling of a specific regulatory measure once policy-makers have become *aware* of the risk of an investor-state dispute. This can result from actual, threatened, or perceived disputes. The key is that the state actor will stop or change its regulatory course because of a threat to a particular regulation.
71. The third kind of regulatory chill, what we term **precedential chill**, occurs when state actors change a regulation in response to a settled or resolved investor-state dispute because they fear future arbitrations based on the same regulation. Thus, a state will roll-back progressive public interest legislation after “losing” an investor-state arbitration. This is technically not a case of “chilling” since the government has already taken the regulatory act and could more accurately be described as “regulatory freezing,” but because of its similar effect on policy-making, we have grouped it with the other forms for regulatory chill.
72. Now that we have defined and categorized regulatory chill, it is important to determine how the concept can be measured. Put differently, how do we know regulatory chill when we see it? The answer to this question is the most difficult

¹⁰⁵ Tienhaara, *op. cit.*, at 609.

and undetermined part of the regulatory chill debate. The largest hurdle here is the difficulty in identifying ISDS as the reason for chilling effects. First, it is difficult, although not impossible, to identify regulations that policy-makers contemplate but decide against. This is easier in the case of specific-response chill, when the government usually has begun administrative rule-making processes to change or enact new regulations. However, even *if* one can identify a drastic change in the adoption of public interest regulations, pinpointing the reason for the change is nearly impossible. Indeed, political choices can hardly ever be adequately explained by one independent variable.¹⁰⁶ Regulations related to public interests such as the environment, health, and natural resources are often fraught with political debate, and the possibility of ISDS may be just one of a number of factors leading to the regulatory chill.

73. In light of the difficulty in testing the regulatory chill theory, researchers have recognized that “regulatory chill does not lend itself to statistical analysis.”¹⁰⁷ Instead, most studies focus on case studies and anecdotal evidence to prove or disprove regulatory chill. The following sections aim to summarize the debate and cases surrounding regulatory chill. The section is not meant to be an exhaust legal or political science study into regulatory chill, but simply to highlight the “regulatory chill theory” as a part of the larger cost-benefit analysis for ISDS.

2. Arguments Supporting Regulatory Chill

74. Proponents of the regulatory chill theory use both anecdotal evidence of governmental acts and case studies from arbitration cases to demonstrate that governments believe investment arbitration is a threat to policy space. First, one can look to statements made by government officials for evidence that they actively consider ISDS. For example, in 2005, a legal adviser for the Sri Lankan Ministry of Foreign Affairs stated:

Sri Lanka believes that an expansive interpretation of regulatory measures could circumvent the national policy space hindering the government’s right to regulate, creating a risk of “regulatory chill”, with

¹⁰⁶ *Id.* at 610.

¹⁰⁷ *Id.* at 611.

*governments hesitant to undertake legitimate regulatory measures in the public interest for fear of claims for compensation being preferred by investors.*¹⁰⁸

75. Others point out that other countries have withdrawn or threatened to withdraw from the ICSID Convention because of perceived biases in ISDS. In an extreme case, South Africa has started terminating existing BITs with countries like Belgium, Luxembourg, Germany, and Switzerland.¹⁰⁹ In March 2014, Indonesia announced its plans to terminate more than 60 BITs with countries such as China, France, Singapore and the UK– and it has in the meantime terminated its IT with The Netherlands, taking effective force from July 2015.¹¹⁰
76. Proponents of the regulatory chill hypothesis also invoke a number of case studies to demonstrate their point. For instance, in a claim filed early in NAFTA’s history, the Government of Canada settled a dispute with Ethyl Corp., agreeing to pay the company compensation and retracting its ban on the gasoline additive MMT. Some have argued that Canada’s settlement constituted regulatory chill because Ethyl’s arbitration claim succeeded in forcing the government to roll-back a measure intended to benefit the environment.¹¹¹ However, interpretation of the outcome in the *Ethyl* case is subject to disputes on its meaning.¹¹² Others counter that outside factors motivated the Canadian government’s decision-making. Those factors include the fact that Canadian provinces successfully challenged the measure in domestic courts and that there was substantial evidence that the legislature was explicitly motivated by trade protectionism rather than concern for the environment.¹¹³ The *Ethyl* case is discussed in greater detail in section

¹⁰⁸ A. Rohan Perera, ‘Technical assistance and capacity building, lessons learned from experiences and the way forward’, ICSID/OECD/UNCTAD Symposium – Making the Most of International Investment Agreements: A Common Agenda, Paris, 12 December 2005.

¹⁰⁹ This was done after a 3-year review of all of South Africa’s BITs, and arbitration was only one of several reasons the report cited.

¹¹⁰ B. Bland, ‘Indonesia to Terminate More Than 60 Bilateral Investment Treaties,’ *Financial Times* (26 March 2014), available at <http://www.ft.com/cms/s/0/3755c1b2-b4e2-11e3-af92-00144feabdc0.html#axzz34QJuirDj>.

¹¹¹ See H. Mann, ‘Private Rights, Public Problems: A Guide to NAFTA’s Controversial Chapter on Investor Rights’, International Institute for Sustainable Development (2001), available at http://www.iisd.org/pdf/trade_citizensguide.pdf.

¹¹² D. Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy’s Promise* (2008), at 129-134.

¹¹³ See Sanford E. Gaines, *The Masked Ball of NAFTA Chapter 11: Foreign Investors, Local Environmentalists, Government Officials, and Disguised Motives*, in John Kirton and Virginia White MacLaren (Eds.) *Linking Trade, Environment, and Social Cohesion: NAFTA Experiences, Global Challenges* (2002), at 103–29.

- analyzing NAFTA cases.
77. Another case involves proposals among Canadian provinces to provide public automobile insurance. In 2003, New Brunswick began considering providing public auto insurance after private insurance rates nearly doubled between 2003 and 2005. Both Canadian and foreign insurance companies lobbied against the proposal, claiming that they would be forced to bring international investment and trade disputes against the government because of the proposed measure. In particular, insurance companies stated that the proposed measure would violate NAFTA Article 1114 (financial services) and GATS market access guarantees. On June 30, 2004 Premier Bernard Lord announced that the government would not adopt the measure. This led observers to draw a causal connection between insurance companies' ISDS threats and the decision to not proceed with the measure.¹¹⁴ Like in most specific-response chill cases, there is no “smoking gun” in this case to indicate why the government stopped its initiative, but this certainly could be a case where the *threat* of ISDS contributed to regulatory roll-back. Likewise, it should be noted, however, that the Select Committee on Public Automobile Insurance completed a legal analysis of the measure prior to public debate and concluded that it was both NAFTA- and GATS-compliant.¹¹⁵ As well, the ISDS threats did not spill over and impact public insurance in other provinces. Indeed, Saskatchewan, Manitoba, British Columbia, and Quebec had public insurance schemes in effect for over 30 years, and the government of Ontario rejected a similar proposal in 1990.
78. A further example considers a measure adopted by Indonesia in 2002 to regulate certain open-pit mines. In 2002, Indonesia considered a measure to ban open-pit mining in protected forests and listed 23 companies (of 150 total mining companies) impacted by the designation of protected forests.¹¹⁶ A group of foreign-owned mining companies then reportedly threatened the Government of Indonesia with international arbitration pursuant to BITs if the measure would be

¹¹⁴ S. Shyrbman and S. Sinclair, “Public Auto Insurance and Trade Treaties”, 5 Canadian Centre for Policy Alternatives Trade and Investment Series 1 (2004).

¹¹⁵ Legislative Assembly of New Brunswick, Select Committee on Public Automobile Insurance, “Final Report on Public Automobile Insurance in New Brunswick (April 2004), available http://www.consumer.ca/uploads/general/2004_04_final_report_public_auto_insurance_NewBrunswick.pdf.

¹¹⁶ S. Gross, *Inordinate Chill: BITS, Non-NAFTA MITS, and Host-state Regulatory Freedom: An Indonesian Case Study*, 24 Michigan Journal of International Law 893–960 (2003).

adopted. The House of Representatives and Ministry of Forestry then “agreed in principle” to change the forest designation of three locations from “protected” to “production”, essentially exempting certain foreign companies from the measure. This has led commenters to observe, that “the timing of the government’s actions, statements to the media and other factors suggest that the government was strongly motivated to remove the threat of arbitration.”¹¹⁷

79. Of course, these three examples only represent a sample of cases used to demonstrate the threat ISDS may pose to policy space. Each one demonstrates a credible *prima facie* case for regulatory chill with full acknowledgement that from a legal and factual background, proving ISDS was the source of the regulatory chill is complex and difficult.

3. Arguments Against Regulatory Chill

80. Countering the above theories of regulatory chill, lawyers and political scientists have advanced a number of arguments. First, it is important to realize that law, by its very nature “chills” certain government activities. International law, by definition, curbs sovereign state actions. The purpose of international law is to place limitations on the behavior states. This inevitably restricts states from being able to carry out acts they otherwise could pursue based on traditional notions of sovereignty. International law, as a system of laws and norms, has thus developed with the idea that some state measures *should* be chilled. The Permanent Court of International Justice in *The S.S. Wimbledon*, in its very first merits judgment, summarized international law’s restraint on sovereignty as follows:

*The Court declines to see in the conclusion of any Treaty by which a State undertakes to perform or refrain from performing a particular act an abandonment of its sovereignty. No doubt any convention creating an obligation of this kind places a restriction on the exercise of the sovereign rights of the State, in the sense that it requires them to be exercised in a certain way. But the right of entering into international engagements is an attribute of State sovereignty.*¹¹⁸

81. This is what gives specific areas of international law their authority: states

¹¹⁷ Tienhaara, *op. cit.*, at 621.

¹¹⁸ *The S.S. Wimbledon* (U.K. v. Japan), 1923 P.C.I.J. (ser. A) No. 1 (Aug. 17), at 25.

relinquish their sovereignty to a larger, international system of rule of law. This concept even allows international law to regulate state acts that never impact another state (e.g., international human rights law and international environmental law). International investment law, which stems from long-standing customary law regarding the protection of aliens, applies the same concept. By necessity, international investment law prevents a state from treating foreign investors unfairly. Hence, the essential thrust of international investment protection is to achieve some level of “chill”, that is, to chill governments from treating foreign investors unfavorably.

82. This clearly leads to the distinction between *bona fide* measures and spurious or nefarious measures. Although this distinction may seem obvious, it deserves repeating because if one accepts that ISDS may chill *bona fide* measures, one must simultaneously admit that ISDS could equally chill protectionist measures.
83. The second argument against regulatory chill is that most ISDS claims do not challenge legislative acts. Instead, the vast majority of “regulatory” challenges are administrative in nature: they arise from a preexisting contract, permit, license, or promise from the government. In a study published in April 2014, researchers *Jeremy Caddel* and *Nathan Jensen* concluded that the vast majority of investor-state claims arise from executive branch decisions instead of legislative decisions. After analyzing all concluded ICSID decisions, the researchers found that 47% of disputes were associated with ministries or agencies while only 9% (14 total cases) resulted from legislative acts. According to the study: “Given the low rate of disputes involving legislative branch activity, arguments that investor-state arbitration may encroach on the legitimate prerogatives of domestic governments appear to be overstated. Instead, democratic legislatures should embrace investor-state arbitration as an additional check on executive branch misbehavior.”¹¹⁹ The NAFTA Case Studies section of this report (see below) also bears this out by analyzing specific NAFTA claims. The case studies support Caddel and Jensen’s findings that the majority of investor claims stem from administrative acts. In particular, the NAFTA cases further demonstrate that most claims do not challenge

¹¹⁹ J. Caddel and N. Jensen, “Which Host Country Government Actors are Most Involved in Disputes with Foreign Investors?”, Columbia FDI Perspectives: Perspectives on topical foreign direct investment issues by the Vale Columbia Center on Sustainable International Investment (No. 120, 28 April 2014) <<http://academiccommons.columbia.edu/catalog/ac:173529>>

the executive's ability to adopt the new measure but rather concern specific guarantees owed to the investor. What is more, the cases also demonstrate that NAFTA claims that *do* directly challenge legislative and regulatory acts have all failed.

84. A third perspective on regulatory chills questions whether policy-makers are even aware of ISDS. *Coe* and *Rubins* argue that although regulators and policy makers try to acquaint themselves with international ramifications of contemplated measures, they may remain unaware of potential impacts on all foreign investors.¹²⁰ It may be difficult for regulators to predict how a measure will impact specific investors, especially given how investor-specific many ISDS claims are, i.e. they pertain to one particular company's existing license or permit that was hampered by a new regulation. However, *Coe* and *Rubins* even admit that with the unprecedented public awareness of investor-state arbitration now, ISDS would certainly have more visibility among regulators.¹²¹ This is particularly poignant given the increased governmental and civil society awareness of ISDS surrounding the TTIP, TTP, and CETA debates.
85. Finally, the regulatory chill theory, if proven, would apply equally to potential domestic court claims. Indeed, any time a government changes or promulgates new regulations, it exposes itself to potential legal claims by domestic and foreign investors alike. If policy-makers are concerned with potential international arbitration claims resulting from a considered measure, it would be unlikely that they would not equally be concerned with potential domestic liability resulting from the same measure. In fact, several of the cases often cited by proponents of the regulatory chill theory were simultaneously challenged through ISDS and domestic judicial processes (e.g., *Ethyl*). Controversial measures that impact both public interests and investment are clearly not limited to foreign investors, and can and *are* challenged by domestic counterparts. What is more, policy-makers very well may be *more* concerned with potential domestic court actions since domestic courts, unlike international arbitral panels, have the authority to overturn or invalidate government measures in addition to awarding compensation.

¹²⁰ J. Coe and N. Rubins, *Regulatory Expropriation and the Tecmed Case: Context and Contributions*, in Todd Weiler (Ed.) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (2005), at 599.

¹²¹ *Id.*

86. Focus on ISDS as the cause of regulatory chill is myopic and obscures the fact that other important values are often at stake simultaneously.¹²² ISDS claims do not occur in a political vacuum. The same measures designed to protect the environment, public health, and natural resources that lead to international arbitration claims are usually widely debated. ISDS is one factor among many that policy-makers consider, and it seems disingenuous to suggest that ISDS alone will cause governments to refrain from regulating for public interests. *Coe and Rubins* also aver that “[w]hile the apprehension of international liability may prompt reflection and careful tailoring of means to ends, it seems less likely to cause the abandonment of legislation at the heart of a government’s mandate.”¹²³ Indeed, governments might well expect, and often do, win direct challenges to regulatory and legislative measures.

4. Applied to the situation of The Netherlands

87. As indicated in the previous section, the majority of government decisions challenged in ISDS relate to actions of the executive branch, rather than legislation. In fact, only 14 of the cases brought before ICSID (out of 163 concluded cases which provide sufficient information) challenge legislative measures, some of which gave rise to multiple disputes. Such figures suggest that concerns regarding delimitation of governments’ policy space have been overstated.¹²⁴

88. Based on the statistical research on FDI (see paras. 48-55), a number of sectors can be identified that are of high importance in terms of US investments in the EU and the Netherlands, and where accordingly the risk for ISDS cases may be larger. These include some sectors that are relatively heavily regulated, notably the sectors of processed foods, (petro)chemicals, water, finance and insurance.

¹²² See Soloway, *op. cit.*, at 19.

¹²³ *Id.*

¹²⁴ See, for example, C. Cross, *The Treatment of Non-Investment Interests in Investor-State Disputes: Challenges for the TAFTA / TTIP Negotiations*, in D. Cardoso *et al.* (Eds.) *The Transatlantic Colossus, Global Contributions to Broaden the Debate on the EU-US Free Trade Agreement* 76 at 78-79 (2013), available at: <http://www.collaboratory.de/images/archive/8/8d/20140118121833!TheTransatlanticColossus.pdf> ; W. Raza *et al.*, *ASSESS TTIP: Assessing the Claimed Benefits of the Transatlantic Trade and Investment Partnership (TTIP)*, at 21-22 (2014), available at: http://guengl.eu/uploads/plenary-focus-pdf/ASSESS_TTIP.pdf; A. Wessels, *ISDS Threatens Privacy and Reform of Copyright and Patent Law*, at 9 (2014), available at: http://people.ffii.org/~ante/ISDS/FFII_NL_ISDS-threatens-privacy.pdf

C. The Right to Regulate

89. Closely linked to regulatory chill is the concept of the “right to regulate.” The right to regulate captures the fundamental concept under international and domestic law that a sovereign has the power to choose its own domestic law and promulgate any regulation it feels necessary to protect the public interest within its borders. Some view investor-state arbitration as a threat to this right to regulate, and thus it is equated to regulatory chill. The right to regulate as a *legal* concept, however, is a tool to ensure that governments are free to pursue legitimate public policy goals without being liable to foreign investors. In this sense, the “right to regulate” is a shield that prevents ISDS claims from piercing the heart of state sovereignty.
90. The right to regulate is well-known in international investment law. The concept originated from arbitral tribunals as a way to clarify ambiguous treaty provisions, and it has now become common among a new generation¹²⁵ of BITs and IIAs to expressly include the right to regulate in investment provisions. Arbitration panels now consider the right to regulate and public policy concerns in three key areas of investment law: indirect expropriation, fair and equitable treatment, and national treatment. The following section examines how international investment tribunals have arrived at and articulated the right to regulate in expropriation, fair and equitable treatment, and national treatment, paying particular attention to how NAFTA panels have approached this issue. Finally, the section concludes with an analysis of three ways modern IIAs explicitly include the right to regulate: (1) definitions of specific protections; (2) general exceptions; and (3) preambular language.

1. Expropriation

91. It is well recognized in international law that a state may not take the property of aliens, whether for public purposes or otherwise, without adequate compensation.¹²⁶ Property can be both tangible and intangible, including

¹²⁵ See S. Spears, “The Question for Policy Space in a New Generation of International Investment Agreements,” 13 *Journal of International Economic Law* 1037 (2010); OECD Directorate for Financial and Enterprise Affairs, “Indirect Expropriation and the Right to Regulate in International Investment Law,” OECD Working Papers on International Investment No. 2004/4, at 22 (Sept. 2004).

¹²⁶ Brownlie, *Public International Law* (2005), at 509. International tribunals have been adjudicating such rights for over nine decades. See, e.g., *Norwegian Ship-owners’ Case* (Nor. v. U.S.), 1

investments. The key distinction in international law is between direct expropriation, in which the government directs the transfer of private property to the state or a third-party, and indirect expropriation, in which a government measure while not on its face expropriatory results in the deprivation of a foreign investor's property. Tribunals and recent BITs and IIAs also refer to indirect expropriation as equivalent, tantamount, *de facto*, creeping, constructive, consequential, regulatory, or virtual. Regardless of the term used, indirect expropriation law examines the effect a government measure has on an investor's property, and thus becomes the focus of the right to regulate.

92. Defining when a regulation is indirectly expropriatory and when it is not has become the defining characteristic of the right to regulate.¹²⁷ According to tribunals, a measure that is a *bona fide*, general regulation that furthers a legitimate purpose in a nondiscriminatory and proportionate way cannot amount to an indirect expropriation. Thus, the right to regulate is part of the definition of expropriation and not considered an exception to expropriation provisions. It is well recognized in international law that legitimate regulations are non-expropriatory, and thus the state need not pay compensation to investors in these cases. The rationale for non-compensation is that property rights have inherent limitations—they are never absolute.¹²⁸
93. This concept is not only enshrined in numerous investment arbitration decisions and agreements but also in the European Convention of Human Rights. Article 1 of First Additional Protocol of the ECHR implies that the duty to compensate does not apply to legitimate regulations:

Every natural or legal person is entitled to the peaceful enjoyment of its possessions. No one should be deprived of his possessions except in the public interest and subject to the conditions provided for by the law and by the general principles of international law.

The proceeding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of

R.I.A.A. 307, 332 (Perm. Ct. Arb. 1922); *German Interests in Polish Upper Silesia* (F.R.G. v. Pol.), 1926 P.C.I.J. (ser. A) No 7 (May 1925).

¹²⁷ OECD (2004), *op. cit.*, at 2; R. Dolzer, "Indirect Expropriations: New Developments?", 11 NYU Environmental Law Journal 64 (2003).

¹²⁸ A. Newcombe, "The Boundaries of Regulatory Expropriation in International Law", 20 ICSID Review 1 (2005), at 21.

property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

94. Similar language appears in the 1961 Harvard Draft Convention on the International Responsibility of States for Injuries to Aliens, the 1967 OECD Draft Convention on the Protection of Foreign Property, the *Restatement (Third) of Foreign Relations Law of the United States*, NAFTA, and a host of BITs and IIAs (further examined in section C(1) below). To distinguish between legitimate public regulations not requiring compensation to investors and indirect expropriation requiring compensation, arbitral tribunals have arrived at three key criteria: (1) the character of the government measure; (2) proportionality of the government measure to the legitimate aim sought; and (3) the degree of interference with property rights.

a. Character of the Government Measure and “Police Power”

95. A significant factor in characterizing as government measure as expropriatory, is if it refers to the state’s right to promote a recognized “social purpose” or the “general welfare.” According to *Brownlie*, “state measures, prima facie a lawful exercise of powers of governments, may affect foreign interests considerably without amounting to expropriation. Thus, foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas, or measures of devaluation. While special facts may alter cases, in principle such measures are not unlawful and do not constitute expropriation.”¹²⁹ Thus, non-discriminatory measures related to anti-trust, consumer protection, securities, environmental protection, and land planning have been regarded as non-compensable takings.¹³⁰
96. In the context of the Article 1 of Protocol 1 of the European Convention of Human Rights, the ECtHR has adopted a broad interpretation of “public interest” and allowed states a wide margin of appreciation in determining their own public concerns. The state’s public purpose must not be manifestly unreasonable, and the taking must be proportionate.¹³¹ The Court examines whether the government action strikes a reasonable balance between public and private interests and

¹²⁹ Brownlie, *op. cit.*, at 509.

¹³⁰ OECD (2004), *op. cit.*, at 5.

¹³¹ *Id.* at 17.

whether an unjust burden has been placed on the claimant.¹³² In the *James* case for example, the Court stated:

*The taking of property in pursuance of a policy calculated to enhance social justice within the community can properly be described as being ‘in the public interest’. In particular, the fairness of a system of law governing the contractual or property rights of private parties is a matter of public concern and therefore legislative measures intended to bring about such fairness are capable of being in the ‘public interest’, even if they involve the compulsory transfer of property from one individual to another.*¹³³

97. Investment arbitration panels have applied similar public policy definitions in the context of defining indirect expropriation. For example, in examining the meaning of NAFTA Article 1110(1)’s use of the phrase “tantamount to expropriation,” the panel in *S.D. Myers* explained: “Both words require a tribunal to look at the substance of what has occurred and not only at form. A tribunal should not be deterred by technical or facial considerations from reaching a conclusion that an expropriation or conduct tantamount to an expropriation has occurred. It must look at the real interests involved and the purpose and effect of the government measure.”¹³⁴
98. In examining the character of the governmental measure, most arbitral tribunals adopt the so-called “**policy power**” doctrine in determining whether a general regulation demands compensation to an investor. This principle was described by the Iran-U.S. Claims Tribunals as follows:

*A State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price...*¹³⁵

99. The ICSID panel in *Tecmed v. Mexico*, brought under the Spain-Mexico BIT,

¹³² *James v. United Kingdom*, 98 Eur. Ct. H.R. (ser. A) 9, 32 (1986); *Sporrong and Lönnroth v. Sweden*, 52 Eur. Ct. H.R. (ser. A) (1982).

¹³³ *James v. United Kingdom*, *op. cit.*, at 32.

¹³⁴ *S.D. Myers, Inc. v. Canada* (Partial Award of 13 November 2000), 40 I.L.M. 1408, para. 285.

¹³⁵ *Too v. Greater Modesto Insurance Associates* (Award of 29 December 1989), 23 Iran-United States Cl. Trib. Rep. 378.

although ultimately finding an expropriation, held that “[t]he principle that the State’s exercise of its sovereign power within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable.”¹³⁶ Although not mentioning the term “police power” expressly, almost all other investment tribunals examining an indirect expropriation claim apply the principle in practice.

b. Proportionality of the Measure

100. The second requirement that most investment tribunals apply to an investor’s claim of indirect expropriation is proportionality. The government’s regulation must be proportionate to the legitimate public interest sought. General regulations will only constitute expropriation to the extent they impose a disproportionate burden. Conversely, a host state will not have to compensate investors for proportionate general regulations.
101. The concept of proportionality was fully elaborated on by the tribunal in *Tecmed v. Mexico*. In that case, a Spanish investor filed a claim with ICSID pursuant to a BIT with Mexico alleging that the Mexican government’s failure to re-issue a license of its hazardous waste site constituted an expropriation. Citing the ECtHR’s practice, the tribunal held that it must consider “whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account the significance of such impact has a key role upon deciding the proportionality.”¹³⁷ The tribunal further added that the relationship between the aim sought and the measure imposed must also be reasonable. Thus, tribunals when determining whether a regulation amounts to expropriation express take public policy interests into account, weighing the importance of the regulatory interest by the host state with the property rights of the investor.
102. The proportionality principle also mandates that general measures do not target or unequally affect one investor compared to other investors. In this regard, some tribunals consider the “reasonable investment-backed expectations” of the

¹³⁶ *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, (Award of 2003) ICSID Case No. ARB(AF)/00/2, at para. 119.

¹³⁷ *Id.* para. 122.

individual investor.¹³⁸ In investor's expectation must, of course, be *reasonable*, which does not include ordinary legal or regulatory changes taken by governments. After all, "[g]overnments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue..."¹³⁹ Instead, most tribunals determine disproportionate impact by looking at specific promises made by the government to the investor.¹⁴⁰ According to a tribunal in the *Methanex* case, this requirement stems from basic concepts of fairness and equity:

*[A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.*¹⁴¹

103. In sum, the proportionality element of indirect expropriation analysis first ensures that the state only impacts investments in order to achieve its legitimate public policy aims while secondly ensuring that a government taking does not disproportionately impact a single investor to whom the government made specific promises.

c. Degree of Interference with Property Rights

104. The final element of indirect expropriation is an assessment of the interference with the investor's foreign investment. While all investment tribunals now agree that this is a primary consider in expropriation analysis, the threshold level of interference applied by tribunals varies among panels. According to *Brower* and *Schill*, however, a few general themes can be identified: "With respect to intensity of the impact of the measure on the property, tribunals rather unanimously require

¹³⁸ *Marvin Roy Feldman Karpa (CEMSA) v. United Mexican States* (Award of 16 December 2002), ICSID Case No. ARB(AF)/99/1; *Tecmed* at para. 50; *Starret Housing Corp. v. Iran*, 4 Iran-United States Cl. Trib. Rep. 122, 154 (1983).

¹³⁹ *CEMSA*, *op. cit.*, at para. 112.

¹⁴⁰ *E.g., Tecmed*, *op. cit.*, at para. 50.

¹⁴¹ *Methanex Corp. v. United States* (Final Award of 3 August 2005) UNCITRAL, at Part IV, Chapter D. para. 7.

the passing of a high threshold. A diminution in the value of foreign-owned property alone is not sufficient.”¹⁴² Most tribunals agree that there must be a **substantial interference** with the investment.

105. Expropriation cases arising under NAFTA are particularly illustrative here. For example, in *Pope & Talbot*, the tribunal did not find an indirect expropriation even though export quotas reduced the investor’s profits because the measure did not entirely prevent sales abroad and the investor was still able to make profits. According to the tribunal, NAFTA’s term “tantamount to expropriation” does not mean that mere interference is expropriation, rather, there still must be a significant effect in terms of severity or magnitude.¹⁴³ Similarly in the *CEMSA* case, a foreign trading company alleged that Mexico’s denial of a tax refund for certain cigarette exports amounted to an expropriation. The tribunal rejected the investor’s expropriation claim because “the regulatory action has not deprived the Claimant of control of his company, interfered directly in the internal operations of the company or displaced the Claimant as the controlling shareholder.”¹⁴⁴ In *LG&E*, the ICSID tribunal articulated that expropriation cannot occur “where the investment continues to operate, even if profits are diminished. The impact must be substantial in order that compensation may be claimed...”¹⁴⁵ An investor must demonstrate that the investment “disappeared; [in other words], the economic value of the use, enjoyment or disposition of the assets or rights affected [have] been destroyed.”¹⁴⁶
106. While the majority of tribunals agree that mere economic impact cannot support an expropriation claim, it should also be noted that a number of individual panels have applied the “sole effects” doctrine. Under this approach, the tribunal does not consider the purpose or context of the measure but only its economic impact.¹⁴⁷ Although used only in a handful of cases, the sole-effects doctrine was most notably applied by a NAFTA tribunal in the *Metalclad Corp. v. Mexico* case. In that case, an American waste management company challenged Mexican

¹⁴² Brower and Schill, *op. cit.*, at 486.

¹⁴³ *Pope & Talbot, Inc. v. Canada*, (Interim Award of 26 June 2000), at para. 96.

¹⁴⁴ *CEMSA, op. cit.*, at para. 142.

¹⁴⁵ *LG&E Energy Corp. v. Argentina* (Award of 25 July 2007), ICSID Case No. ARB/02/1, at para. 191.

¹⁴⁶ *Tecmed, op. cit.*, para. 116.

¹⁴⁷ R. Dolzer and F. Bloch, “Indirect Expropriation: Conceptual Realignment?”, 5 *Forum du Droit International* 155, 158-163 (2003); Dolzer (2003), *op. cit.*, at 79.

municipal, state, and federal action preventing it from operating a hazardous waste landfill. The tribunal defined expropriation as follows:

*expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be expected economic benefit of property even if not necessarily to the obvious benefit of the host State.*¹⁴⁸

107. Although the tribunal clearly applies a substantial impact much like other investment panels, the decision is notable because the tribunal also stated that in order to decide the expropriation question it “need not decide or consider the motivation, nor intent of the adoption of the [government’s measure].”¹⁴⁹ This statement has since been widely criticized, and other NAFTA tribunals have refused to apply the principle in subsequent expropriation claims under NAFTA. As well, the *Metalclad* case is also unique among expropriation cases because the tribunal found that the Mexican federal government gave the investor specific assurances regarding its operation of its waste management site and the investor reasonably relied on those promises when making further investments. Thus, the tribunal could find an expropriation based on the proportionality and non-discrimination principles without looking at the intended public interest protected by the measure.¹⁵⁰

108. In sum, the accepted definition of indirect expropriation under international law allows host states the freedom to regulate for the public interest so long as the regulation serves a legitimate and non-discriminatory purpose, strikes a proportionate balance between the protection of the investor’s investment and the public interest, and does not substantially interfere with a specific investor’s property rights.

¹⁴⁸ *Metalclad Corp. v. United Mexican States* (Award of 30 August 2000), ICSID Case No. ARB(AF)/97/1, at para. 103.

¹⁴⁹ *Id.* para. 111.

¹⁵⁰ Brower and Schill, *op. cit.*, at 487. For more information, see T. Weiler, *Good Faith and Regulatory Transparency: The Story of Metalclad v. Mexico*, in Todd Weiler (Ed.) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (2005), at 701, finding that “Metalclad’s investment was clearly held hostage to parochial interests and subjected to acts of regulatory malfeasance in Mexico.”

2. Fair and Equitable Treatment

109. The same protection of the “right to regulate” has been applied the concept of fair and equitable treatment, a touchstone of international investment law. Although a seemingly vague concept, fair and equitable treatment has been interpreted by arbitral panels very narrowly to only include a violation of an investor’s fundamental rights or a denial of justice. Fair and equitable treatment obliges states to accord basic substantive and procedural rights pursuant to the rule of law. Investors are entitled to a stable and predictable legal framework, consistent decision-making by the host state, procedural due process, protection against discrimination and arbitrariness, and transparency in dealing with the host government.¹⁵¹
110. In practice, tribunals have applied the same proportionality and specific inducement principles from expropriation claims to fair and equitable treatment claims. In a recent ICSID case, the tribunal stated:

*It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilization clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.*¹⁵²

111. This approach combines proportionality and the requirement that the state not renege on specific commitments or promises to the investor. This was similarly adopted by the tribunal in *Saluka Investment BV v. Czech Republic*, in which it held that fair and equitable treatment requires “a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other.”¹⁵³ Hence, an investor’s expectations

¹⁵¹ Brower and Schill, *op. cit.*, at 487.

¹⁵² *Parkerings-Compagniet AS v. Lithuania* (Award of 11 September 2007), ICSID Case No. ARB/05/8, at para. 332.

¹⁵³ *Saluka Investment BV v. Czech Republic* (Partial Award of 17 March 2006), UNCITRAL, at para. 306.

are not absolute and states may restrict them proportionately. A host state has the authority to “implemen[t] its policies bona fide by conduct that is . . . reasonably justifiable by public polices and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination.”¹⁵⁴

3. National Treatment

112. Arbitral tribunals have also interpreted national treatment obligations in light of the right to regulate. Just like the expropriation and fair and equitable treatment standards, national treatment was not originally defined with a right to regulate element; instead, tribunals have implied such a right as part and parcel of national treatment analysis as part of a weighing and balancing of “likeness.” In *S.D. Meyers*, for example, the tribunal explicitly stated that it must consider the aim of protecting the environment when assessing the like circumstances between foreign and domestic investors and investments.¹⁵⁵ In that case, a U.S.-based waste disposal company challenged Canada’s ban on PCB (polychlorinated biphenyl) exports as a denial of national treatment under NAFTA, among other claims. Meyers argued that the measure discriminated against U.S. waste disposal companies that sought to operate in Canada by preventing them from exporting PCBs to the U.S. for processing at U.S. facilities. The tribunal held that, in principle, an examination of “likeness” should consider the legitimate public policy aims of the measure. According to the panel, an assessment of likeness must take into account two key elements: (1) the “general principles that emerge from the legal context of NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified environmental measures”; and (2) “the circumstances that would justify governmental regulations that treat [foreign investors] differently in order to protect the public interest.”¹⁵⁶ The tribunal deduced a number of critical elements from NAFTA Article 1102 and its supporting documents:

- States have the right to establish high levels of environmental protection, They are not obliged to compromise their standards

¹⁵⁴ *Id.* para. 307.

¹⁵⁵ *S.D. Meyers, op. cit.*, at para. 250.

¹⁵⁶ *Id.* para. 250.

merely to satisfy the political or economic interests of other states;

- States should avoid creating distortions to trade; and
- Environmental protection and economic development can and should be mutually supportive.¹⁵⁷

113. Here, the tribunal recognized that environmental policy concerns may provide a legitimate basis for finding circumstances to be “unlike.”

114. The tribunal applied this public policy analysis to two interests preferred by the Canadian government. First, the tribunal reviewed the legislative record in Canada and concluded that the measure was “intended primarily to protect the Canadian PCB disposal industry from US competition” and that “there was no legitimate environmental reason for introducing [it].¹⁵⁸ The tribunal concluded that the measure was not intended to protect the environment based on a host of documentary and testimonial evidence stating that “PCB waste should be disposed of in Canada by Canadians.”¹⁵⁹ The tribunal then considered Canada’s alternative argument that the measure was intended to secure economic strength of the Canadian industry’s ability to process PCBs in Canada in case the U.S. decided to close its borders to PCB again. The tribunal agreed that promoting economic strength and capacity-building within the Canadian industry was a legitimate public interest, but that the measure was not the least restrictive means of achieving the aim.¹⁶⁰

115. While this element of likeness not commonly addressed by tribunals, some other have addressed “rational government policies” when assessing like *circumstances* of investors.¹⁶¹ The tribunal in *Parkerings v. Lithuania*, for example, recently expressly recognized that “less favourable treatment is acceptable if a State’s legitimate objective justifies different treatment in relation to the specificity of the

¹⁵⁷ *Id.* para. 247.

¹⁵⁸ *Id.* paras. 194-195.

¹⁵⁹ *Id.* para. 162 (statement made in the House of Commons).

¹⁶⁰ *Id.* para. 255. Before applying this rule to NAFTA Article 1102, the tribunal discussed general principles of interpreting NAFTA in light of environmental concerns. The tribunal concluded that NAFTA and the North American Agreement on Environmental Cooperation (NAAEC) confirmed that “where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade.” *Id.* para. 221.

¹⁶¹ *Pope & Talbot Inc. v Government of Canada* (Award on Merits of Phase 2 of 10 April 2001), UNCITRAL, para 78. See also *GAMI Investments, Inc. v United Mexican States* (Award of 15 November 2004), UNCITRAL, 44 ILM 545, at para. 114.

investment.”¹⁶² Although the above analysis review only a handful of cases interpreting substantive protections in investment agreements, it demonstrates a trend among tribunals to consider legitimate public interest concerns even when treaty language remains undefined or ambiguous.

4. The Right to Regulate in a New Generation of BITs and IIAs

116. Investment tribunals began interpreting treaty provision regarding expropriation, fair and equitable treatment, and national treatment in light of a state’s public policy interests in the 1990s and early 2000s.¹⁶³ This developed out of necessity. At the time, treaties were ambiguous in their scope and definitions, and tribunals began to consider public policy goals in weighing and balancing a measure’s impact on investors. Over time, however, states began to more expressly include these concepts in their investment agreements, leading to a new generation of more detailed treaties. Today, states have taken a number of approaches to preserve their right to regulate within investment agreements. The three most common techniques are described below. This analysis is solely focused on the “right to regulate” and “regulatory chill” and is not to be confused with the section of “Filter Mechanisms,” although there may be some overlap.

a. Definitions of Specific Protections

117. A number of new agreements include interpretative language defining principal investment protections—non-discrimination, fair and equitable treatment, and compensation for expropriation—in light of a state’s legitimate regulatory concerns. The first major change in modern investment treaties responded to differing tribunals’ interpretation of **indirect expropriation**. In 2004, both Canada and the United States revised their model BITs to provide more explicit guidance for tribunals. Both interpretive guidances state that all indirect expropriation claims should be considered case-by-case, fact-specific inquiries examining three factors: (1) the economic impact of the measure; (2) the extent to which the measure interferes with distinct, reasonable investment-backed expectations; and (3) the character of the government measure.¹⁶⁴ The model BITs also include in an annex that “Except in rare circumstances,” measures “designed and applied to protect

¹⁶² *Parkerings-Compagniet, op. cit.*, at para. 371.

¹⁶³ *Spears, op. cit.*, at 1045.

¹⁶⁴ 2004 US Model BIT, Annex B; Canadian Model BIT, Annex B.13(1).

legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation.”¹⁶⁵ Other agreements have since included similar interpretive statements, such as the 2005 Singapore-India FTA and the 2006 China-India BIT.

118. Other agreements have taken a more absolutist approach to indirect expropriation and eliminated that “except in rare circumstances” caveat. The 2007 COMESA Common Investment Area Agreement includes the following statement:

*Consistent with the right of states to regulate and the customary international law principles on police powers, bona fide regulatory measures taken by a Member State that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, shall not constitute an indirect expropriation under this Article.*¹⁶⁶

The 2009 ASEAN Comprehensive Investment Agreement takes the same approach.¹⁶⁷

119. So far, the EU consultation document on TTIP, based on text adopted in CETA, follows the U.S. and Canada model BIT approach with further clarifications. The TTIP draft uses the same three factors with an additional factor considering the “duration of the measure or series of measures.” In the section on “economic impact,” the text clarifies that “the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred.” This directly rejects the “sole-effects doctrine” articulated in *Metalclad* for example. The Annex also states that the “character” of the measures considers the “object, context, and intent” of the measure, mirroring cases such as *Tecmed*. Finally, the draft text puts even more limiting language on the “except in rare circumstances” caveat:

[E]xcept in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are

¹⁶⁵ 2004 US Model BIT, Annex B; Canadian Model BIT, Annex B.13(1).

¹⁶⁶ Common Market for Eastern and Southern Africa, Investment Agreement for the COMESA Common Investment Area (2009), Art. 20(8).

¹⁶⁷ ASEAN Comprehensive Investment Agreement (signed 26 February 2009 and entered into force 29 March 2012), Annex 2.

designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

120. The addition of more restrictive language requiring the measure to be “severe” and “manifestly excessive” further limits the claims that could successfully challenge public policy measures as expropriatory.
121. The most dramatic shift in defining investment protections has been under the **fair and equitable treatment** standard. Most BIT and IIA language ensuring investors “fair and equitable treatment” does not elaborate on its meaning, including the Dutch Model BIT.¹⁶⁸ But what was once a mere token phrase in investment agreements with a notable “paucity of jurisprudence”¹⁶⁹ has been subject to a flood of jurisprudence over the past decade. Now, fair and equitable treatment has “emerged from the shadows of investment law to become a potent tool in the assessment of the adequacy of the judicial and administrative systems of host states.”¹⁷⁰ Most investment agreements remain enigmatic when it comes to fair and equitable treatment, however. It has traditionally been left to arbitral panels to determine what constitutes a denial of fair and equitable treatment.
122. A more recent approach has been to limit the scope of fair and equitable treatment by further defining it and providing examples of it. This trend began with the 2004 US model BIT, which states in Article 5(2) that “for great certainty”, fair and equitable treatment should be interpreted to be the same at the customary international law standard for the treatment of aliens. It then states that fair and equitable treatment “includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world.”¹⁷¹ This approach has since been applied outside the United States. The Japan-Mexico FTA, for example, mirrors the U.S. model BIT approach almost entirely.¹⁷² Other agreements such as the UK and the Canadian model BITs, however, continue a minimalist approach and do not provide examples of breaches of the fair and equitable treatment

¹⁶⁸ Dutch Model BIT, Art. 3(1).

¹⁶⁹ S. Vasciannie, “The Fair and Equitable Treatment Standard in International Investment Law and Practice,” 70 *British Yearbook of International Law* 99, 162-63 (1990).

¹⁷⁰ C. McLachlan, L. Shore, and M. Weiniger, *International Investment Arbitration* (2007), at 201.

¹⁷¹ 2012 U.S. Model BIT, art. 5(2)(a).

¹⁷² Japan-Mexico FTA, art. 60.

standard.¹⁷³ The IISD Model International Agreement on Investment for Sustainable Development takes another approach with a general protection of minimal standard of fair and equitable treatment in Article 6, which is further elaborated on in Article 19, which generally provides for “Procedural Fairness” in the host state’s treatment of investors.

123. Other express clarifications include provisions stating that fair and equitable treatment does not require additional requirements beyond the minimum standard of treatment and does not create stand-alone substantive rights.¹⁷⁴ This is a direct response to cases like *Tecmed* and *Pope & Talbot*, which held that FET was an “additive” or autonomous standard from MST.
124. The E.U.’s proposed text for TTIP takes another new approach to fair and equitable treatment. Building on the recent trends in BITs to provide examples of a breach of fair and equitable treatment. The TTIP proposed language is based on language the E.U. and Canada already agreed upon in CETA and reads as follows:
1. *Each Party shall accord fair and equitable treatment and full protection and security to investments and investors of the other Party in its territory.*
 2. *To comply with the obligation to provide fair and equitable treatment in para 1, neither Party shall adopt measures that constitute, notably:*
 - a. *Denial of justice in criminal, civil or administrative proceedings; or*
 - b. *Disregard of the fundamental principles of due process; or*
 - c. *Manifest arbitrariness; or*
 - d. *Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; or*
 - e. *Abusive treatment of investors, including coercion, duress and harassment; or*
 - f. *A breach of legitimate expectations of investors arising from a government's specific representations or investment-inducing measures; or*
 - g. *A disregard of the principle of effective transparency in any applicable administrative or judicial procedures.*

Such a detailed listing of potential violative measures is new for both Europe and

¹⁷³ See, e.g., Canada model BIT art. 5; 2005 UK Model BIT, art. 2; 2008 German model BIT, art. 2.

¹⁷⁴ E.g., 2012 US Model BIT, art. 5(2); COMESA CIAA, art. 14(2).

the United States, although it mirrors CETA almost exactly. This can be considered a further elaboration of “denial of justice” and “due process” included in the US and Canada model BITs. This proposed language is a step forward for the standard itself and as a filtering mechanism. First, although tribunals have generally come to agreements on what constitutes a violation of fair and equitable treatment, the explicit list is an expression of greater party control over the definition. Although not an exhaustive list, this delineation will help unify party and tribunal interpretation of fair and equitable treatment. Moreover, this list is further emphasized by the fact that it is placed in the article itself rather than a Note or Annex.

b. General Exception Clauses

125. General exception clauses identify sectors or types of regulatory measures excluded from the treaty’s coverage. This usually centers on key policy objectives. Thus, rather than directing the tribunal to *balance* competing objectives of investor protection against social and environmental protection, like interpretative statements do, exception clauses exclude types of regulations entirely from the agreement’s coverage. Most general exceptions are based on GATT Article XX and GATS Article XIV. These exempt measures designed to protect “public order” or to “protect human, animal, or plant life or health.” The measure must also usually be necessary, relating to, or “designed and applied” to achieve the policy objective.
126. Although developed in the context of WTO agreements, general exception clauses began being included in international investment agreements in the late 1990s. Canada, for instance, started including general exceptions based on GATT Article XX in 1997, and revised its Model BIT to include an article on general exceptions for measures necessary to “protect human, animal or plant life or health” and “for the conservation of living or non-living exhaustible natural resources.”¹⁷⁵ Exceptions clauses based on the GATT or GATS have also been included in the COMESA CIAA¹⁷⁶ and many bilateral FTAs or BITs.¹⁷⁷

¹⁷⁵ Canada Model BIT, art. 10.

¹⁷⁶ COMESA CIAA, art. 22.

¹⁷⁷ E.g., Singapore–Australia FTA, art. 19 (2003); Singapore–Japan FTA, art. 83 (2007); Singapore–Jordan BIT, art. 18 (2004); Singapore–India FTA, art. 6.11 (2005); Japan–Malaysia FTA, art. 10 (2005); China–ASEAN FTA, art. 16 (2009); India–Korea FTA, art. 10.18 (2009); Taiwan–Panama

127. Despite their growing use in BITs and FTAs, particularly among Asian nations, general exception clauses have not yet been applied or interpreted by an investment arbitration panel.¹⁷⁸ Thus, it is uncertain how disparate tribunals would interpret key elements in general exception clauses. In the GATT and GATS context, any measure taken to protect one of the listed fundamental interests must also be “necessary” to achieve its stated purposes. The WTO Appellate Body has interpreted the necessity element to require the measure to be close to “indispensable.”¹⁷⁹ Necessity also requires panels to make a judgment about the relative importance of the domestic policy compared to the investment protection aims of the treaty.¹⁸⁰ Of course, these sorts of interpretative issues will always arise any time a panel is called upon to apply new treaty language.
128. The European Commission’s public consultation document on TTIP and preliminary TTIP text make use of a general exception article to ensure that a government may pursue legitimate public policy measures that are non-discriminatory and not disguised trade restrictions.¹⁸¹ As of now, the TTIP text would provide exceptions for measures necessary to protect: public security; public morals; public order; human animal or plant life or health; conservation of exhaustible natural resources; “national treasures of artistic, historic or archaeological value”; and data privacy, confidential records, and safety. The Commission’s public consultation also proposes a separate statement recognizing that the exceptions encompass “environmental measures necessary to protect human, animal or plant life or health.” These are important additions for the right to regulate and to help shield against potential regulatory chill. Although interpretative statements can be added to substantive definitions of investment protections to ensure the right to regulate, general exceptions provide an extra layer of protection for legitimate social or environmental measures. Also, general

FTA, art. 20.02 (2003); Singapore–Korea FTA, art. 21.2 (2005); ASEAN–Australia–New Zealand FTA, Chapter 15, arts. 1–5 (2009).

¹⁷⁸ Panels have had occasion to interpret exceptions for “national security,” for example, but these are regarded as distinct from general exception clauses. *See, e.g., Continental Casualty Co. v The Argentine Republic* (Award of 5 September 2009), ICSID Case No. ARB/03/09.

¹⁷⁹ WTO Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161,169/AB/R, adopted 10 January 2001, para 161.

¹⁸⁰ WTO Appellate Body Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DSB/M/188, adopted 20 April 2005; WTO Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Materials*, WT/DSB/M/103, adopted 5 April 2001.

¹⁸¹ This language mirrors the *chapeau* of GATT Article XX and GATS Article XIV.

exception clauses can be applied to the entire measure at issue, unlike substantive definitions which still require panels to weigh the government's interest against the particular investor's interests and circumstances.

c. Preambular Language

129. A final way that a new generation of BITs and IIAs have sought to prevent wanton regulatory chill is through more comprehensive preambles. Why are preambles important? Treaties must be interpreted in light of their overall object and purpose,¹⁸² and thus, investor-state tribunals often refer to preambles to identify the treaty's overall goals. This is in line with Article 31 (2) of the Vienna Convention on the Law of Treaties.¹⁸³ In the early 1990s, when tribunals had to interpret BITs and IIAs that did not include preamble language about social welfare and the environment, tribunals often resolved ambiguous treaty language in favor of investors' rights based on the preamble language.¹⁸⁴ This also led tribunals to interpret investment provisions expansively and exceptions narrowly.¹⁸⁵ But preambles have also been used otherwise. The tribunal in *S.D. Meyers* took into account NAFTA's preamble, which states that members undertake obligations in a "manner consistent with environmental protection". The tribunal thus concluded that it should interpret NAFTA's substantive obligations in light of the "right to establish high levels of environmental regulation."¹⁸⁶
130. In response, a number of new BITs and IIAs contain language suggesting that investment protection, while the goal of the agreement, is not an end that must be achieved at all costs. The 2004 Model Dutch BIT acknowledges that the objectives of promoting and protecting investments "can be achieved without compromising health, safety and environmental measures of general application." The Netherlands has used this language in its BITs with Mozambique (2001), Namibia

¹⁸² Vienna Convention on the Law of Treaties (VCLT), art. 31(1), 1155 U.N.T.S. 331 (signed 23 May 1969 entered into force 27 January 1980).

¹⁸³ Art. 31 para. 2 VCLT reads in part as follows: "The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: ...".

¹⁸⁴ Examples include: *Societe General de Surveillance v. Philippines* (Decision on Jurisdiction of 29 January 2004), ICSID Case No. ARB/02/6, para. 116; *Siemens A.G. v. Argentina* (Decision on Jurisdiction of 3 August 2004) ICSID Case No. ARB/02/8, para. 81; *MTD Equity Sdn Bhd and MTD Chile S.A. v. Chile* (Award of 25 May 2004), ICSID Case No. ARB/01/7, para. 104.

¹⁸⁵ See e.g., *Enron Corp., Ponderosa Assets, L.P. v. Argentine Republic* (Award of 22 May 2007) ICSID Case No. ARB/01/3, para 331; *Sempra Energy Int'l v. Argentine Republic*, (Award of 28 September 2007) ICSID Case No. ARB/02/16, para 373; *Canfor Corp. v. United States* (Decision on Jurisdiction of 6 June 2006), UNCITRAL, para 187.

¹⁸⁶ *S.D. Meyers, op. cit.*, para. 221.

(2002), Suriname (2005), Dominican Republic (2006), and Burundi (2007).

131. The 2012 US Model BIT similarly highlights the parties' "[d]esir[e] to achieve [investor protection] objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights." A number of BITs signed in the past fifteen years also include similar preamble language.¹⁸⁷ Another set of agreements also expressly include sustainable development among the agreement's objectives.¹⁸⁸ Finally, yet another set of new FTAs also expressly say that the agreement does not diminish a party's right to regulate regarding issues of public interest.¹⁸⁹
132. The Commission's draft text for TTIP includes the following language about the right to regulate in Article 1 on "Objective, coverage and definitions":

Consistent with the provisions of this Title, each Party retains the right to adopt, maintain and enforce measures necessary to pursue legitimate policy objectives such as protecting society, the environment, and public health, ensuring the integrity and stability of the financial system, promoting public security and safety, , and promoting and protecting cultural diversity.

133. Strictly speaking, this is not preambular language because it appears in an article, which makes the case of the right to regulate even stronger. What is more, the Commission's public consultation uses the example of the CETA preamble, which affirms the "commitment to sustainable development" and "the right of the Parties to take measures to achieve legitimate public policy objectives" such as the promotion of high environmental and labor standards.
134. Each of these methods is an important element when considering the potential risks of ISDS to the Netherland's regulatory policy space. From above, we can see that not only is the risk of "regulatory chill" exaggerated in international investment case law, but also that modern approaches to investment agreements further mitigate this risk by more clearly delineating a "right to regulate."

¹⁸⁷ E.g., Japan–Korea BIT (2002); Canadian Model BIT (2004); Jordan–Singapore BIT (2004); Canada–Peru BIT (2007); COMESA CCA (2007); China–New Zealand FTA (2008); ASEAN–Australia–New Zealand FTA (2009); and India–Korea FTA (2009).

¹⁸⁸ Panama–Taiwan FTA (2003); US–Australia FTA (2004); India–Singapore CECA (2005); US–Peru TPA (2006); China–ASEAN FTA (2009); Canada–Colombia FTA (2008); Canada–Peru FTA (2009).

¹⁸⁹ Panama–Taiwan FTA (2003); US–Peru TPA (2006); Canada–Colombia FTA (2008); China–New Zealand FTA (2008); Canada–Peru FTA (2009); China–ASEAN Investment Agreement (2009).

D. Impartiality

135. In the absence of an ISDS mechanism in the TTIP, claims brought by US or Dutch investors would have to be settled through the domestic courts. Although it is undisputable that both the US and the Netherlands have strong rule-of-law traditions, questions of the impartiality of domestic courts could possibly arise due to the sensitive and at times highly political character of the cases at issue – particularly (but far from exclusively) in cases decided by lay juries. The *Loewen* case may serve as an example.¹⁹⁰ In this case, the arbitral tribunal held that the rights of a Canadian investor had been violated by US courts. The tribunal found that “*the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment*”,¹⁹¹ although the claim was fortuitously held inadmissible on other grounds.
136. The possibility of judicial loyalty to the forum State, especially in cases involving substantial claims or decisions of high-profile politicians, should not be discarded lightly.¹⁹² In ISDS the party to the dispute can appoint its ‘own’ arbitrator, who could then be seen as ‘loyal’ to the party that appointed them. However, as both parties can select an arbitrator, this helps to cancel out bias, and as arbitrators need to be re-appointed for every case, they tend to be aware of the need to be (and be seen as) unbiased in order not to jeopardise future appointments. This immediate accountability to those seeking legal redress is not present in the case of national judges who are mostly (with notable exceptions in the US) appointed for life.

E. Expertise

137. Arguably, domestic courts may lack the required time and resources to acquire sufficient expertise concerning highly technical topics within the field of international investment law.¹⁹³ Also, a variety of interpretations by local courts on core international investment law notions could result in a jurisprudential

¹⁹⁰ The *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3 (June 26, 2003); *See also Mondev* case in which an investor was denied redress because of an immunity clause; *Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 (October 11, 2002).

¹⁹¹ *Id.*, at 137.

¹⁹² *See* R. Dolzer & C. Schreuer, *Principles of International Investment Law* 214 (2008).

¹⁹³ *Id.*

fragmentation (as tests and thresholds developed in different systems of domestic law would apply) that would be undesirable for the stability and predictability of the legal system. This would imply that investors no longer would know what their rights are, nor would States be confident about the extent of their obligations.

138. On the other hand, in terms of judicial efficiency, the Netherlands is considered as a safe capital destination. According to the 2013 Investment Climate Statement by the US Department of State:

*The Dutch civil court system has a special chamber dedicated to business disputes, the Enterprise Chamber. This feature is unique among EU member states and the Enterprise Chamber has received positive reviews from institutional investors, companies and investors around the world. Enterprise Chamber judges include experts in commercial fields as well as the legal profession. They have proven their ability to act swiftly and decisively in a wide range of corporate disputes, including conflicts regarding corporate control.*¹⁹⁴

139. However, as this quote highlights, judicial efficiency of this type is to some extent the exception, rather than the rule, even in EU Member States.
140. One proposal is to create a specialised national court in each Member State to deal with international investment claims but this would not seem viable as it raises multiple new questions. For example, what is the need for a standing investment court, if some States are rarely sued? Who would appoint the judges on such court (and on what basis)? Which procedural rules would apply, since national rules might not always be suitable, for example with regard to provisional measures? Although questions on judges' expertise would be ostensibly tackled, what about concerns on their impartiality? Should a specialised appellate court be established too?

F. De-politicisation of disputes

141. State-to-State dispute settlement, whereby a State espouses the claim of its investor, has sometimes been considered an alternative to ISDS,¹⁹⁵ although it was

¹⁹⁴ U.S. Department of State, Bureau of Economic and Business Affairs, '2013 Investment Climate Statement – Netherlands', available at: <http://www.state.gov/e/eb/rls/othr/ics/2013/204703.htm>

¹⁹⁵ See, for example, A. Wessels, ISDS Threatens Privacy and Reform of Copyright and Patent Law, at 3 (2014), available at: http://people.ffii.org/~ante/ISDS/FFII_NL_ISDS-threatens-privacy.pdf

historically a much older process, one which normally involved exhaustion of local remedies and which was available only as a last resort. Yet, among the main objectives for the establishment of ISDS is de-politicisation of investment disputes. Notwithstanding the excellent bilateral relations between the Netherlands and the US, involvement of the Dutch government in order to protect a Dutch investor in a dispute with the US, or *vice versa*, would elevate the matter to an inter-state level, possibly even giving rise to a political controversy between the two States that may negatively, and needlessly, affect other pending issues.

142. As part of its research, Ecorys has looked at the effect of ISDS on the political relationship between the Netherlands and the US.¹⁹⁶ One argument in favour of ISDS is that it would de-politicise investment disputes as a company could bring a case against the host country of its investment, without the involvement of its own government. The inclusion of ISDS in the TTIP would bring about a change from the current situation, as the Netherlands does not have a BIT with the US, let alone an ISDS mechanism to govern their disputes. According to the *status quo*, investors may bring a claim through the national court system of the host country and/or seek support from their home state to discuss the issue at a political level, e.g. through diplomatic channels. In the latter case, companies could confront political considerations that might lead to insufficient support to defend their case.
143. To analyse the effect of ISDS on the Dutch-US political relations we would first need to establish whether politicisation of investment disputes between the two countries is currently an issue. Based on interviews with various persons in the Dutch Ministry of Foreign Affairs and the Dutch employer organisation VNO-NCW, it appears that there have not been any investment-related complaints either from US companies to the Dutch government or the other way around in the past years. There have been contacts between the US and Dutch governments on general economic and investment-related policies, but these have always been at a general policy level. As these discussions have not focused on company-specific issues, they are regarded as part of the general relations and lobbying between countries.

¹⁹⁶ In line with the ToR, this analysis is largely based on interviews mainly with representatives of the Ministry of Foreign Affairs, complemented with interviews with an academic expert, a business representative and an NGO.

144. It was also noted by the interviewees that the current political relations between the US and the Netherlands are regarded as good. Especially in the context of international trade and investments, the US considers the Netherlands as an ally, since both countries in general favour free trade and FDI flows in each other's markets are relatively large.
145. Even though ISDS allows investors to launch a case independently from their home government, interviewees believed that these governments are still likely to be involved in the dispute. Companies are not expected to lightly initiate an ISDS case, given the costs involved (*e.g.*, direct financial costs, effects on the relation with the government of the host country possibly posing a risk for future business activities, potential reputational damage, etc.). Companies are therefore likely to first try to settle a dispute through "conventional" diplomatic channels with support of their home government. In practice, therefore, political relations between the home and host states may still be affected. There have been investment disputes of Dutch companies against other States with which the Netherlands does have a BIT, in which the Dutch government has played a facilitating role, *e.g.*, by exerting influence in meetings with policy makers. According to the interviewees, this has not affected political relations between the countries. However, it should be noted that many of the ISDS cases by Dutch investors are filed by holding companies which are established in the Netherlands while their mother company is based elsewhere. The Dutch government is much less likely to be involved in the latter cases.
146. There has never been an investment dispute against the Dutch government under any of its BITs. Therefore, we cannot refer to any effect on political relations once dispute is launched against the Netherlands.
147. Despite the apparent absence of investment complaints between the US and the Netherlands in the past, the mere existence of the instrument may give rise to such disputes in the future. In the context of a growing number of ISDS cases at global level in recent years and the relative economic importance of NL-US investments this is not unlikely, although this will also partly depend on the specific ISDS provisions agreed (*e.g.* how frivolous claims are prevented). . Investors may be aware of the limited effectiveness of support by the home government (*e.g.*

through diplomatic channels) in solving cases, as stated by one of the interviewees. Based on past experience with Dutch BITs and the current good relations between the US and the Netherlands the effect of a possible increase in investment disputes on the political relation is however not expected to be dramatic.

148. Another risk of ISDS related more specifically to the de-politicisation of investment disputes is the possible abuse of the instrument by foreign investors. An ISDS mechanism could be used as a leverage by investors to obtain amicable settlements with the host State, as has been the case with various NAFTA disputes.¹⁹⁷ This could potentially exert pressure on the Netherlands to settle disputes favourably to avoid costs as well as reputational damage which is expected to be higher in ISDS, due to the publicity such cases may attract, which could be greater than in the case of proceedings before domestic courts. In some cases, this pressure on governments could also affect political relations between the Netherlands and the US. This will depend among others on the issue at stake in the dispute and the type of settlement. The likeliness of such cases is however difficult to predict.

G. Domestic law and procedure

149. The attractiveness of the Netherlands as an investment location is attributed *inter alia* to its corporate governance laws and efficient legal framework in terms of regulation and enforcement.¹⁹⁸ The property of foreigners is protected in Article 14(1) of the Dutch Constitution, according to which “*expropriation may take place only in the public interest and on prior assurance of full compensation, in accordance with regulations laid down by or pursuant to Act of Parliament*”¹⁹⁹

¹⁹⁷ See L.N Skovgaard Poulsen, J. Bonnitca & J. Webb Yackee, *Costs and Benefits of an EU-USA Investment Protection Treaty*, LSE Enterprise, Apr. 2013, at 30, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/260380/bis-13-1284-costs-and-benefits-of-an-eu-usa-investment-protection-treaty.pdf

¹⁹⁸ N. Schrijver & V. Prislán, *The Netherlands*, in C. Brown & D. Krishan (Eds.), *Commentaries on Selected Model Investment Treaties* 535 at 537 (2013).

¹⁹⁹ The Constitution of the Kingdom of the Netherlands (2008), available at: <http://www.government.nl/documents-and-publications/regulations/2012/10/18/the-constitution-of-the-kingdom-of-the-netherlands-2008.html>

while the relevant administrative procedure is regulated in the Law on Expropriation.²⁰⁰

150. The Dutch constitution does not, as such, provide in a guarantee of fair and equitable treatment, or full protection and security, although it does protect against discrimination in general terms.²⁰¹ Furthermore, due to the monist relationship between international and domestic law, Article 1 of Protocol No 1 to the European Convention on Human Rights²⁰² and Article 17 of the Charter of Fundamental Rights of the European Union²⁰³ may be invoked in domestic judicial proceedings.²⁰⁴ This type of protection evidently stays in place, even if a TTIP including investment protection, would enter into force.
151. Likewise, provisions on the protection of property form an integral part of the US legal order. According to Amendment V of the US Constitution, “[n]o person shall be [...] deprived of [...] property, without due process of law; nor shall private property be taken for public use, without just compensation.”²⁰⁵ In addition, at a regional human rights level, Article 21(2) of the American Convention on Human Rights provides that “[n]o one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law.”²⁰⁶
152. On the other hand, neither Constitutions nor regional human rights Conventions guarantee fair and equitable treatment or full protection and security. Detailed

²⁰⁰ *Id.*

²⁰¹ According to Article 1 of the Dutch Constitution: “All persons in the Netherlands shall be treated equally in equal circumstances. Discrimination on the grounds of religion, belief, political opinion, race or sex or on any other grounds whatsoever shall not be permitted.”

²⁰² According to Article 1 of Protocol No 1 to the European Convention of Human Rights: “Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.”

²⁰³ Article 17 of the Charter of Fundamental Rights of the European Union provides that “Everyone has the right to own, use, dispose of and bequeath his or her lawfully acquired possessions. No one may be deprived of his or her possessions, except in the public interest and in the cases and under the conditions provided for by law, subject to fair compensation being paid in good time for their loss. The use of property may be regulated by law in so far as is necessary for the general interest.”

²⁰⁴ N. Schrijver & V. Prislán, *supra* note 43.

²⁰⁵ The Constitution of the United States, available at: <http://www.usconstitution.net/const.pdf>

²⁰⁶ American Convention on Human Rights ‘Pact of San Jose’, available at: http://www.oas.org/dil/access_to_information_American_Convention_on_Human_Rights.pdf

protections provided under IIAs and the availability of an ISDS mechanism could perhaps encourage US investors to make investments in the Netherlands as they would be assured that their investment would be properly protected and enforced according to international recognised standards. However, such a direct causal link would be difficult to prove as investors base their business plans on a multitude of factors, the individual impact of each being very hard to establish.

H. Expenses

153. The Netherlands has never been sued under any of its BITs by foreign investors. Yet, given that a large US outward capital flow to the Netherlands will be covered by the TTIP, US investors' claims against the Netherlands under ISDS cannot be ruled out. This was the case in the Energy Charter Treaty (ECT); almost half of the ISDS cases under the ECT were brought against EU Member States.²⁰⁷ Thus, a similar trend may emerge following the conclusion of the TTIP.
154. Although the Netherlands is not likely to be involved in ISDS cases in which foreign investors invoke gross violations of investment protections, it could still incur legal costs for a successful defence. In practice this would mean that, even if a potential claim against the Netherlands is unsuccessful, the Netherlands would have to bear the legal costs for its defence. This is supported by a 2012 OECD report which states that ISDS costs for both parties average over USD 8 million while occasionally reaching over USD 30 million.²⁰⁸
155. It should be noted though that several tribunals have recently adopted some form of the 'loser pays' approach ordering the losing party not only to bear all arbitration costs (being the costs of the registry office and of the tribunal itself) of an adverse award but also to make a substantial contribution to the winning party's legal fees.²⁰⁹ Cases in point are *ADC v. Hungary*,²¹⁰ *Plama v. Bulgaria*,²¹¹ *Europe Cement v. Turkey*²¹² and *Gemplus v. Mexico*.²¹³

²⁰⁷ See <http://www.encharter.org/>

²⁰⁸ OECD, *Investor-State Dispute Settlement, Public Consultation: 16 May-9 July 2012*, at 18 (2012), available at: <http://www.oecd.org/investment/internationalinvestmentagreements/50291642.pdf>

²⁰⁹ House of Lords, European Union Committee, *The Transatlantic Trade and Investment Partnership*, 14th Report of Session 2013-14, at 53 (2014), available at: <http://www.publications.parliament.uk/pa/ld201314/ldselect/ldeucom/179/179.pdf>

156. Finally, it is highly doubtful whether settlement of disputes domestically is a cheaper option for the Netherlands. National court procedures are subsidised by the State (litigants only pay a notional fee that does not cover the actual costs of the trial) whereas in arbitration costs are divided between the litigating parties (if not borne by the losing party). Moreover, whereas in ISDS tribunals' decisions are final (with the exception of annulment proceedings in ICSID cases), investors' claims before domestic courts may be brought from the court of first instance, to an appeals court, to a supreme court, thus tripling the amount of legal costs to be incurred, both for the legal defence of the State as for the maintenance of the court system itself. Hence expenses for the Dutch State may be significantly increased when investors decide to appeal a decision of a district court, let alone bring it to the *Hoge Raad*.

I. Comparative Assessment of the NAFTA and CAFTA Experience

157. Another major part of this study will focus on the effects of ISDS case law for NAFTA and CAFTA countries. Since NAFTA and CAFTA represent the largest trade regimes allowing private U.S. investors to bring ISDS claims, these two treaty bodies provide an excellent sample of cases both brought by U.S. investors and brought against the U.S. government. The following sections assess NAFTA and CAFTA case law in light of the most common criticisms levied against the ISDS system, namely the perpetuation of an "American claim culture" and "regulatory chill." This will be done at both the macro and micro level: first, examining overall trends from NAFTA and CAFTA cases by number and types of claims brought as well as amounts paid out by governments; and second, homing in on specific cases to explore what, if any, effect individual ISDS claims have had on policy areas such as the environment, health, food, and agriculture.

²¹⁰ ADC Affiliate Limited and ADC & ADMC Management Limited v. the Republic of Hungary, ICSID Case No. ARB/03/16, Award (Oct. 2, 2006), ¶¶ 531-533.

²¹¹ Plama Consortium Limited v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Award (Aug. 27, 2008), ¶¶ 316-324.

²¹² Europe Cement Investment & Trade S.A. v. Republic of Turkey, ICSID Case No. ARB(AF)/07/2, Award (Aug. 13, 2009), ¶¶ 185-186.

²¹³ Gemplus S.A., SLP S.A., Gemplus Industrial S.A. de C.V. v United Mexican States, ICSID Cases Nos. ARB(AF)/04/3 & ARB(AF)/04/4, Award (Jun. 16, 2010), ¶¶ 18-2-18-10.

1. Overall Trends from NAFTA & CAFTA Case Law

158. Since NAFTA's entry into force in 1994, investors have brought 73 total claims pursuant to the investor-state dispute settlement mechanisms in Chapter 11. Of the known Chapter 11 claims, 34 have been brought against Canada, 20 against the United States and 19 against Mexico. However, only a handful of these claims have reached arbitration. Indeed, 39.7% of claims were withdrawn or remain "inactive", never reaching an arbitral tribunal. A further 27% of claims have been dismissed either on procedural or jurisdictional grounds. In total, investors have only prevailed against a member-state government 8 times since 1994. As well, the Canadian and Mexican governments have elected to settle disputes with investors—either for compensation or not—in four instances.
159. Of the 34 claims against Canada, tribunals have awarded damages to the complaining investors in three instances: 6 million Canadian Dollars in *S.D. Meyers* and 408,000 USD in *Pope & Talbot*, while the last award in *Mobil Investments* is still pending. Canada has also settled four claims "out of court", and in two instances (*Ethyl Corp.* and *AbitibiBowater*) agreed to pay damages to the investors. These two settlements proved quite costly for the Canadian government, shelling out 20 million Canadian Dollars to Ethyl Corp. and 130 million Canadian Dollars to AbitibiBowater. However, Canada has also had five claims dismissed, while another seven claims remain pending.
160. The United States, meanwhile, has yet to lose a NAFTA arbitration. Of the 20 recorded claims against the U.S., tribunals have dismissed investors' claims in 9 cases. Three claims were withdrawn by the complainant. Four claims are "inactive," and another four claims are still active.
161. Mexico has lost more investment dispute claims than any other NAFTA party. Of the 19 known claims against Mexico, tribunals have awarded damages to complaining investors in five cases.²¹⁴ Since 1994, Mexico has paid a total of USD 187.29 million in damages to investors. However, 90% (USD 169.19 million) of these damages were awarded in three "Soft Drink Cases" challenging the same set

²¹⁴ *Metalclad, op. cit.*; *CEMSA, op. cit.*; *Corn Products Int'l, Inc. v. Mexico* (Award of 18 August 2009), ICSID Case No. ARB(AF)/04/1; *Archer Daniels Midland (ADM) Co. and Tate & Lyle Ingredients Americas, Inc. v. Mexico* (Award of 21 November 2007), ICSID Case No. ARB(AF)/04/5; *Cargill, Inc. v. Mexico* (Award of 18 September 2009), ICSID Case No. ARB(AF)/05/2.

of Mexican measures taxing soft drinks sweetened with high-fructose corn syrup. Mexico has also had six claims dismissed, and another seven claims remain “inactive.” In one instance, *International Thunderbird Gaming*, the tribunal dismissed the claims and ordered the investor to pay Mexico USD 1.25 million in legal costs.²¹⁵

162. The success rate on NAFTA ISDS claims, even the majority brought by U.S. investors, lags behind global trends in ISDS. For instance, according to UNCTAD, between 1993 and 2013, investors prevailed in 31% of the claims while States prevailed in 43%.²¹⁶ Another 26% of the 274 ISDS claims concluded since 1993 have been settled without full arbitration.²¹⁷ Using UNCTAD’s definition of “concluded” (meaning only cases that are either decided in favor of the state, in favor of the investor, or settled), investors have only prevailed in 25% of concluded NAFTA cases, while the states has prevailed in 62.5% and 12.5% were settled.
163. NAFTA claims, particularly those brought by U.S. investors, also do not seem to follow international trends in the *amount* of claims brought through ISDS. Many observers have noted a marked increase in the number of ISDS arbitrations since 1999. According to UNCTAD, investors brought 57 new claims pursuant to treaty-based disputes settlement mechanisms in 2013.²¹⁸ 2012 also saw the highest number of known ISDS cases in any given year with 58. UNCTAD also notes that this comports with an overall trend in ISDS internationally as the amounts of claims filed increases every year. NAFTA claims, however, do not demonstrate a cognizable upward trend. The number of NAFTA claims filed against any of the three member state governments fluctuates during any given year between 1 and 9. There were also noticeable declines in claims brought between 2002 and 2003 and again between 2008 and 2010. What is more, the upward trend is even less apparent when singling out claims brought by U.S. investors. Between 1994 and 2012, U.S. investors brought 51 claims against Canada and Mexico, but those claims are also evenly distributed over the 17-year period. On average, U.S. investors bring 3 claims per year under NAFTA Chapter 11. Additionally, it should be noted that the highest spike in overall NAFTA claims, in 2002, occurred when

²¹⁵ See *International Thunderbird Gaming Corp. v. Mexico* (Award of 26 January 2006), UNCITRAL (NAFTA).

²¹⁶ UNCTAD (2014), *op. cit.*, at 1.

²¹⁷ *Id.*

²¹⁸ *Id.*

Canadian investors brought 6 of the 9 total claims that year. These trends thus help to debunk two myths of ISDS: first, ISDS mechanisms promote litigiousness; and second, U.S. investors filed large amounts of claims under a theory of an “American claim culture.”

164. CAFTA cases, on the other hand, reveal different trends. CAFTA was only signed in 2004 and, as such, investors have only submitted seven claims pursuant to its terms. Five of these cases are concluded, with two decided against the state, two dismissed, and one settled. Although only a few cases have concluded under CAFTA, tribunals have awarded somewhat large sums to claimants. In *Railroad Development Corp. v. Guatemala*, an ICSID panel ordered Guatemala to pay USD 18.6 million in compensation to a U.S.-based railroad company for the revocation of a railroad concession.²¹⁹ In *TECO v. Guatemala*, an ICSID panel ordered Guatemala to pay a U.S. energy company USD 25 million in damages to its electricity utility contracts.²²⁰ Finally, the Dominican Republic recently settled with a U.S. investment management corporation for USD 26.5 million over a dispute involving the electricity distribution contracts.²²¹

2. NAFTA & CAFTA Case Studies – Does ISDS Cause Regulatory Chill?

165. The most common criticism levied against ISDS is the already discussed idea of “regulatory chill”—that by allowing private investors to bring claims against sovereign governments challenging state legislative and regulatory changes, ISDS dissuades those governments from making important changes in the first place. ISDS’s critics claim that ISDS threatens “policy space” by preventing governments from making policy changes that would benefit social welfare, health, or the environment because governments fear paying out millions of dollars in damages to foreign investors via resultant ISDS claims.
166. The following section examines whether ISDS in practice has actually resulted in regulatory chill. This section reviews a handful of key cases from the NAFTA and

²¹⁹ *Railroad Development Corp. v. Guatemala* (Award of 29 June 2012), ICSID Case No. ARB/07/23.

²²⁰ *TECO Guatemala Holdings, LLC v. Guatemala* (Award of 19 December 2013), ICSID Case No. ARB/10/23.

²²¹ Luke Eric Peterson, “Dominican Republic Settles Trio of Electricity Arbitrations”, *Investment Arbitration Reporter* (19 September 2009), available at http://www.iareporter.com/articles/20091008_12; *TCW Group, Inc. and Dominican Energy Holdings, L.P. v. The Dominican Republic* (Consent Award of 16 July 2009), UNCITRAL (CAFTA-DR).

CAFTA regimes. The cases were selected because of their subject-matter, namely, they appear to be claims made by investors directly challenging governmental regulatory changes in the areas of (A) natural resources, (B) the environment, (C) health, and (D) food and agriculture policy. Each case is analyzed for a number of factors related to regulatory chill, such as the kind of measure challenged by the investor, policy areas at stake, whether the challenge directly related to the government's ability to regulate within that policy area, and whether the challenge was successful.

a. Cases involving the environment

167. One of the largest categories of NATA and CAFTA claims involves policy space related to the environment. These can be divided into two loosely-based groups: first, claims responding to "traditional" environmental regulations such as bans on certain chemicals or toxins; and second, claims arising out of concern for the environment but not directly related to environmental regulation.
168. Among the first group, there are five key cases that will be used to test to "regulatory chill" hypothesis. That is, cases that seem to directly result from a government's change in environmental regulation. For example, *Ethyl Corp. v. Canada* was an early NAFTA case some critics consider to have started a wave of ISDS claims related to environmental regulations. In 1997, Ethyl Corporation, a Virginia corporation with a Canadian subsidiary, submitted a claim under the UNCITRAL Rules against Canada. Ethyl claimed that a Canadian statute banning imports of the gasoline additive MMT for use in unleaded gasoline breached Chapter 11's requirement of national treatment (Article 1102), prohibition of expropriation (Article 1110) and prohibition of performance requirements (Article 1106). Earlier that year the Canadian Parliament acted to ban the import and inter-provincial transport of MMT, which it considered a dangerous toxin. The legislature was concerned that manganese in MMT emissions posed a public health risk. The Parliament, however, could not ban MMT under the Canadian Environmental Protection Act (CEPA) and instead chose to ban MMT's import and transport. Ethyl filed a claim pursuant to NAFTA Chapter 11 in April 1997, claiming USD 201 million in damages. Canada lost its initial jurisdictional challenge before the NAFTA tribunal. In the meantime, three Canadian provinces challenged the same Parliamentary act, and a federal-provincial dispute settlement

panel found the measure invalid under Canadian law. The Canadian government then chose to settle the NAFTA dispute, agreeing to pay Ethyl Corp. approximately CAD 20 million.

169. On the surface, the *Ethyl* dispute appears to be a case-in-point for regulatory chill. The Canadian government attempted to ban what it viewed as a dangerous chemical only to face a 200 million dollar suit from Ethyl, a large U.S. chemical corporation. According to some, the Canadian government's settlement with Ethyl demonstrated the government caving to corporate interests and set a dangerous precedent for future environmental regulation.²²² The reason for the settlement, however, actually cuts against the regulatory chill argument. The Canadian government only agreed to settle the dispute after Canada's own provinces successfully challenged the legitimacy of the law in Canadian court.²²³ The dispute settlement panel invalidated the measure after finding that it exceeded the scope of the government's authority. Thus, this case does not support the notion of regulatory chill because the act of regulation itself was not legal. Ethyl's arbitration claims cannot accurately be described as threatening policy space because the government was not allowed to regulate the policy space as it did.
170. Only a year after the *Ethyl* filing, the Canadian government faced another challenge to its attempt to ban a chemical. In 1995, the Canadian Minister of the Environment signed an interim order banning the exportation of polychlorinated biphenyl (PCB) from Canada. The Canadian government stated that the export ban was in line with the Basel Convention on the management of the toxic-waste. The PCB export ban was discretionary under the Convention and not mandatory. S.D. Meyers, Inc., a U.S. company engaged in PCB remediation in the United States and Canada, filed a claim against Canada in 1998. S.D. Meyers established an investment in Canada to obtain Canadian PCB waste and export it for treatment at one of its U.S. facilities. In 1980, the U.S. closed its border for the movement of PCBs, but in the fall of 1995, the U.S. government granted Meyers permission to import PCB from Canada. Canada's response was to immediately pass its temporary ban on all PCB exports, a move that was directed at S.D. Meyers rather

²²² Canadian Centre for Policy Alternatives, *NAFTA Chapter 11 Investor-State Disputes* (1 October 2010), at 25.

²²³ Report of the Article 1704 Panel concerning the Dispute between Alberta and Canada regarding the Manganese-Based Fuel Additives Act (12 June 1998), available at http://www.international.alberta.ca/documents/international/ait_ab-can_mmt_rpt-12june98.pdf.

than a concern for PCB's environmental harm.

171. *S.D. Meyers* alleged four violations of NAFTA. First, Myers argued the measure violated national treatment obligation under Article 1102 alleging that the Canadian government discriminated against U.S. waste disposal companies seeking to export PCBs to the United States for treatment. Second, Myers argued that the export ban did not represent treatment in line with international law in breach of Article 1105. Third, Myers argued for a performance requirement under Article 1106. And fourth, Myers alleged that the measure's effect was tantamount to an expropriation under Article 1110.
172. *S.D. Meyers* was one of the first NAFTA disputes to be fully adjudicated on its merits, with the tribunal eventually ordering Canada to pay the investor 5 million dollars in damages plus interest. In 2000, the tribunal dismissed Meyers' expropriation claim but upheld its discrimination claim, finding that the discrimination violated the minimum standard of treatment foreign investors must be accorded under NAFTA. The award was instrumental in establishing how damages and compensation should be assessed in NAFTA cases. In response, the Canadian government petitioned the Federal Court of Canada to have the tribunal decision overruled on the grounds that the decision exceeded the tribunal's jurisdiction and was made in conflict with Canada's public policy. In 2004, the federal court dismissed both of Canada's claims, finding that that any jurisdictional claims were barred since the government failed to raise them before the NAFTA panel and that upholding the tribunal award would not be contrary to Canadian "public policy."²²⁴ Although Canadian courts are allowed to overturn arbitral decisions contrary to public policy,²²⁵ the Court nonetheless found that "the Tribunal's findings with respect to the two jurisdictional questions, and with respect to Article 1102, are not 'patently unreasonable', 'clearly irrational', 'totally lacking in reality' or 'a flagrant denial of justice'. Accordingly, the Court concludes that there is no aspect of the Tribunal decisions under review which 'conflicts with the public policy of Canada'."²²⁶
173. The *S.D. Meyers* case is instructive in two regards. First, the government's ban on

²²⁴ Canada (Attorney Gen.) v. *S.D. Meyers* (F.C.), 2004 FC 38, [2004] F.C.R. 368., (<http://reports.fja.gc.ca/eng/2004/2004fc38.html>).

²²⁵ See *id.* para. 55, citing Article 34(2)(b)(ii) of the Code.

²²⁶ *Id.* para. 56.

PCB exports, although applying to all exports, was really targeted at S.D. Meyers since the company was the only U.S. company permitted to import PCBs into the U.S. at the time. The Canadian federal court decision elucidates the facts surrounding the PCB ban:

*On or about November 15, 1995 the United State Environmental Protection Agency (EPA) issued an “enforcement discretion” permitting [S.D. Meyers] to import PCBs upon certain conditions. Anticipating this development, two Canadian operators of hazardous waste facilities met with the Environment Minister at her office to advise that this anticipated U.S. action would threaten the economic viability of their own operations. On November 16, 1995, Canada banned exports to the United States of PCB wastes ...*²²⁷

This suggests that Canada’s ban was *not* motivated by a desire to protect the environment but to protect the economic interests of two Canadian companies, the precise type of trade protectionism NAFTA’s national treatment provision is intended to prevent. Second, Canada’s own federal court ruled that even under Canadian law, the NAFTA tribunal’s decision did not threaten public policy. Thus, even when there are legal standards to ensure the protection of “policy space,” NAFTA decisions have not been found to threaten public policy.

174. Two other cases against Canada—*Chemtura Corp.* and *Dow AgroSciences*—challenged the Canadian government’s ability to regulate pesticides. In 1998, four chemical companies engaged in the sale of canola and rapeseed voluntarily agreed with the Canadian Pest Management Regulatory Agency (PMRA) to restrict production of products containing lindane, a hazardous persistent organic pollutant. Chemtura, a U.S.-based chemical company, was among these companies, although it attempted in May 2001 to reinstate its use of lindane for canola.²²⁸ In December 2001, the PMRA concluded that the potential harm to farm and commercial seed treatment workers exposed to lindane warranted its phase-out.²²⁹ PMRA conducted extended reviews, evaluations, and re-evaluations of Chemtura’s requests and denied them. Chemtura filed a notice of arbitration in 2001, alleging NAFTA violations for discrimination, performance requirements, expropriation, and a

²²⁷ *Id.* paras. 8-9.

²²⁸ *Chemtura Corp. v. Canada* (Award of 2 August 2010) UNCITRAL, para. 26.

²²⁹ *Id.* para. 30.

violation of the minimum standard of treatment. Chemtura's claim was not focused on the efficacy of the ban itself, but rather the regulatory review process undertaken by PMRA. Specifically, Chemtura alleged that PMRA's "Special Review" of lindane was flawed.²³⁰ The NAFTA tribunal ruled against Chemtura on all counts in August 2010, in part because the company's own actions initiated the ban. Moreover, the panel expressly recognized Canada's right to make scientific and environmental regulatory decisions: "[T]he rule of Chapter 11 Tribunal is not to second-guess the correctness of the science-based decision-making of highly specialized regulatory agencies."²³¹ The panel also found persuasive consistent international practice since 1970 to restrict or ban lindane.²³² Finally, the panel also ordered Chemtura to pay Canada CAD 2.89 million, half of the government's legal fees.

175. In a more recent case, *Dow AgroSciences*, a wholly-owned subsidiary of U.S.-based Dow Chemical Company, brought a Chapter 11 claim against Canada after Quebec banned certain chemical pesticides. In 2006, the Province of Quebec banned certain pesticides and herbicides designed for cosmetic lawn care, including the chemical 2, 4-D. The Supreme Court of Canada had previously upheld the constitutional validity of provincial pesticide bans. Dow, a manufacturer of 2,4-D, alleged that that ban was without scientific basis, was imposed without any meaningful opportunity to demonstrate the safety of the product, and amounted to an expropriation. In 2011, both parties agreed to an amicable settlement without reaching full arbitration. Under the settlement, Quebec could maintain its ban on 2,4-D and Dow was not entitled to any compensation. In exchange, the Government of Quebec is to acknowledge Health Canada's conclusion that products containing 2,4-D not pose an unacceptable risk to human health or the environment. Upon settling with Dow, Canada's Minister of International Trade stated that the agreement "demonstrates that the NAFTA dispute settlement mechanism works." The Minister also noted, "Today's agreement also confirms the right of governments to regulate the use of pesticides. This right will not be compromised by Canada's participation in NAFTA or any other trade

²³⁰ *Id.* para. 125-126.

²³¹ *Id.* para. 134.

²³² *Id.* para. 135.

agreement.”²³³

176. A similar challenge to provincial/state government chemical regulation occurred in 1999 when Canadian investors brought suit against the United States in *Methanex Corp. v. United States*. In 1999, the state of California issued an Executive Order calling for the ban of MTBE, a gasoline additive, by 2002. California argued that MTBE was contaminating drinking water supplies and therefore posed a significant risk to public health and the environment. Methanex, a Canadian producer of methanol, a key component of MTBE, filed a Chapter 11 claim alleging the ban amounted to an expropriation and violated the principles of national treatment and minimum standards of treatment. In 2005, the tribunal dismissed all of the investor’s claims and ordered Methanex to pay the U.S. government USD 3 million in legal costs plus the full costs of arbitration.²³⁴
177. The tribunal undertook an extensive review of the process by which California enacted its MTBE ban. In brief, it found that the legislative process has been transparent, science-based, subject to due process and peer review.²³⁵ The tribunal’s expropriation analysis is particularly important for the regulatory chill debate. According to the tribunal, as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and affects foreign investors, “is not deemed expropriatory and compensable unless specific commitment had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.”²³⁶ The tribunal also indicated that no compensation is due to investors for a non-discriminatory measure intended for a public purpose.²³⁷ The *Methanex* case was also a landmark case for transparency and NGO participation in NAFTA Chapter 11 disputes. The tribunal

²³³ Canadian Ministry of International Trade, “Canada Welcomes Agreement with Dow AgroSciences”, Press Release No. 145 (May 27, 2011), available at http://www.international.gc.ca/media_commerce/comm/news-communiques/2011/145.aspx?lang=eng (emphasis added).

²³⁴ *Methanex Corp. v. United States* (Final Award of the Tribunal on Jurisdiction and Merits of 3 August 2005) UNCITRAL (NAFTA). The California ban was also upheld in U.S. courts in two separate legal actions brought by the Oxygenated Fuels Association. See *Oxygenated Fuels Ass'n, Inc. v. Davis*, 331 F.3d 665 (9th Cir. 2003); *Oxygenated Fuels Ass'n, Inc. v. Pataki*, 293 F. Supp. 2d 170 (N.D.N.Y. 2003).

²³⁵ *Methanex* Final Award, *op. cit.*, at Part III, Chapter A, section 6.

²³⁶ *Id.* Part IV, Chapter D, para 15.

²³⁷ *Id.* Part IV, paras. 7, 15, 18.

issued orders allowing *amicus* briefs and mandating public hearings.²³⁸

178. The *Methanex* decision can be compared with *Metalclad*, the only tribunal award finding an unlawful expropriation under NAFTA Article 1110. In *Metalclad*, a Mexican municipality refused to grant a U.S. firm a building permit even after Mexican state officials authorized land use permits and federal authorities authorized the operation of a landfill on the site with the condition that Metalclad clean up existing toxic waste at the site. The site also passed a federal environmental impact assessment. Metalclad also alleged that it built and completed the facility upon the invitation of Mexican officials and that the facility met all Mexican legal requirements. After refusing the construction permit, the Mexican state government also declared the site an ecological preserve, further preventing Metalclad from operating its business, and paid no compensation to Metalclad for its lost property. Metalclad then filed a Chapter 11 claim against Mexico, alleging violations of NAFTA articles 1102, 1103, 1104, 1105, 1106, and 1110.
179. In August 2000, the tribunal rules that Mexico's failure to grant the investor a municipal permit and the state decree declaring the site an ecological preserve were tantamount to indirect expropriation and that Mexico violated NAFTA's minimum standard of treatment guaranteed foreign investors because Metalclad was not granted a "clear and predictable" regulatory environment. The case has also become known for the application of the "economic impact test" in expropriation cases. The tribunal also based its decision on Metalclad's "justified reliance" on the federal government's representations about the required permits. The tribunal awarded Metalclad USD 16.5 million in damages. However, the Mexican government challenged the decision in the Supreme Court of British Columbia, where the arbitration panel sat, as outside the panel's jurisdiction. In October 2000, the Canadian court upheld most of the tribunal's decision. The court, however, did rule that the tribunal erred by importing transparency requirements from NAFTA Chapter 18 into Chapter 11 and thus reduced the total award to USD 15.5 million. The court simultaneously upheld the tribunal's expropriation finding and award.

²³⁸ *Methanex Corp. v. United States* (Decision of the Tribunal on Petitions of Third Persons to Intervene as Amici Curiae of 15 January 2001) UNCITRAL (NAFTA); Procedural Order June 2003. (submissions were made by the International Institute for Sustainable Development, Bluewater Network, Communities for a Better Environment and the Centre for International Environmental Law).

180. Although still controversial, the *Metalclad* decision also highlights to unique situation of many NAFTA claimants. *Metalclad* can be seen as a case about the treatment of one company and competing regulatory standards applied by the federal, state, and municipal governments. The case was not directed at the government's ability to regulate the environment or even ability to create an ecological preserve, but instead focused on the fact that a country's regulations and permits should be predictable and that governments can establish ecological preserves but must also compensate land-owners for their loss.
181. Finally, two recent cases brought by U.S. investors are of particular note in the area of environmental policy. Both cases involve investor challenges to provincial government environmental legislation that impact the individual investors' previously-granted licenses and permits. First, in 2012 the U.S. company Windstream Energy LLC filed a Chapter 11 claim pursuant to UNCITRAL rules against Canada.²³⁹ The claim arises from the Government of Ontario's adoption of a moratorium on offshore wind energy farms on Lake Ontario. Windstream, through its wholly-owned Canadian subsidiary, began investing in offshore wind energy on Wolfe Island in 2008 after the Ontario Ministry of Natural Resources called for applications to develop offshore wind projects. As well, in 2009, the Ontario Legislature passed the Green Energy Act and established a Feed-in-Tariff Program (FIT) creating a 20-year fixed premium price paid to the Ontario Power Authority for onshore and offshore renewable energy projects.
182. In 2010, Ontario authorities granted Windstream a FIT Contract constituting the largest single FIT contract and 19.6% of wind energy in Ontario. On February 11, 2011, however, the Government of Ontario placed a moratorium on further development of offshore wind development reportedly because the government needed further scientific research. The government made statements that Windstream's FIT contract was merely "frozen" until research is concluded, but the moratorium has never been officially promulgated pursuant to Ontario law, only announced. Windstream filed a Chapter 11 claim, alleging violations of article 1102, 1103, 1105, and 1110 and claiming CDN 475 million in damages, including sunk costs related to the project and lost profits. The Canadian government last

²³⁹ *Windstream Energy LLC v. Government of Canada* (Notice of Arbitration (Amended) of 5 November 2013) UNCITRAL.

responded in December 2013, arguing that there remains “significant amount of uncertainty regarding the effects of [offshore wind project] on human health, safety, and the environment” and that Windstream was aware of Ontario’s underdeveloped regulations related to offshore energy contracts.²⁴⁰ Canada also argues that the moratorium cannot be considered an expropriation because “it was squarely within the legitimate policymaking power of the Government of Ontario to regulate in the public interest.”²⁴¹

183. Rather than being a direct challenge to Ontario’s regulatory authority in this area, this case concerns a specific contract between the government and the investor. Thus, it’s more in line with the *Metalclad* line of cases rather than *Ethyl* or *S.D. Meyers*. Also, Windstream’s challenge is more specific than simply its FIT Contract. It also claims that it was given specific assurances and promises by the government that its contract would not be impacted and the project would move forward. Also, although Canada claims that the moratorium applies generally to all offshore wind projects, at the time of the moratorium, Windstream was the only company with a FIT Contract for such a project. This dispute is still pending and has yet to reach determinations on either jurisdiction or merits.
184. The second recent case involving environmental policy-making was raised by Lone Pine Resources 2012. Lone Pine, a U.S. gas and oil company, challenged Quebec’s revocation of its “right to mine for oil and gas under the St. Lawrence River.”²⁴² In June 2011, the Quebec National Assembly passed a moratorium on hydraulic fracturing (“fracking”) of shale gas below the St. Lawrence River until the practice’s uncertain environmental and health impacts could be assessed. The bill also revoke all permits pertaining to oil and gas resources beneath the river, and according to Lone Pine was passed without consulting or compensating permit-holders. In 2006, the investor obtained Petroleum and Natural Gas Exploration Permits for four blocks of the Utica Shale Gas Basin from another oil and gas company. In 2009, the investors, through an agreement with the other gas company, obtained working interest in two Exploration Permits granted by the Quebec government for areas of the St. Lawrence River. The right were formally

²⁴⁰ *Windstream Energy LLC v. Government of Canada* (Canada’s Response to the Notice of Arbitration (Amended) of 5 December 2013) UNCITRAL, at para. 4.

²⁴¹ *Id.* para. 7; see also *id.* para. 60.

²⁴² *Lone Pine Resources v. Government of Canada* (Notice of Arbitration of 6 September 2013) UNCITRAL, at para. 10.

transferred to the investor in April 2010. A year later, Quebec passed the fracking moratorium revoking all mining rights, including exploration permits, for the St. Lawrence River. Lone Pine alleges that between 2006 and 2011 it expended millions of dollars in research, exploration, and obtaining fracking permits.

185. The Lone Pine dispute has been framed as demonstrative case for regulatory chill. For example, the director of the Sierra Club's trade program claimed in 2013 that "If a government is not even allowed to take a time out to study the impact without having to compensate a corporation, it puts a tremendous chill on a governments' ability to regulate in the public interest."²⁴³ Critics have directly tied the case to Canada's proposed trade and investment agreements with the E.U. and China. The case is particularly newsworthy because the practice of fracking is still controversial and governments like the province of Quebec have yet to decide whether fracking poses a tangible harm to health, safety, or the environment. However, Lone Pine itself acknowledges that it does not challenge Quebec's right to promulgate scientifically-justified environmental laws or even the moratorium itself, but rather the dispute focuses on Lone Pine's specific permits, lack of compensation, and the inadequate administrative review the moratorium underwent.²⁴⁴

b. Cases involving natural resources

186. Natural resources are the largest policy area implicated in NAFTA and CAFTA cases. For example, 16 NAFTA Chapter 11 claims involved the area of natural resources. However, this policy description is quite broad. For example, most cases classified as natural resources involved the protracted softwood lumber disputes between the U.S. and Canada.²⁴⁵ The only investor to receive any compensation from a lumber dispute was *Pope & Talbot*, with whom the Canadian government settled for USD 408,000. Another large set of natural resources cases in individual denials or revocations of hunting or fishing licenses (David Biship, William Jay Greiner, John R. Andre). None of those cases ever reached an arbitral tribunal.

²⁴³ J. Beltrame, "Quebec Fracking Ban Lawsuit Shows Perils Of Free Trade Deals: Critics", *The Canadian Press* (3 October 2013), available http://www.huffingtonpost.ca/2013/10/03/quebec-fracking-ban-lawsuit_n_4038173.html.

²⁴⁴ J. Grey, "Quebec's St. Lawrence fracking ban challenged under NAFTA", *The Globe and Mail* (22 November 2012), available at <http://www.theglobeandmail.com/globe-investor/quebecs-st-lawrence-fracking-ban-challenged-under-nafta/article5577331/>.

²⁴⁵ E.g., *Pope & Talbot*, *Ketcham Investments*, *Merrill & Ring*, *Canfor*, *Doman*, *Tembec*, *Terminal Forest Products*, *Domtar*.

187. Three comparable cases involving governments' ability to regulate mining for natural resources are instructive here: *Glamis Gold*, *AbitibiBowater*, and *Pacific Rim*. In *Glamis Gold*, a Canadian mining company sought compensation after California passed a law requiring backfilling and restoration of open-pit mines near Native American sacred sites. Glamis had rights to mine gold in California and maintained a large project (the Imperial Project) for an open-pit cyanide heap leach mine. Both U.S. federal and state authorities became concerned about the environmental and cultural impact, particularly on the Quenchan Indian Nation. First, the federal mining authorities declined to approve Glamis' plan operation, and then California introduced specific measures on open-pit mining near Native American lands. Glamis argued that the federal government's permit denial was not in conformity with its administrative standards and that California's measures were designed to block the Imperial Project rather than address genuine environmental and cultural concerns.
188. In 2009, the NAFTA tribunal rejected all of Glamis' claims on their merits.²⁴⁶ First, regarding Glamis' expropriation claim, the tribunal found that Glamis' mining rights still retained significant value despite federal delays and California's new backfilling requirements, and thus Glamis suffered no expropriation. With respect to the fair and equitable standard under NAFTA, the tribunal applied the *Neer* test and found that none of the measures at issue amounted to sufficiently egregious or shocking treatment.
189. A similar case involving an investor's existing rights to natural resources arose in 2009 with the case of *AbitibiBowater Inc. v. Canada*. AbitibiBowater, one of the world's largest pulp and paper firms, filed for bankruptcy in 2009. In November 2008, the company announced it would close its last mill in Newfoundland, putting 800 employees out of work. Two weeks later in December 2008, the provincial government of Newfoundland and Labrador enacted the Abitibi-Consolidated Rights and Assets Act to return the company's water use and timber rights to the crown while also taking back certain AbitibiBowater lands associated with water and hydroelectricity rights. The provincial government argued that the timber and water rights were contingent on AbitibiBowater's continued operation of the paper mill, pursuant to a 1905 concessions contract. AbitibiBowater filed its NAFTA

²⁴⁶ *Glamis Gold, Ltd. V. United States* (Award of 8 June 2009) UNCITRAL (NAFTA).

claim alleging that the province expropriated its property, treated it less favorably than other companies facing financial difficulty in the province, the legislation targeted AbitibiBowater's assets, and did not provide the company with an opportunity to respond before its passage.

190. In 2010, the Canadian government agreed to settle the dispute, agreeing to pay AbitibiBowater CDN 130 million, the largest settlement in NAFTA history.²⁴⁷ This was only a fraction of the CDN 500 million Abitibi claimed initially for its expropriated land and timber and water rights. Some observers have argued that the settlement set a dangerous precedent of governments capitulating to foreign investors.²⁴⁸ However, this doomsday scenario has yet to materialize. Since settling with Abitibi in 2010, the Canadian government has not settled another NAFTA claim except for in *St. Mary's VCNA LLC v. Canada*, which was settled without any compensation paid and included a public acknowledgment by the investor that the investor never had standing. In fact, at the same time as settling with Abitibi, Canada successfully defeated an environment-based claim in the *Chemtura* case. Moreover, the Abitibi case is so unique it is unlikely to have any precedential effect. The case was solely dependent on century-old timber and water rights and a provincial government revoking those rights in response to Abitibi's mill closure rather than concern for natural resources or the environment. There is also no evidence that the *AbitibiBowater* settlement impacted policy decision-making by either the Canadian federal government or the province of Newfoundland and Labrador.
191. A final case involving natural resources rights arose under CAFTA. Pacific Rim began operations in El Salvador in 2002, obtaining a permit to explore El Salvador for gold mining opportunities. In 2004, the company applied for an exploitation concession for the "El Dorado" mine to begin mining for profit. It submitted an environmental impact assessment pursuant to Salvadorian law, evaluating the environmental and public health consequences of gold mining in the vicinity of El

²⁴⁷ Foreign Affairs and International Trade Canada, "Foreign Affairs and International Trade Canada Issues Statement on AbitibiBowater Settlement", Press Release No. 268 (24 August 2010), available at http://www.international.gc.ca/media_commerce/comm/news-communicues/2010/268.aspx?lang=eng.

²⁴⁸ S. Sinclair, "\$130 Million NAFTA Payout Sets Troubling Precedent", Canadian Centre for Policy Alternatives (22 March 2011), available at <https://www.policyalternatives.ca/publications/commentary/130-million-nafta-payout-sets-troubling-precedent>.

Dorado. While the government considered the application, public concern grew about the adverse impacts of gold mining in the region, focusing on threats to groundwater through cyanide, mercury, and arsenic spoiling. There was also concern that local wells had already begun to dry up due to Pac Rim's exploration.²⁴⁹ Meanwhile, the Salvadorian government chose not to act on Pac Rim's application or final environmental assessment submitted in 2006, and the national legislature considered (but never passed) bills proposing a ban on mining all precious metals in El Salvador. The issue became highly contentious, drawing the attention of every political parties, the Catholic Church, and several NGOs.

192. Pac Rim filed a notice of intent to arbitrate in 2008 pursuant to CAFTA.²⁵⁰ Pac Rim alleged violations of articles 10.3 (national treatment), 10.4 (national treatment), 10.5 (minimum standard of treatment), and 10.7 (expropriation). In June 2012, an ICSID panel dismissed all of the CAFTA claims for lack of jurisdiction because the claimant could not be considered a US investor for purposes of CAFTA.²⁵¹ The case, however, was not dismissed entirely, but claims arising under Salvadorian domestic law remain.²⁵²

J. Preliminary conclusions

186. On balance, as far as the inclusion of an ISDS mechanism in TTIP is concerned advantages may seem to outweigh disadvantages. Although investment protection and ISDS under a treaty between developed countries may constitute a change of Dutch BIT practice, Netherlands would obtain an extra negotiating leverage under the EU umbrella. Expertise of judges and high-quality court proceedings are already guaranteed in the Netherlands. But the well-developed rule of law and court system of the EU Member States and the US should not *ab initio* preclude an ISDS mechanism. The argument that international redress is not necessary in countries which have well-developed high-standing court systems is *mutatis mutandis* applicable in the context of human rights law. However, who would

²⁴⁹ K. Zaunbrecher, *Pac Rim Cayman v. Republic of El Salvador: Confronting Free Trade's Chilling Effect on Environmental Progress in Latin America*, 33 *Houston Journal of International Law* 489 (2011).

²⁵⁰ *Pacific Rim Cayman LLC v. The Republic of El Salvador* (Notice of Intent to Submit a Claim to Arbitration of 9 December 2008) ICSID Case No. ARB/09/12.

²⁵¹ *Pacific Rim Cayman LLC v. The Republic of El Salvador* (Decision on the Respondent's Jurisdictional Objection of 1 June 2012) ICSID Case No. ARB/09/12, para. 4.92.

²⁵² *Id.* para. 5.48.

- advocate that, because Dutch law also protects human rights which are enforced by capable Dutch courts, the European Convention on Human Rights and the Strasburg Court ought to be abolished?
187. Moreover, concerns as to the democratic deficit of IIAs do not seem tenable. Treaties are negotiated/signed/ratified by or under the control of democratically elected representatives. If IIAs are to be seen as undemocratic in that they are not directly decided upon by the people through a referendum, then such an argument would also be applicable for every piece of national legislation.
188. While costs may be high both in international arbitration and in domestic courts (especially when a claim is brought before multiple instances), concerns about impartiality of judges when deciding upon cases in which their own State is a defendant could be raised. However, the ISDS system as it currently exists suffers from serious drawbacks that must be overcome.²⁵³ Not only efficient mechanisms that do not leave an extremely wide margin of appreciation to the arbitral tribunal shall be established, but also other legitimacy-related questions of ISDS shall be tackled.
193. Moreover, the potential for actual, threatened, or perceived investment arbitrations to chill legitimate public policy-making is a major concern for TTIP and many other international investment agreements. And rightly so. International investment law has increasingly recognized the investment protection does not occur in a vacuum; indeed, investment protection should not diminish or prevent protections for the environment, natural resources, health, human rights, or other social concerns. This being said, claims that ISDS causes regulatory chill are overstated.
194. As explained above, there are few, if any, cases to support the theory that investment arbitration has caused states to halt, curtail, or roll back regulations aimed at legitimate policy concerns. Although we acknowledge that regulatory chill, by its very nature, is difficult to prove empirically, we also consider that fact that there is a considerable paucity of even anecdotal evidence for regulatory chill despite a high number of ISDS claims over the past twenty years. This may be for a number of reasons. First, the vast majority of ISDS claims challenge

²⁵³ Improving the ISDS mechanism through filter mechanisms is preferable to abolishing the system altogether as it has been supported by Wessels; A. Wessels, *ISDS Threatens Privacy and Reform of Copyright and Patent Law*, at 5 (2014), available at: http://people.ffii.org/~ante/ISDS/FFII_NL_ISDS-threatens-privacy.pdf

administrative decisions affecting single investors rather than legislative or regulatory acts *per se*. Second, it is difficult to pinpoint ISDS as the sole cause or tipping point in preventing progressive regulation, especially since regulations impacting areas like the environment and natural resources usually involve already continuous policy debates. Third, a legal analysis of the new generation of BITs and IIAs suggests that tribunals and states have already begun minimizing potential regulatory chill by incorporating a “right to regulate” in substantive definitions, general exception clauses, and preamble language in new investment agreements. This approach, we believe, strikes the best balance in promoting progressive policy changes while respecting investor’s rights. Rather than eliminate arbitration altogether, modern agreements retain ISDS as an option for investors while also more explicitly detailing states’ rights to regulate in certain legitimate public interest areas. A similar approach can, and should, be taken with TTIP. Regulatory chill alone is not enough reason to excise ISDS provisions from TTIP because any cost or risk associated with ISDS regarding regulatory chill can be mitigated through careful drafting.

189. Finally, these conclusions are further supported from analysis of cases from NAFTA and CAFTA, which is a useful comparative tool since they are the most often used ISDS mechanisms for American investors. After examining twelve cases under NAFTA and one under CAFTA related to policy space, we can identify three primary conclusions. First, the cases that succeed in ISDS have not directly challenged any government’s authority or ability to regulate within a given policy space. Instead, tribunal awards requiring governments to pay out large sums to investors usually involve indirect challenges to government regulation and instead involve individual contractual, tax, or export control issues. Because these decisions concern individual administrative treatment rather than legislative acts, they also do not result in precedent for future investors to rely upon. Second, those cases that do directly challenge government regulations, and thus the government’s policy space, have never resulted in an award for the investor. Third, there is no evidence that any government has changed a policy position or refrained from acting in a policy area for fear of potential ISDS claims.

V. *Risk mitigation*

190. Although we conclude above that ISDS itself does not pose a tangible legal or political threat to the Netherlands, and more precisely that the benefits of including ISDS in TTIP outweigh the costs, we must also consider ways to continue to reduce the risk of any potential costs. Overall, the concept of ISDS can serve as a benefit to TTIP, but the system is not perfect. In fact, how ISDS works is dependent on each particular agreement that includes it. While this creates a complex overlapping system for international investment arbitration law, it is also an opportunity for the Netherlands and the EU since ISDS can be moulded to fit their particular needs. Thus, a benefit in drafting TTIP is that drafters and negotiators can build the ISDS system they desire.
191. The following section examines several options for “risk mitigation” in TTIP. This does not alter our overall conclusion that ISDS itself is a benefit for TTIP, but rather is meant to demonstrate ways that TTIP can be drafted to further enhance those benefits and limit potential costs. These considerations are an important element in a risk assessment of ISDS because TTIP can be written in a way to mitigate risks and strike an appropriate balance between protecting investors’ rights with protecting Member States’ rights. These risk mitigation techniques also help respond to common criticisms of ISDS and ensure that if it is included in TTIP, it is done so in a transparent and accountable way while ensuring that only legitimate claims against states proceed and ultimately prevail.

A. Qualifying procedural access to ISDS

1. Exhaustion of local remedies

192. According to Article 26 of the ICSID Convention:

*Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.*²⁵⁴

²⁵⁴ Convention on the Settlement of Investment Disputes between States and Nationals of Other States (1965), available at: https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf

193. Although exclusion of other remedies is set as default, the ICSID Convention permits parties to reserve the right to set the exhaustion of local remedies offered by the host State's courts as a condition of consent to arbitration. The local remedies rule before resorting to international arbitration has not been a common practice in IIAs.²⁵⁵ Significantly, this requirement has been laid down in neither the US nor the Netherlands Model BITs.
194. If the rule of exhaustion of local remedies were to be included, international arbitration would function in effect as a second-level remedy, an 'appeal' at an international level after domestic redress has been sought. However, such requirement would result in significant delays (as parties would have to go through two, possibly more, levels of litigation in the host State which would take a number of years) as well as entail significant additional costs for both the investor and the home State.
195. In sum, it would not seem advisable to include this requirement as the potential benefits would not outweigh the significant costs in terms of added time and financial burden. But in case such a pre-condition would be included, it is recommended to carefully word the most-favoured nation (MFN) clause. In the past, investors have avoided the application of the exhaustion of local remedies requirement by invoking the MFN clause in order to rely on other BITs of the host State that did not include such requirement.²⁵⁶ Thus, in order for the exhaustion of local remedies rule to be effective, the MFN clause would have to specify that it excludes dispute settlement.²⁵⁷

2. Fork in the road clause

196. The fork in the road provision aims at preventing concurrent or subsequent proceedings before different international or domestic tribunals or courts. More specifically, according to such a provision, an investor must choose between settlement of an investment dispute in the host State's courts or in international

²⁵⁵ R. Dolzer & C. Schreuer, *Principles of International Investment Law* 215 (2008).

²⁵⁶ See, for example, *Emilio Agustín Maffezini v. the Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (Jan. 25, 2000), ¶¶ 54-64; *Siemens A.G. v. the Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (Aug. 3, 2004), ¶¶ 32-110; *Suez, Sociedad General de Aguas de Barcelona S.A., and Vivendi Universal S.A. v. the Argentine Republic and AWG Group Ltd. v. the Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Jurisdiction (Aug. 3, 2006), ¶¶ 52-68.

²⁵⁷ See, for example, Article 6(2) of *Australia-New Zealand Closer Economic Relations Trade Agreement*.

arbitration, such a choice being irreversible.²⁵⁸ According to case law, in order for the fork on the road provision to be triggered, the subject-matter in the domestic and international proceedings must be substantially the same.²⁵⁹ Hence the investor may bring separate causes of action before different fora.²⁶⁰ The main rationale of this provision is to avoid contradictory results as well as to confine the investor to one remedy by forestalling recourse to others.²⁶¹

197. This option seems more desirable than the previous one because it does not entail extra costs and time, but most importantly it obstructs foreign investors from having a wider range of *fora* available to pursue a claim, especially when compared with domestic investors.

3. Frivolous claims safeguards

198. ISDS can be designed in a fashion that obstructs ‘bad-faith’ recourse to international arbitration. To this end, a filter mechanism that would permit tribunals to rapidly dismiss frivolous claims is nowadays indispensable. The European Commission has already promoted such an improvement,²⁶² yet its application in practice remains to be seen. A greater role could be given to ICSID to screen disputes.²⁶³ Given though that this could require substantial resources (since ICSID would have to examine law and facts)²⁶⁴, the efficiency of such a system remains a challenge.
199. Frivolous claims safeguards would raise the threshold of investors’ access to international arbitration thus discouraging investors from bringing ‘long-shot’

²⁵⁸ See, for instance, Article 26(3)(b)(i) of the Energy Charter Treaty; Article 8(2) of the France-Argentina BIT; Article 1121 of NAFTA; Article 26(2) of the 2012 US Model BIT.

²⁵⁹ See, for example, *Ronald S. Lauder v. the Czech Republic*, UNCITRAL, Final Award (Sep. 3, 2001), ¶¶ 156-166; *Middle East Cement Shipping and Handling Co. S.A. v. Arab Republic of Egypt*, ICSID Case No. ARB/99/6, Award (Apr. 12 2002), ¶¶ 70-73; *Occidental Exploration and Production Company v. The Republic of Ecuador*, UNCITRAL, LCIA Case No. UN3467, Final Award (Jul. 1, 2004), ¶¶ 37-63.

²⁶⁰ J. Paulsson, *Denial of Justice in International Law* 127 (2005).

²⁶¹ See European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 10-11, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

²⁶² European Commission, ‘Fact sheet: Investment Protection and Investor-to State Dispute Settlement in EU agreements’, Nov. 2013, at 8, available at: http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf; See also European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 13, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

²⁶³ K. P. Sauvart & F. Ortino, *Improving the International Investment Law and Policy Regime: Options for the Future*, Ministry for Foreign Affairs of Finland, at 106 (2013).

²⁶⁴ *Id.*

claims. In order for the mechanism to be effective, it should be coupled with cost shifting to the investor in case the screening process indicates the frivolous nature of their claim. Such a cost shifting would be the application of the ‘loser pays’ rule at an earlier stage of the proceedings.

200. Examples of these provisions include the U.S. model BIT and the ICSID Arbitration Rules. Article 28(4) of the U.S. model BIT requires the tribunal to address and decide any preliminary objection that, as a matter of law, the claim is not one for which the tribunal can award in favor of the claimant. ICSID rule 41(5) similarly allows parties to object to a claim “manifestly without legal merit.” These sorts of provisions are well-known in domestic jurisdictions, such as a motion to dismiss for failure to present a claim upon which relief can be granted under U.S. Federal Rules of Civil Procedure, Rule 12(b)(6) or summary judgment on the grounds that the claimant has no real prospect of success pursuant to Part 24.2 of the English Civil Procedure Rules.
201. The CETA text, for example, provides to separate provisions to eliminate frivolous claims. The first provision applies to “Claims Manifestly Without Legal Merit.” The provision gives the respondent 30 days from the constitution of the arbitral tribunal to submit an objection that the claim is manifestly without legal merit. The disputing parties have the opportunity to then present observations to the tribunal, and then the tribunal will render a decision assuming alleged facts to be true. Thus, the objection is meant to cover cases in which, even if all of the investor’s alleged facts are proven, the facts do not support a breach of any treaty commitment.
202. The second CETA provision covers “Claims Unfounded as a Matter of Law.” Here, the tribunal may dispense with the case if, as a matter of law, the claim or any part thereof is not one for which an award in favor of the claimant can be made. This objection is not to be considered if the respondent has simultaneously submitted an objection for a claim “manifestly without legal merit.”

4. Mandatory alternative to ISDS proceedings

203. Amicable settlement of disputes that could be achieved through consultation, negotiation or mediation could be provided for as a pre-requisite of ISDS.²⁶⁵ Such

²⁶⁵ See, for example, Article 10(14) of the US-Chile FTA; Article 88 of the Japan-Chile FTA; Article 11(15) of the Korea-Australia FTA.

an option, as an equivalent to the WTO consultations phase,²⁶⁶ would give the investor and the host State the chance to exchange arguments and tackle their dispute without recourse to ISDS thus saving time and costs.

204. Almost all BITs include language encouraging the amicable settlement of disputes. Although comprehensive statistics on negotiated settlements for investor-state disputes are not available,²⁶⁷ it is known that many cases are settled amicably. UNCTAD has pointed out that “estimates are that, over the last two decades, such settlements vastly outnumbered” cases actually taken to arbitration.²⁶⁸ Statistics following ICSID claims demonstrate this trend. As 2010, 40% of registered ICSID cases were resolved without a final award.²⁶⁹ Of course, some of those cases involve instances where the investor simply dropped the claim by not pursuing it any further, but it also includes those cases with both parties agreeing to end the arbitration. UNCTAD’s most recent numbers estimate that 26% of all *concluded* cases have settled.²⁷⁰
205. Most provisions on the amicable settlement of disputes include a provision regarding the resort to consultations. Under such provisions, parties can agree at any time, including after arbitration has commenced, to seek the settlement of the dispute through party consultation. However, this usually occurs before the arbitration begins and can be in written as a prerequisite to dispute settlement, such as under state-to-state disagreements under NATFA and the WTO Dispute Settlement Understanding. Making consultations mandatory can serve as a filter mechanism because it (1) encourages the settlement of disputes before arbitration, and (2) may discourage investors from filing frivolous or unfounded claims since they must engage with the government for a required period of time and reveal the basis for their claim before they can submit any claims to arbitration.
206. Consultations must typically occur within a defined time period after a request for consultation is submitted, such as 60 days under CETA.

²⁶⁶ According to Article 5 of the GATT Understanding on Rules and Procedures Governing the Settlement of Disputes (1994) (hereafter DSU), the disputing parties shall seek to settle their dispute through good offices, conciliation or mediation before the complaining party requesting the establishment of a panel.

²⁶⁷ 2010 UNCTAD study on alternatives to investment treaty arbitration, UNCTAD, 2010b: 41

²⁶⁸ *Id.* at 96.

²⁶⁹ *Id.* at 13.

²⁷⁰ UNCTAD (2013), *op. cit.*, at 10.

207. Most modern BITs also provide for a “cooling off” period during which claims cannot be brought pending settlement attempts. For example, the French model BIT provides for 6 months, the UK 3 months, and the German model 6 months. The CETA text mandates a 6-month cooling off period from the end of the consultation period.
208. Modern BITs and IIAs often include language allowing for disputing parties to seek mediation rather than arbitration. Under this process, the parties agree to a mediator with the goal of quickly settling the dispute rather than resorting to prolonged and potentially expensive arbitration proceedings. CETA, for example, states that the disputing parties should endeavor to resolve the dispute within 60 days of appointment of a mediator. Alternative dispute resolution is an emerging field in investment and serves as a viable alternative to full arbitration.
209. Although included in some investment agreements, mediation has yet to become a common tool in investor-state disputes. According to UNCTAD, “[d]espite the existence of rules and facilities dealing with conciliation and mediation procedures, their application in the investor-State context has to date been minimal.”²⁷¹ For example, only seven cases have ever used ICSID’s Conciliation Rules in the past 30 years, none of which involved a dispute under an international investment agreement.²⁷²

B. Delimiting the protection scope of investment treaties

1. Defining protected investors and investments

a. Denial of benefits

210. The access to ISDS procedures to investors using corporate structuring has been listed among the “system deficiencies” of the ISDS system.²⁷³ A denial of benefits clause would afford the Member States the right to deny the benefits of the TTIP to investors that do not have an economic connection to the EU or the US but merely invest through an EU or US vehicle (‘nationality planning’) although they do not

²⁷¹ UNCTAD, 2010b: 61.

²⁷² The ICSID Caseload – Statistics, Issue 2014-1. <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English51>

²⁷³ UNCTAD, *World Investment Report 2013, Global Value Chains: Investment and Trade for Development*, at 112 (2013), available at: http://unctad.org/en/publicationslibrary/wir2013_en.pdf

have substantial business activity there. If such clause is to be included, there should be specific provisions as to how it functions in practice.

b. Prudential and other carve outs

211. A proper balance between investors' protection and government's right to regulate could also be struck by the inclusion of exceptions or carve-outs, such as prudential, essential security and taxation carve-outs.²⁷⁴
212. A number of IIAs exclude from their scope certain areas of regulation such as financial services.²⁷⁵ Likewise, in TTIP concerns over the interaction between investment protection and financial regulation may be addressed through prudential carve-outs. In essence, such exceptions would not prevent States from closely regulating banks and other financial service providers in order to ensure the stability of the financial sector and the protection of depositors. The inclusion of prudential carve-outs would, for example, prevent US banks from resorting to ISDS against the Netherlands for damages due to prudentially motivated policy decisions, thus arguably avoiding a potential chilling effect on regulators.
213. Likewise, exceptions on taxation and essential security²⁷⁶ would enhance the host State's policy space and limit the investor's right to challenge State decisions.
214. Including such carve-outs may coincide with a complete exclusion of the possibility of foreign investment in these sectors (for example, the military sector), but not necessarily so. If foreign investors are allowed to operate in a sector covered by a carve-out, this merely implies that they are not covered by the investment treaty (or chapter) so they cannot invoke its protections standards or rely on an ISDS mechanism. They do, however, have the same access to courts as national investors in the same sector have: so they can initiate proceedings before the appropriate national instances. Should this prove to be unsatisfactory for the investor, the only 'international option' is to convince its home State to take up its claim against the host State, *i.e.*, the diplomatic protection system.

²⁷⁴ See European Commission, 'Public consultation on modalities for investment protection and ISDS in TTIP', at 7-8, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

²⁷⁵ See, for example, Article 1410 of NAFTA; Article 20 of the US-Uruguay BIT; See also Article 20 of the 2012 US Model BIT.

²⁷⁶ See Articles 21 and 18 of the 2012 US Model BIT respectively.

2. Clarifying investment treaty standards

215. ISDS provisions are only the enforcement mechanism; rather emphasis be laid upon the substantive protections afforded to foreign investors.²⁷⁷ Open-ended standards are characterised by low predictability while entailing high enforcement costs.²⁷⁸ Although the TTIP is expected to contain comprehensive substantial investment provisions in accordance with the 2012 US Model BIT, vague notions such as ‘minimum standard of treatment’ may result in expansive interpretations by arbitral tribunals. Circumscription of key investment protection standards not only would provide sufficient guidance to tribunals but it would also limit States’ exposure to ISDS.
216. Indeed the uncertainty of core investment standards could be seized by US investors to bring ‘long-shot’ claims against the Netherlands aspiring to be awarded damages. Hence careful drafting shall be employed to meet such concerns. The TTIP shall clarify, for example, the scope of notions such as ‘fair and equitable treatment’ (FET) and include a restrictive clause of indirect expropriation. The FET standard could be defined to comprise the customary international law minimum standard of treatment²⁷⁹ while indirect expropriation shall not arise in any case that a reduction of the value of the investment occurs²⁸⁰ but shall be defined so as to limit the types of government measures that could be successfully challenged.

3. Excluding ‘umbrella clauses’

217. Some IIAs include the so-called ‘umbrella clause’ which requires host states to observe any undertakings with regard to foreign investments, thus bringing

²⁷⁷ House of Lords, European Union Committee, *The Transatlantic Trade and Investment Partnership*, 14th Report of Session 2013-14, at 52 (2014), available at: <http://www.publications.parliament.uk/pa/ld201314/ldselect/ldeucom/179/179.pdf>

²⁷⁸ K. P. Sauvart & F. Ortino, *Improving the International Investment Law and Policy Regime: Options for the Future*, Ministry for Foreign Affairs of Finland, at 65 (2013).

²⁷⁹ See European Parliament Resolution of 6 April 2011 on the Future European International Investment Policy (2010/2203(INI)), ¶¶ 19, available at: <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P7-TA-2011-0141+0+DOC+PDF+V0//EN>

²⁸⁰ Relevant criticism has been expressed in A. A. Wessels, *ISDS Threatens Privacy and Reform of Copyright and Patent Law* (2014), available at: http://people.ffii.org/~ante/ISDS/FFII_NL_ISDS-threatens-privacy.pdf; Corporate Europe Observatory & Transnational Institute, *Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom* (2012), available at: <http://www.tni.org/sites/www.tni.org/files/download/profitfrominjustice.pdf>

obligations undertaken in contracts or other arrangements under the umbrella of protection of the IIA.²⁸¹ Such a clause has the effect of elevating breaches of investors' contractual rights at the same level as breaches of investors' rights caused by administrative or legislative acts.²⁸² This would provide investors with an additional redress mechanism, namely ISDS, for the settlement of contractual disputes between them and the host state thus increasing the instances in which ISDS can be employed by investors. Most importantly, the inclusion of an 'umbrella clause' in IIAs has been considered as overly limiting governments' right to regulate.²⁸³ Therefore, it be sought that an 'umbrella clause' is not included in the TTIP.

4. Excluding market access rights

218. Another question that should be addressed concerns the scope of investor protection, whether it is limited to established investments or whether it is extended to market access/establishment. Most US investment treaties (as well as, for example, Canadian and Japanese BITs) provide standards for pre-admission treatment, meaning that only investments which have already been established are covered by the protective scope of the treaty.²⁸⁴ If this is the case, the TTIP would afford additional protection for US investors compared to the ones that Dutch law currently provides. In such a case, US investors would be likely to bring claims under the TTIP which would not be actionable under Dutch law, given that Dutch law only protects non-EU investors at the post-establishment phase. The extension of investor protection at the pre-establishment phase is a reasonable possibility especially if the US Model BIT approach on the scope of NT and MFN clauses is adopted – as would seem to be the case based on the leaked CETA drafts. Contrary to the Dutch model text,²⁸⁵ according to the former, NT and MFN clauses are not limited to post-establishment; they also apply to the pre-establishment phase. The

²⁸¹ A. Newcombe & L. Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* 437 (2009).

²⁸² R. Dolzer & M. Stevens, *Bilateral Investment Treaties* 81-82 (1995).

²⁸³ J.W. Salacuse, *The Law of Investment Treaties* 278 (2009); see also K. P. Sauvant & F. Ortino, *Improving the International Investment Law and Policy Regime: Options for the Future*, Ministry for Foreign Affairs of Finland, at 69-70 (2013).

²⁸⁴ See, for example, Article II of the United States-Azerbaijan BIT; Article III of the Canada-Costa Rica BIT.

²⁸⁵ Limitation towards post-establishment protection has also been the BIT practice of other EU Member States such as Germany, Italy and the United Kingdom.

broader scope of NT and MFN clauses entails that investors have *locus standi* before arbitral tribunals not only when it comes to investment protection, but also to issues relevant to liberalisation of FDI.

219. It could be considered desirable to exclude pre-admission protection in the TTIP, so that investors who feel they have been treated unfairly in the process of establishing an investment cannot bring a claim on the basis of the TTIP. However, this could make the treaty internally inconsistent, as pre-admission treatment will in all likelihood be provided for in the chapter on Trade in Services, one mode of which is transborder trade, or, in other words, foreign investment. This means that a transborder investment activity as such could receive pre-establishment protection under the Services chapter but that a violation of this rule could not be remedied under the investment chapter.

5. Incorporating public policy protection into the investment treaty

220. A debate has recently been sparked off as far as governments' regulatory space to pursue public interest objectives is concerned. Arguably a perception could arise that the regulatory policy space of the Dutch government could be restricted and that a fear of potential ISDS claims might provoke a political backlash concerning sensitive public regulation. Concerns have been voiced particularly in the light of pending ISDS claims challenging public policy regulation,²⁸⁶ the most notorious of which being *Vattenfall v. Germany*²⁸⁷ and *Phillip Morris v. Australia*²⁸⁸ cases.
221. The *Vattenfall* case concerns a claim brought by the Swedish energy company Vattenfall under the ECT asking for compensation because of the rapid change in German politics from first extending permits for nuclear power plants and only month later to suddenly withdrawal this decision. This dispute followed an earlier one between the parties regarding environmental restrictions on a EUR 2.6 billion coal-fired power plant under construction which were introduced by the

²⁸⁶ See, for example, C. Cross, *The Treatment of Non-Investment Interests in Investor-State Disputes: Challenges for the TAFTA / TTIP Negotiations*, in D. Cardoso et al. (Eds.) *The Transatlantic Colossus, Global Contributions to Broaden the Debate on the EU-US Free Trade Agreement* 76 at 77 (2013), available at: <http://www.collaboratory.de/images/archive/8/8d/20140118121833!TheTransatlanticColossus.pdf>; Corporate Europe Observatory & Transnational Institute, *Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom*, at 13 (2012), available at: <http://www.tni.org/sites/www.tni.org/files/download/profitfrominjustice.pdf>

²⁸⁷ *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12 [pending].

²⁸⁸ *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12 [pending].

Government only after the initial permit was granted. This dispute was ultimately settled. In the *Phillip Morris* case, the tobacco company challenged under the Hong Kong-Australia BIT the Tobacco Plain Packaging Act 2011 enacted by Australia. Furthermore, in 2013 several environment-related arbitrations have been initiated, including *Lone Pine Resources Inc. v. The Government of Canada*,²⁸⁹ *Windstream Energy LLC v. Government of Canada*,²⁹⁰ *Spence v. Costa Rica*²⁹¹ and *Lieven Rit et. al v. Croatia*²⁹² cases.

222. Based on current case law, it can be concluded that arbitral tribunals tend to rule in favour of respondent States when the latter have enacted non-discriminatory regulations in the public interest.²⁹³ BIT practice indicates that public policies, such as public health, the environment and labour rights, have not been deliberately promoted frequently in the framework of IIAs.²⁹⁴ As far as Dutch investment treaty policy is concerned, several IIAs make reference to environmental and health concerns. The Netherlands-Mozambique BIT (2001), the Netherlands-Namibia BIT (2002), the Netherlands-Suriname BIT (2005), the Netherlands-Dominican Republic BIT (2006), the Netherlands-Burundi BIT (2007) and the Netherlands Model BIT (2004) include a preambular clause on environmental and health concerns, while the Netherlands-Dominican Republic BIT also refers to social protection measures. Furthermore, the Netherlands-Costa Rica BIT (1999) is the only Dutch BIT which contains explicit language reserving policy space for the parties, according to which its provisions only apply to investments made in

²⁸⁹ *Lone Pine Resources v. the Government of Canada*, UNCITRAL, Notice of Arbitration (Sep 6, 2013).

²⁹⁰ *Windstream Energy LLC v. Government of Canada*, UNCITRAL, Notice of Arbitration (Amended) (Nov 5, 2013).

²⁹¹ *Spence International Investments, LLC, Bob F. Spence, Joseph M. Holsten, Brenda K. Copher, Ronald E. Copher, Brette E. Berkowitz, Trevor B. Berkowitz, Aaron C. Berkowitz and Glen Gremillion v. The Government of the Republic of Costa Rica*, UNCITRAL, Notice of Arbitration and Statement of Claim (Jun 10, 2013).

²⁹² *Lieven J. van Riet, Chantal C. van Riet and Christopher van Riet v. Republic of Croatia*, ICSID Case No. ARB/13/12, Notice of Arbitration (Jun 21, 2013 [not public]) (Jun 21, 2013).

²⁹³ See S. D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 Harvard International Law Journal 435, at 447 (2009). Note, for example, *Methanex Corporation v. United States of America*, UNCITRAL, Final Award of the Tribunal on Jurisdiction and Merits (Aug 3, 2005); *Chemtura Corporation v. Government of Canada*, UNCITRAL, Award (Aug 2, 2010). However, see also earlier *Metalclad* case which ruled that the respondent State had no authority to deny the company's construction permit on environmental grounds; *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (Aug 30, 2000). The decision now seems something of an outlier.

²⁹⁴ See K. Gordon & J. Pohl, *Environmental Concerns in International Investment Agreements: a Survey*, OECD Working Paper No. 2011/1, available at: www.oecd.org/daf/investment/workingpapers

accordance with the laws and regulations of the host State “including its laws and regulations on labour and environment.”²⁹⁵

223. Although these constitute only a handful of treaties in the large Dutch BIT network, it indicates that the Netherlands has developed a trend (even if it is limited) of including public policy considerations in some of its BITs. Likewise, the 2012 US Model BIT contain distinct provisions addressing the intersection between investment on the one hand and the protection of the environment and labour on the other.²⁹⁶ A clear statement in the TTIP that the parties retain their right to regulate in such areas would sufficiently address the environment and social impacts of investment.²⁹⁷ In this respect, referral to or incorporation of the Organisation for Economic Co-operation and Development (OECD) Guidelines on social corporate responsibility²⁹⁸ and International Labour Organization (ILO) Declaration²⁹⁹ could be of value.

B. Building safeguards into the process

1. Transparency

224. The promotion of greater transparency could be achieved through the incorporation of the United Nations Commission on International Trade Law (UNCITRAL) transparency rules³⁰⁰ adopted in 2013 in the TTIP.³⁰¹ These rules apply to investor-State arbitration initiated under the UNCITRAL Arbitration Rules pursuant to an IIA concluded on or after 1 April 2014³⁰² and will thus be applicable to the TTIP.

²⁹⁵ Article 10(1) of the Agreement on Encouragement and Reciprocal Protection of Investments Between the Republic of Costa Rica and the Kingdom of the Netherlands.

²⁹⁶ Articles 12 and 13 of the US Model BIT.

²⁹⁷ See European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 6-8, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

²⁹⁸ OECD Guidelines for Multilateral Enterprises, 2011 Edition, available at: <http://www.oecd.org/daf/inv/mne/48004323.pdf> ; see also International Chamber of Commerce (ICC), ‘ICC Guidelines for International Investment’, at 18-19 (2012), available at <http://www.iccwbo.org/Advocacy-Codes-and-Rules/Document-centre/2012/2012-ICC-Guidelines-for-International-Investment/> ; K. P. Sauvant & F. Ortino, *Improving the International Investment Law and Policy Regime: Options for the Future*, Ministry for Foreign Affairs of Finland, at 73-74 (2013).

²⁹⁹ ILO Declaration on Fundamental Principles and Rights at Work (1998), available at: <http://www.ilo.org/declaration/thedeclaration/textdeclaration/lang--en/index.htm>

³⁰⁰ UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (2013), available at: <http://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf> (hereafter UNCITRAL Transparency Rules).

³⁰¹ See European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 9-10, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

³⁰² Article 1(1) of the UNCITRAL Transparency Rules.

Importantly, parties to a dispute based on a post-April 2014 IIA cannot derogate from the Transparency Rules, unless such derogation is permitted by the IIA.³⁰³ The following sections set out the main tenets of the new Transparency Rules, focusing on (a) publication of information about the dispute; (b) exceptions to transparency: confidential or protected information; and, (c) discretionary powers of the tribunal and prevalence in case of conflict.

a. Publication of information about the dispute

225. One of the most-often quoted reasons for deciding upon arbitration, as opposed to court litigation, as a means to settle disputes, is the confidentiality of the process. Equally often this confidentiality (or secrecy) is lamented by some commentators and scholars on the ground that it prevents informed public discussion about the pending or concluded case. Such confidentiality can be defended (in most cases) when the dispute concerns only private companies, but in case of investor-State arbitration, there is a clear public interest in making information about the dispute publicly available.
226. Cases under the ICSID Convention and Rules, the subject matter of the dispute and the names of the parties and tribunal members are made public upon initiation of the arbitral proceedings, and so are the following awards, unless the parties expressly agree to deviate from this.³⁰⁴ For cases under the UNCITRAL Arbitral Rules, for example those held under the auspices of the Permanent Court of Arbitration (PCA), this used to be different: not only could the parties demand that the resulting awards remained confidential, they could also request the entire existence of the case be held secret.
227. Under the UNCITRAL Transparency Rules, “*the repository shall promptly make available to the public information regarding the name of the disputing parties, the economic sector involved and the treaty under which the claim is being made*” upon commencement of the arbitral proceedings.³⁰⁵ No option is included whereby parties can request the existence of the dispute to remain confidential. A broad range of documents relating to the case should be made available, including the statement of claim and defence, any written submission and the award.³⁰⁶ This

³⁰³ Article 1(3)(a) of the UNCITRAL Transparency Rules.

³⁰⁴ Article 48(4) of the ICSID Convention.

³⁰⁵ Article 2 of the UNCITRAL Transparency Rules.

³⁰⁶ Article 3(1) of the UNCITRAL Transparency Rules.

provision will make arbitration more transparent than many domestic judicial procedures.

228. Perhaps the most controversial new rule is that hearings for the presentation of evidence or for oral argument will be public, unless this is infeasible for logistical reasons or when “*there is a need to protect confidential information or the integrity of the arbitral process*”.³⁰⁷ This would entirely reverse the current default situation that arbitral hearings are closed to the public, unless parties expressly request the reverse. There is no provision in the new Rules allowing for parties to simply agree to hold a hearing in private; logistical difficulties aside, hearings can only be held with closed doors if the situation is covered by one of the exhaustively enumerated exceptions to transparency.

b. Exceptions to transparency: confidential or protected information

229. Article 7 of the UNCITRAL Transparency Rules outlines the conditions under which certain information, whether written or orally transmitted, will not be made available to the public. Confidential or protected information consists of

- (a) *Confidential business information;*
- (b) *Information that is protected against being made available to the public under the treaty;*
- (c) *Information that is protected against being made available to the public, in the case of the information of the respondent State, under the law of the respondent State, and in the case of other information, under any law or rules determined by the arbitral tribunal to be applicable to the disclosure of such information;*
or
- (d) *Information the disclosure of which would impede law enforcement.*³⁰⁸

230. Importantly, confidential business information is seen as only one form of information that is covered by the exception from transparency – and it has not been defined. It is likely that it will be the most often invoked exception, as it would seem improbable that the IIA or the national law of the respondent State would prohibit disclosure of any particular piece of information. It seems equally implausible that making information concerning an arbitral proceeding available would impede law enforcement, except perhaps in the case of ongoing

³⁰⁷ Article 6 of the UNCITRAL Transparency Rules.

³⁰⁸ Article 7(2) of the UNCITRAL Transparency Rules.

investigations at the domestic level. The only other exception which is sufficiently open to be invoked in various cases is the reference to “*law or rules determined by the arbitral tribunal*”, although arbitral tribunals can be expected to use this provision sparingly so as to avoid making it a loophole to render the entire set of Transparency Rules ineffectual. These exceptions are not self-judging: whenever a party relies on one of these exceptions, the tribunal will determine their applicability.³⁰⁹ In case the tribunal decides that the information should be disclosed, whoever has submitted the information will be permitted to withdraw all or part of the document from the record.

231. Transparency exceptions can be brought up by the parties to the dispute, non-disputing parties to the treaty and even third persons. Also the tribunal can invoke them *proprio motu*, without ever having been invoked by the parties, as it is possible for an arbitral panel to restrain information where publication would jeopardise the integrity of the arbitral process.³¹⁰ Arrangements have to be made by the tribunal to prevent disclosure of confidential or protected information, including the setting of time-limits by which protection against publication has to be sought, procedures for designation and redaction of documents and procedures for private hearings.³¹¹ As the goal is to pursue maximal transparency, where possible, only part of the document will be redacted and only part of the hearings will be behind closed doors.
232. One final exception regards information which is contrary to the essential security interests of the respondent State. The latter can never be required to make such information available to the public.³¹² The Rules do not clarify whether the invocation of this exception is subject to judicial review by the arbitral tribunal. If the same approach is followed as with regard to the equivalent exception in the General Agreement on Tariffs and Trade (GATT) for example, this provision would be self-judging by the State and not open to review by the adjudicatory body. Under the WTO system, States have exercised a measure of self-restraint and this exception has not been excessively relied upon by States.³¹³ Also, it is not

³⁰⁹ Article 7(3)-(4) of the UNCITRAL Transparency Rules.

³¹⁰ Article 7(6)-(7) of the UNCITRAL Transparency Rules.

³¹¹ Article 7(3) of the UNCITRAL Transparency Rules.

³¹² Article 7(5) of the UNCITRAL Transparency Rules.

³¹³ There is still discussion as to whether this provision is justiciable in WTO dispute settlement as there is no adopted panel or Appellate Body report on this issue; *See United States – Trade Measures affecting Nicaragua* L/6053 (Oct 13, 1986) (not adopted).

unthinkable that in case of over-zealous invocation of this provision, arbitral tribunals might decide not to exercise full judicial review over the reason for invoking this exception, but at least it would conduct a marginal check as to whether the boundaries of discretion have not been manifestly exceeded by the respondent State. This would not be an assessment based on the stipulations in the UNCITRAL Transparency Rules, but would have to be devised by the arbitral panel itself.

c. When in doubt: discretionary powers and priority in case of conflict

233. Without directly referring to environmental information, the UNCITRAL Transparency Rules provide that arbitral tribunals shall exercise their discretionary powers while taking into account

(a) *The public interest in transparency in treaty-based investor-State arbitration and in the particular arbitral proceedings; and*

(b) *The disputing parties' interest in a fair and efficient resolution of their dispute.*³¹⁴

234. Furthermore, it falls within the authority of the tribunal to promote transparency by considering third party submissions which could for example include *amicus curiae* briefs by environmental NGOs.³¹⁵ The arbitral tribunal is however not obliged to accept such submissions. The tribunal can also allow, or, after consultation with the disputing parties even invite submissions from the home State of the investor (the “non-disputing Party to the treaty”).³¹⁶ Consent of the parties to the dispute is not required, but the tribunal should ensure to avoid submissions which would be tantamount to the exercise of diplomatic protection.

235. In case of conflict between various applicable legal instruments, the UNCITRAL Transparency Rules set out a clear hierarchical structure: the provisions of the IIA at hand prevail over all other Rules, followed by the Transparency Rules, with the lowest position reserved for the more general arbitration rules.³¹⁷

³¹⁴ Article 1(4) of the UNCITRAL Transparency Rules.

³¹⁵ Articles 1(5) and 4 of the UNCITRAL Transparency Rules.

³¹⁶ Article 5(1)-(2) of the UNCITRAL Transparency Rules.

³¹⁷ Article 1(7) of the UNCITRAL Transparency Rules.

2. Active role for States parties to the treaty and other stakeholders

a. States parties to the treaty

236. With the view to clarifying the meaning of key investment protection notions, States parties to the TTIP could reserve the right to issue binding interpretations, which is among the suggestions promoted by the European Commission.³¹⁸ Such an advancement which is comparable to the binding interpretations of the NAFTA Free Trade Commission³¹⁹ will afford the parties to the TTIP an active role when it comes to interpretation of investment protections standards thus confirming their intention while drafting the treaty. Clauses are to be included that would allow the parties to the agreement to provide a joint agreement on the interpretation of the treaty, and the investor's home country to make submissions.³²⁰
237. Such interpretative powers of State-parties to the TTIP should be greeted given that they would contribute to enhancing the predictability of norms.³²¹ In order for this to be the case, respect of the principle of non-retroactivity (so as there is not in effect a disguised treaty amendment rather than an interpretation) and of fundamental procedural rights (so as interpretation taking place in the course of ongoing arbitral proceedings does not influence the arbitration at issue) shall be guaranteed.³²² However, it should not be overlooked that such an engagement would tend to lead to politicisation of disputes.

b. Other stakeholders

238. The current advancement promoted by the European Commission could be further enhanced if the submission of *amicus curiae* briefs, including by NGOs,

³¹⁸ European Commission, 'Fact sheet: Investment Protection and Investor-to State Dispute Settlement in EU agreements', Nov. 2013, at 9, available at: http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf ; See also European Commission, 'Public consultation on modalities for investment protection and ISDS in TTIP', at 8, 14-15, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

³¹⁹ Articles 2001(2)(c) and 1131(2) of the NAFTA.

³²⁰ European Commission, 'Fact sheet: Investment Protection and Investor-to State Dispute Settlement in EU agreements', Nov. 2013, at 9, available at: http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf

³²¹ See G. Kaufmann-Kohler, *Interpretive Powers of the Free Trade Commission and the Rule of Law* (2011), available at: http://www.arbitration-icca.org/media/1/13571335953400/interpretive_powers_of_the_free_trade_commission_and_the_rule_of_law_kaufmann-kohler.pdf

³²² *Id.*

representatives of civil society and other third parties with a particular interest, such as industry federations, were permitted in the course of the proceedings.³²³

3. Code of conduct and roster of arbitrators

239. The adoption of a code of conduct of arbitrators addressing conflicts of interest and ethics and the establishment of a roster of arbitrators are two further options to improve legitimacy.³²⁴ The former are not entirely new as several codes of conduct already exist and are frequently relied upon, for example to decide on disclosure obligations and arbitrator challenges.³²⁵ It remains to be seen whether a fixed roster of arbitrators would contribute to achieving the desired result. Looking at the list of arbitrators of the PCA, for example, it is clear that a number of listed persons (and notwithstanding the stipulation in the founding convention that such arbitrators have to be “*of known competency in questions of international law, of the highest moral reputation and disposed to accept the duties of arbitrators*”)³²⁶ were apparently not nominated because of any relevant expertise in the field. This also explains why only few of them are ever actually appointed. However, this does not create much of a problem in the context of the PCA given that parties to a dispute are not obliged to select an arbitrator from the PCA list.
240. On the contrary, the roster of arbitration currently designed by the European Commission will be employed in case the investor and the respondent state do not agree on the appointment of a Chairperson.³²⁷ Thus, the experience of the PCA list of arbitrators should serve as a cautionary tale for similar endeavours under the TTIP.

³²³ *Amicus curiae* intervention has also been embraced in WTO and NAFTA proceedings; See for example *United States - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/ABR (Nov 6, 1998), ¶¶ 9-110; *United States - Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities*, WT/DS166/AB/R (Jan 19, 2001), ¶¶ 168-176 and *Methanex Corporation v. United States of America*, UNCITRAL, Decision of the Tribunal on Petitions from Third Persons to Intervene as “*Amici curiae*” (Aug 3, 2005).

³²⁴ See European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 11-12, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

³²⁵ IBA Guidelines on Conflicts of Interest in International Arbitration (2004), available at http://www.ibanet.org/Publications/publications_IBA_guides_and_free_materials.aspx#conflictsofinterest ; ABA Code of Ethics for Arbitrators in Commercial Disputes (2004), available at https://www.adr.org/aaa/ShowProperty?nodeId=UCM/ADRSTG_003867.

³²⁶ Article 23 of the Convention for the Pacific Settlement of International Disputes (1899).

³²⁷ European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 12, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

4. An appellate mechanism

a. Need for an appellate mechanism

241. Domestic dispute settlement offers parties a possibility to appeal against a judgment of a court of first instance before a court of appeal, possibly even to subsequently appeal that decision before a supreme court. In international adjudication, however, appeal possibilities were for a long time exceptional: arbitrations, such as those before the PCA or the Iran-US Claims Tribunal, or litigation before the International Court of Justice, is final – no appeal is possible (except revision/additional award).³²⁸ More recently, developed forms of international adjudication did contain the possibility of appeal: for example the proceedings before the WTO or the European Court of Human Rights.
242. One of the recurrent points of critique on the ISDS mechanism which is usually contained in BITs and in the new generation of FTAs is the lack of a general appeal mechanism. Critics argue that whereas arbitral tribunals in investor-State arbitration proceedings often decide on important and sensitive national measures, there is no general possibility for the home State or for the investor to lodge an appeal against such, even though those tribunals may have completely ignored relevant elements. The existing annulment proceedings under ICSID and the review proceedings before national courts under UNCITRAL rules are not considered ‘real’ appeal options as their grounds are very limited.
243. Another point of critique is the perceived lack of consistency between the numerous awards that are rendered each year by arbitral tribunals, which are established under various arbitration institutions and rules (*i.e.*, ICSID, UNCITRAL, PCA, ICC, SCC etc.). The creation of a general, permanent appeal mechanism, which would allow appeals against all investment arbitration awards and which would enable the Appeal Body to render binding, authoritative decisions could significantly increase the consistency of arbitral awards and allow the parties to have a ‘second’ chance. Such appeals could be limited to points of law and would have to be ring-fenced by very tight timelines in order to prevent frivolous appeals that simply aim at prolonging the proceedings and increase the costs.

³²⁸ See Article 99 of the Rules of Court of the International Court of Justice (1978); Article 37 of the Tribunal Rules of Procedure of the Iran-United States Claims Tribunal (1983); Article 55 of the Convention for the Pacific Settlement of International Disputes (1899).

244. A third point of critique, which an appeal mechanism could alleviate, is the limited pool of arbitrators who are currently appointed to arbitral tribunals. In the framework of creating a permanent, standing Appeal Body, which should consist of a substantial number of arbitrators, it could also be envisaged that a large roster of arbitrators could be created, which takes due account of an adequate geographical and gender distribution as well as using a rotating system which ensures access of new, young arbitrators to the roster.
245. Below, the appeal mechanism which has been proposed by the European Commission is outlined and subsequently compared to similar mechanisms provided in BITs or FTAs with an investment chapter, secondly, to the WTO appeal mechanism, and thirdly, to the ICSID annulment system.

b. Mechanism proposed by the European Commission

246. There has been preparatory work for including in the long- or short-term an appeal mechanism in current FTA negotiations between the EU and Canada, an approach expected to be adopted in the case of the TTIP, too. The creation of an appellate mechanism that is promoted by the European Commission would “ensure consistency and increase the legitimacy of the system by subjecting awards to review”.³²⁹ According to the relevant text that has been developed in the course of CETA negotiations:

The Committee on Services and Investment shall provide a forum for the Parties to consult on issues related to this Section, including:

- a) difficulties which may arise in the implementation of this chapter;*
- b) possible improvements of this chapter, in particular in the light of experience and developments in other international fora; and,*
- c) whether, and if so, under what conditions, an appellate mechanism could be created under the Agreement to review, on points of law, awards rendered by a tribunal under this Section, or whether awards rendered under this Section could be subject to such an appellate mechanism developed pursuant to other institutional arrangements. Such consultations shall take into account the following issues, among others:*

³²⁹ European Commission, ‘Fact sheet: Investment Protection and Investor-to State Dispute Settlement in EU agreements’, Nov, 2013, at 9, available at: http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf ; See also European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 15-16, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

- i. the nature and composition of an appellate mechanism;
- ii. the applicable scope and standard of review;
- iii. transparency of proceedings of an appellate mechanism;
- iv. the effect of decisions by an appellate mechanism;
- v. the relationship of review by an appellate mechanism to the arbitration rules that may be selected under Article x-22 (Submission of a Claim to Arbitration); and
- vi. the relationship of review by an appellate mechanism to domestic laws and international law on the enforcement of arbitral awards.

247. Also the Public Consultation document of the European Commission offers possible draft provisions establishing an appellate mechanism:

Article xx (Award)

Either disputing party may appeal the award to the Appellate Body within 90 days of the issuance of the award. In such an event, if the Appellate Body modifies or reverses the award of the Tribunal then the Tribunal shall, after hearing the disputing parties if appropriate, revise its award to reflect the findings of the Appellate Body. The Tribunal shall seek to issue its revised award within 90 days of receiving the report of the Appellate Body.

Article xx (Appellate review)

*A standing Appellate Body is hereby established. The Appellate Body shall hear appeals on issues of law covered in the Tribunal's decision or award and legal interpretations developed by the Tribunal.*³³⁰

c. Appellate mechanisms in other FTAs/BITs

248. A couple of FTAs concluded by the US contemplated the potential establishment of a standing body to hear appeals from investor-State arbitrations; but such a scenario has not yet materialised. For example, the US-Chile FTA (2003) was the first one to provide that “*an appellate mechanism could be inserted, should one be established*” under a separate multilateral agreement.³³¹

³³⁰ European Commission, ‘Public consultation on modalities for investment protection and ISDS in TTIP’, at 42-43, available at: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

³³¹ According to Article 10.19(10) of the US-Chile FTA: “*If a separate multilateral agreement enters into force as between the Parties that establishes an appellate body for purposes of reviewing awards rendered by tribunals constituted pursuant to international trade or investment agreements to hear investment disputes, the Parties shall strive to reach an agreement that would have such appellate body review awards rendered under Article 10.25 in arbitrations commenced after the appellate body's establishment.*” Furthermore, Annex 10-H provides that: “*Within three years after the date of entry into force of this Agreement, the Parties shall consider whether to establish a*

249. The Dominican Republic-Central America-US FTA (CAFTA-DR) (2004) went further, and required the establishment of a negotiating group to develop an appellate body or similar mechanism.³³² Notwithstanding these provisions, the establishment of any appellate body has yet to occur.

d. Comparison with the WTO Appellate Mechanism

250. **Mandate.** The WTO standing Appellate Body (AB) which is established by the Dispute Settlement Body (DSB) is to “hear appeals from panel cases”.³³³ According to the Dispute Settlement Understanding (DSU), an appeal shall be limited to issues of law covered in the panel report and legal interpretations developed by the panel.³³⁴ The AB may uphold, modify or reverse the legal findings and conclusions of the panel.³³⁵ The AB then produces its own report, possibly overruling the panel report in whole or in part, so there is normally no need to refer the case back to the panel. Relevant to the definition of the AB’s mandate is Article 3.2 DSU, according to which:

The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system. The Members recognize that it serves to preserve the rights and obligations of Members under the covered agreements, and to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law. Recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements.

bilateral appellate body or similar mechanism to review awards rendered under Article 10.25 in arbitrations commenced after they establish the appellate body or similar mechanism.”

³³² According to Annex-F of CAFTA: “ 1. 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. Such appellate body or similar mechanism shall be designed to provide coherence to the interpretation of investment provisions in the Agreement. The Commission shall direct the Negotiating Group to take into account the following issues, among others:

- (a) the nature and composition of an appellate body or similar mechanism;
- (b) the applicable scope and standard of review;
- (c) transparency of proceedings of an appellate body or similar mechanism;
- (d) the effect of decisions by an appellate body or similar mechanism;
- (e) the relationship of review by an appellate body or similar mechanism to the arbitral rules that may be selected under Articles 10.16 and 10.25; and
- (f) the relationship of review by an appellate body or similar mechanism to existing domestic laws and international law on the enforcement of arbitral awards. [...]”

³³³ Article 17(1) of the DSU.

³³⁴ Article 17(6) of the DSU.

³³⁵ Article 17(13) of the DSU.

251. **Size & Composition.** The AB is composed of seven members of recognised authority, with demonstrated expertise in law, international trade and the subject matter of the covered agreements generally, who are broadly representative of the WTO membership.³³⁶ The AB sits on each case in a division of three persons.³³⁷ The members of each division are randomly selected and there is no restriction of AB members from sitting on cases in which the State of their nationality is a disputing party.
252. Most importantly, after the oral hearing, which is attended only by the three members of the division, the written pleadings in each case are discussed amongst *all* members of the AB, although the final decision is to be made by the three-member division.³³⁸ This practice, known as ‘collegiality’ aims at ensuring that regional or legal culture differences in a particular case are fully understood.³³⁹
253. **Time limits.** The disputing party must notify the DSB of any decision to appeal before the adoption of the panel report (which may take place, at the earliest, on the 20th day after the circulation of the panel report and must occur within 60 days after the circulation). The AB shall deliver its report within 60 days or exceptionally 90 days from the date a party to the dispute formally notifies its decision to appeal. Finally, the DSB and the parties shall accept the report by the AB without amendments unless the DSB decides by consensus *not* to adopt the AB report within 30 days following its circulation to the members.³⁴⁰
254. **Comparison with the CETA draft.** The proposed appellate mechanism put forward during the CETA negotiations is largely based on the WTO appellate mechanism model. An appellate body would have competence to undertake a review of the points of law and legal interpretations of the tribunal, like the WTO AB. Furthermore, time constraints are to be established in order to make the process expeditious. According to the CETA draft, a disputing party may file their appeal within 90 days of the issuance of the award, while, in case of modification or reversal of the tribunal’s award, the tribunal shall issue its revised award within 90 days of the reception of the appellate body’s report modifying or reversing its award.

³³⁶ Article 17(3) of the DSU.

³³⁷ Article 17(1) of the DSU.

³³⁸ D. McRae, *The WTO Appellate Body: A Model for an ICSID Appeals Facility?*, 1 Journal of International Dispute Settlement 371, at 375 (2010).

³³⁹ *Id.*

³⁴⁰ Article 17(14) of the DSU.

255. Contrary to the WTO proceedings, the draft CETA text only provides the deadline of filing an appeal and the time-period of the adoption of the appellate body's report by the tribunal, omitting the timetable for the delivery of the appellate report itself. This is a vacuum to be filled since it could unduly delay the whole appellate process. Yet, the CETA text is preferable to DSU in that it provides for a clear deadline for the filing of an appeal by a disputing party in contrast to the DSU in which the deadline may vary from 20 to 60 days (while the winning party may shorten the deadline by placing the panel report on the agenda for a DSB meeting on the 20th day after circulation). The CETA draft does not provide for a possibility of the rejection of the appellate award by consensus, thus implying that the latter is final. As far as the composition of the appellate body is concerned, the draft CETA text makes no relevant provision. The WTO AB model could well be employed in case of EU FTA-based ISDS claims, as collegiality would add to the cohesiveness of case law.

e. ICSID annulment mechanism

256. **Mandate.** An award by a tribunal operating under the ICSID Arbitration Rules is subject to annulment on one or more of the following grounds:

- (a) *that the Tribunal was not properly constituted;*
- (b) *that the Tribunal has manifestly exceeded its powers;*
- (c) *that there was corruption on the part of a member of the Tribunal;*
- (d) *that there has been a serious departure from a fundamental rule of procedure; or*
- (e) *that the award has failed to state the reasons on which it is based.*³⁴¹

257. **Size & Composition.** An *ad hoc* committee of three is appointed from a panel of arbitrators, proposed by contracting parties, with the authority to annul the award or any part of it.³⁴² The panel designees be persons of high moral character and recognised competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgment.³⁴³ Limitations on the membership of the committee are set out in Article 52.3, according to which:

[...] None of the members of the Committee shall have been a member of the Tribunal which rendered the award, shall be of the same nationality as any such member, shall

³⁴¹ Article 52(1) of the ICSID Convention.

³⁴² Article 52(3) of the ICSID Convention.

³⁴³ Article 14(1) of the ICSID Convention.

be a national of the State party to the dispute or of the State whose national is a party to the dispute, shall have been designated to the Panel of Arbitrators by either of those States, or shall have acted as a conciliator in the same dispute. [...]

258. **Time limits.** The application of annulment shall be made within 120 days after the date on which the award was rendered.³⁴⁴ If the committee finds that there was a violation of the standards, it is authorised to annul the award entirely or in part. If the award is annulled, either party may restart the process by submitting the dispute to a new tribunal.³⁴⁵ No time limits on the process of annulment and the submission of the claim to a new tribunal are set out in ICSID Convention. An *ad hoc* Committee has no power to ‘complete the analysis’ by revising the first tribunal’s award to take into account the point or points on which it has been annulled. Thus, there can be (and have been) successive awards and annulments.
259. **Comparison with the CETA draft.** The scope of ICSID annulment is much narrower compared to the scope of appeal contemplated in CETA text which covers any point of law. The deadline is longer (120 days compared to 90 days in CETA); yet no time limits are set out for the rest of the process. If the ICSID annulment text is used as a model in EU FTAs, the extensive limitations of the composition of the *ad hoc* committee might prove to be problematic. If such limitations apply in an appellate body established under the TTIP, in practice all arbitrators who are US nationals and nationals of all EU Members States, when the EU (and not an EU Member State) acts as a respondent, would be excluded. Thus, the DSU provision which allows members of the appellate body to sit on cases involving the State of which they are a national could seem to be a preferred solution. Finally, given that in ICSID annulment proceedings different arbitrators are deciding in different cases in divisions of three without a ‘collegiality process’, consistency among decisions may be (and has been) difficult to achieve.
260. On balance, the WTO appellate mechanism seems to be a more suitable model for an appeals facility in EU FTAs than the ICSID annulment mechanism. Such an appellate mechanism would improve consistency among arbitral awards, correct erroneous decisions of first-level tribunals and enhance the predictability of the

³⁴⁴ Article 52(2) of the ICSID Convention. As an exception, when annulment is requested on the grounds of corruption such application shall be made within 120 days after discovery of the corruption and in any event within three years after the date on which the award was rendered.

³⁴⁵ Article 52(6) of the ICSID Convention.

law.³⁴⁶ However, it would add to the cost of the proceedings as well as taking extra time (if strict deadlines in all stages are not adopted) – which is a major concern for all parties involved.

261. Some practical questions that should be addressed concern the election process of the members of the appellate body as well as how the mechanism would be financed.³⁴⁷ Furthermore, provisions should be included on whether the appellate body would have the power to correct decisions itself or just to remand to the original tribunal³⁴⁸ (under the current CETA draft text the latter option seems to be the most likely to be employed – further adding to the cost and time delay). Finally, the risk exists that as soon as an appellate mechanism is available, the losing party might be pressured by its citizens (in the case of a State) or its shareholders (in the case of a company) to appeal the decision, regardless of the chances of success. Experience from the WTO shows that at the start of the existence of the Appellate Body, this was certainly the case (also out of a motivation to ‘create precedents’) but after a number of years, far fewer decisions are appealed.

VI. Regulation on financial responsibility

A. Drafting history and binding nature

262. In the context of the exclusive EU competence on FDI according to Articles 207(1) and 3(1)(e) of the Treaty of Lisbon³⁴⁹, the European Commission has proposed a Regulation on financial responsibility arising out of investor-to-State dispute settlement.³⁵⁰ The Regulation, which was adopted after amendment by the European Parliament and the Council on 16 April 2014,³⁵¹ addresses the financial

³⁴⁶ However, consistency and predictability should not be overstated as the appellate body will be deciding upon disputes arising under the TTIP alone, the situation under other IIAs remaining unchanged.

³⁴⁷ See UNCTAD IIA Issues Note, *Reform of Investor-State-Dispute Settlement: In Search of a Roadmap*, Jun 2013, at 9, available at: http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf

³⁴⁸ *Id.*

³⁴⁹ Consolidated Version of the Treaty on the Functioning of the European Union (2008/C115/47), available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:C:2008:115:FULL&from=EL>

³⁵⁰ Proposal for a Regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is party (COM(2012) 335 final), available at: http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149567.pdf

³⁵¹ See

consequences following a third-country investor's claim against a Member State or the EU as well as questions of representation in the arbitral proceedings and settlement.

263. The Regulation is designed to apply to the agreements entered into by the EU which will include ISDS, such as, potentially, the TTIP. Given that it is the main regulation implementing the EU's investment policy³⁵², particular attention is being paid to its drafting so that the effectiveness of the investment policy at this very early stage can be safeguarded.
264. Once it enters into force, the Regulation will be binding upon the EU and its Member States. In order for it to have a binding force upon third States and their investors as well as the arbitral tribunal, the Regulation must be incorporated in the international agreements concluded by the EU and third countries.³⁵³ Thus, the provisions of the Regulation may only have a practical effect in the course of the arbitral proceedings - as binding upon the claimant and the arbitral tribunal - if included or directly referred to in an arbitration clause of the IIA under which the claim has been brought.

B. Respondent status

265. Regarding the determination of respondent status, the Regulation provides that in case the treatment that triggered the arbitral proceedings has been afforded by the institutions, bodies or agencies of the EU, the EU shall act as respondent.³⁵⁴ Likewise, the Member State shall act as respondent when the dispute concerns, fully or partially, treatment afforded by that Member State.³⁵⁵

<http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2014-0419&language=EN#BKMD-30>; Regulation of the European Parliament and of the Council

establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is a party (SN 2065/1/14) REV 1.

³⁵² See Press Release, Council of the European Union, '3266th Council Meeting: Foreign Affairs – Trade Items' (Oct 18, 2013), at 11, available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/139062.pdf

³⁵³ F. Baetens, G. Kreijen & A. Varga, *Determining International Responsibility Under the New Extra-EU Investment Agreements; What Foreign Investors in the EU Should Know*, Vanderbilt Journal of Transnational Law (forthcoming).

³⁵⁴ Regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is a party (SN 2065/1/14) REV 1, Article 4, available at: http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149567.pdf

³⁵⁵ *Id.*, Articles 5, 9.

266. However, a range of exceptions to the Member States' respondent status is included. More specifically, the EU, represented by the Commission, shall act as respondent when: (i) a Member State has confirmed its intention not to act as respondent within 45 days of the reception of notice or notification of arbitration ; or when the Commission takes the decision within 45 days of the reception of notice or notification of arbitration that the EU act as a respondent in case (ii) the EU would bear all or at least part of the potential financial responsibility ; (iii) the dispute also concerns treatment afforded by the institutions, bodies or agencies of the EU ; (iv) similar treatment is being challenged in a related claim against the EU in the WTO, where a panel has been established and the claim concerns the same specific legal issue, and where it is necessary to ensure a consistent argumentation in the WTO case.³⁵⁶
267. The above-mentioned exceptions have been significantly differentiated compared with the initial proposal put forward by the Commission. Contrary to the initial exceptions proposed which allowed the EU to unilaterally determine its respondent status in numerous situations without the consent of the Member State concerned, the amended version of the Regulation provides for an active cooperation between the Commission and that Member State. Indeed, whether the EU takes up the role of the respondent be decided following consultations between the Commission and the Member State concerned. In particular:
- 1. In accordance with the principle of sincere co-operation referred to in Article 4(3) TEU, the Commission and the Member State concerned shall take all necessary steps to defend and protect the interests of the Union and the Member State concerned.*
 - 2. The Commission and the Member State concerned shall enter into consultations on the management of disputes pursuant to this Regulation, bearing in mind any deadlines set down in this Regulation and in the agreement concerned, and shall share with each other information where relevant to the conduct of disputes.*³⁵⁷
268. Furthermore, when it comes to decisions by the Commission that the EU is to act as respondent, the Commission may decide relying on “*a full, balanced and factual analysis and legal reasoning provided to the Member States*”³⁵⁸ in accordance with

³⁵⁶ *Id.*, Article 9(1)-9(3).

³⁵⁷ *Id.*, Article 6.

³⁵⁸ *Id.*, Article 9(2), 9(3).

the advisory procedure (in cases (ii) and (iii)) or the examination procedure (in case (iv)) of Regulation (EU) No 182/2011.³⁵⁹

C. Attribution of conduct

269. Regarding the determination of external responsibility under public international law, the division of competences between the EU and the Member States is material.³⁶⁰ The Regulation's approach that the attribution of a conduct under public international law either to the EU or the Member State should be based on the competence of the subject-matter and not the entity which afforded the treatment in question may be considered in the light of Article 64 of the International Law Commission's Articles on the Responsibility of International Organizations.³⁶¹ However, relying on competence for the determination of external responsibility may well infringe upon Article 206(7) of the Treaty of Lisbon, according to which, the exercise of the EU's competences:

*in the field of the common commercial policy shall not affect the delimitation of competences between the Union and the Member States, and shall not lead to harmonisation of legislative or regulatory provisions of the Member States in so far as the Treaties exclude such harmonisation.*³⁶²

270. Given that IIAs concluded by the EU may indirectly touch upon aspects under the Member States' exclusive or shared competence, it is likely that the international responsibility of the EU entails the EU requiring harmonisation of Member States' law contrary to Article 206(7) of the Treaty of Lisbon. As the division of competences between the EU and the Member States is far from undisputed – and

³⁵⁹ Articles 4 and 5 respectively of the Regulation (EU) No 182/2011 of the European Parliament and of the Council of 16 February 2011 laying down the rules and general principles concerning mechanisms for control by Member States of the Commission's exercise of implementing powers (2010/0051/COD), available at: <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32011R0182>

³⁶⁰ *Id.*, at 4.

³⁶¹ International Law Commission, Articles on the Responsibility of International Organizations (2011), available at: http://legal.un.org/ilc/texts/instruments/english/draft%20articles/9_11_2011.pdf ; See C. Tietje, E. Sipiorski & G. Topfer, *Responsibility in Investor-State-Arbitration in the EU - Managing Financial Responsibility Linked to Investor-State Dispute Settlement Tribunals Established By EU's International Investment Agreements*, (Dec 2012), EXPO/B/INTA/FWC/2009-01/Lot 7/31, at 16, available at: <http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=79450>

³⁶² Article 206(7) of the Treaty of Lisbon.

it is likely to remain so until guidance is given by the Court of Justice of the European Union (CJEU) – the principle of proportionate allocation of international responsibility may be questioned.

271. The transposition of EU law to the Member States' domestic legal order may cause additional problems, especially when it comes to the implementation of directives, as Member States enjoy wide discretion in this respect. The EU system of 'executive federalism' may thus entail the potentially unwelcome outcome of the EU bearing international responsibility even when it did not influence the measure in question and did not itself breach the IIA.³⁶³

D. Allocation of financial responsibility

272. As opposed to the competence-based attribution of conduct, financial responsibility is to be borne by the author of the act that gave rise to the investment claim before the tribunal. To specify, when the treatment in question was afforded by the institutions, bodies or agencies of the Union or required by the law of the Union, the Union be financially responsible.³⁶⁴ In contrast, financial responsibility be shouldered by the Member State when it comes to a treatment afforded by that Member State.³⁶⁵
273. According to the Regulation, in case of Member States having financial responsibility the EU "*should be able to either accumulate the contributions of the Member State concerned first before implementing the relevant expenditure or implement the relevant expenditure first and be reimbursed by the Member States concerned after.*"³⁶⁶ The system of internal reimbursement in case of disagreement, as currently stands under Article 19, may be considered in conjunction with EU law in order for its efficiency to be safeguarded. Indeed, unwillingness or inability of a Member State to live up to its financial obligations may not be ruled out. The

³⁶³ C. Tietje, E. Sipiorski & G. Topfer, *Responsibility in Investor-State-Arbitration in the EU - Managing Financial Responsibility Linked to Investor-State Dispute Settlement Tribunals Established By EU's International Investment Agreements*, (Dec 2012), EXPO/B/INTA/FWC/2009-01/Lot 7/31, at 18-19, available at: <http://www.europarl.europa.eu/committees/en/studiesdownload.html?languageDocument=EN&file=79450>

³⁶⁴ Regulation of the European Parliament and of the Council establishing a framework for managing financial responsibility linked to investor-state dispute settlement tribunals established by international agreements to which the European Union is a party (SN 2065/1/14) REV 1, Article 3, available at: http://trade.ec.europa.eu/doclib/docs/2012/june/tradoc_149567.pdf

³⁶⁵ *Id.*

³⁶⁶ *Id.*, at 14.

EU budget is not, however, to bear the costs of a Member State's failure to comply with its international obligations. In this respect, Articles 258 and 259 of the Treaty of Lisbon³⁶⁷ seem to be the only recourse to avoid disproportionate burdening of the Member States indirectly through the EU budget.

E. Settlement

274. According to the Regulation, when the disputed conduct is that of the EU, the Commission may settle the dispute provided that this is in the interests of the EU, in which case it may adopt an implementing act to approve the settlement in accordance with the examination procedure of Regulation 182/2011.³⁶⁸ When the EU is respondent but the treatment in question has been afforded at least in part by the Member State, consultations shall take place between the EU and the Member State in order to reach a settlement, provided that the latter is in the financial interests of the EU and the examination procedure of Regulation 182/2011 is followed.³⁶⁹
275. When it comes to the latter case (*i.e.* the EU being the respondent in a dispute concerning a treatment afforded by a Member State) four separate scenarios may come into play:
- (i) if the Member State alone would bear financial responsibility, only that Member State may settle the dispute;
 - (ii) if the Member State has confirmed its intention not to act as a respondent, the Commission may opt for the settlement of the dispute following

³⁶⁷ According to Article 258 of the Treaty of Lisbon: “If the Commission considers that a Member State has failed to fulfil an obligation under the Treaties, it shall deliver a reasoned opinion on the matter after giving the State concerned the opportunity to submit its observations. If the State concerned does not comply with the opinion within the period laid down by the Commission, the latter may bring the matter before the Court of Justice of the European Union.” According to Article 259 of the Treaty of Lisbon: “A Member State which considers that another Member State has failed to fulfil an obligation under the Treaties may bring the matter before the Court of Justice of the European Union. Before a Member State brings an action against another Member State for an alleged infringement of an obligation under the Treaties, it shall bring the matter before the Commission. The Commission shall deliver a reasoned opinion after each of the States concerned has been given the opportunity to submit its own case and its observations on the other party's case both orally and in writing.

If the Commission has not delivered an opinion within three months of the date on which the matter was brought before it, the absence of such opinion shall not prevent the matter from being brought before the Court.”

³⁶⁸ *Id.*, Article 13.

³⁶⁹ *Id.*, Article 14(1), 14(8).

consultations provided that the settlement is in the financial interests of the EU (which is to be indicated by a full, balanced and factual analysis and legal reasoning);

(iii) if the Commission has taken the decision that the EU is to act as respondent and the financial responsibility is exclusively to be borne by the EU, the Commission may decide to settle the dispute;

(iv) if the Commission has taken the decision that the EU is to act as respondent and the financial responsibility is to be borne by both the EU and a Member State, the Commission and the Member State in question may agree on the settlement while the latter may submit a full analysis of the impact of the settlement on its financial interests. In case of the Member State opposing to the settlement, the Commission can only settle on the condition that the settlement does not have any financial or budgetary implications for the Member State on the basis of a full, balanced factual analysis and legal reasoning, taking account of the Member State's analysis and demonstrating the financial interests of the EU and of the Member State.³⁷⁰

276. In case the treatment has been exclusively afforded by a Member State but the EU acts as respondent, the Member State concerned may propose to settle the dispute, if (i) the Member State accepts any potential financial responsibility, (ii) any settlement arrangement is enforceable only against the Member State and (iii) the terms of settlement are compatible with EU law.³⁷¹ The Commission and the Member State shall enter into consultations to evaluate the proposed settlement arrangement, but the Commission may oppose such settlement (within 90 days of the notification of the draft settlement by the Member State) through an implementing act in accordance with the examination procedure of Regulation 182/2011 on the grounds that the draft settlement does not meet the cumulative conditions above.³⁷²

277. Finally, when the treatment has been afforded in part by a Member State and the EU acts as respondent, consultations shall take place between the Commission and

³⁷⁰ *Id.*, Article 14(3)-14(6).

³⁷¹ *Id.*, Article 15(1).

³⁷² *Id.*, Article 15(2), 15(3).

the Member State if the latter considers that settlement of the dispute would be in its financial interests.³⁷³ In case of the Commission not consenting to such settlement, it may refuse to settle based on a full, balanced and factual analysis and legal reasoning through an implementing act in accordance with the examination procedure of Regulation 182/2011.³⁷⁴

F. Preliminary conclusions

278. The initially proposed Regulation which would afford the Commission a far-reaching discretion regarding its participation/interference in the arbitral proceedings caused criticism among the Parliament and the Council. The amendments that have been introduced are to be greeted in that the fashion in which the determination of the respondent status and the settlement provisions are formulated is balanced without leaving an excessive leverage to the Commission.
279. Although the Commission's intention to solidify its newly acquired investment policy is understandable, the Netherlands, as well as the other Member States, may have been concerned to the extent that the Commission's actions could have important financial consequences. Thus, under the amended version of the Regulation, not only were the unity of external representation and the consistent interpretation of agreements to which the EU is a party taken into consideration but also the Member States' right of defence. Most importantly, the need to obstruct undue interference with the Member States' powers has been addressed through rendering as a condition the cooperation between the Commission and the Member States as well as the provision of sufficient and rational justification for any decision made by the Commission.
280. Finally, the employment of the examination procedure of Regulation 182/2011 (which entails that any decision by the Commission is subject to the approval of a committee composed of representatives of all Member States) where a close involvement of the Commission is anticipated contributes to affording relevant decisions with sufficient legitimacy.

³⁷³ *Id.*, Article 16(1).

³⁷⁴ *Id.*, Article 16(3).

VII. Final comments

281. The TTIP and the TPP are the first plurilateral FTAs whose scope will be covering a wide range of economies. The EU and the US economies account together for about half the entire world GDP and for nearly a third of world trade flows.³⁷⁵ Most importantly, the TTIP is expected to serve as a catalyst for the improvement of current international investment law regime. Given that either the EU or the US is the largest trade and investment partner for almost all other countries in the global economy,³⁷⁶ the TTIP may serve as a template for future bilateral negotiations and even set the ground for a multilateral breakthrough.³⁷⁷
282. An ISDS mechanism has been included in most BITs over the past decades and has been extensively tested through arbitral practice. Although problematic issues do occur, the TTIP could precisely improve the existing ISDS mechanisms by raising the threshold to access international arbitration and affording the entire system with the required legitimacy.
283. There is no conclusive empirical evidence for “regulatory chill” due to the existence of an investment treaty providing for ISDS. Moreover, the 260+ ISDS cases which have been concluded worldwide demonstrate that most procedures concern individual administrative treatment of investors. Legislative acts are subject to ISDS procedures only in exceptional cases, and these claims are hardly, if ever, successful.
284. International investment law recognizes both individual economic interests of investors and public interests of the host state. Arbitral tribunals have underlined the importance of “policy space” in several cases. This, however, does not mean that there is no room for improvement of the system. Any potential risks ISDS may pose for the Netherlands and other EU Member States can be mitigated through a careful and progressive drafting of the TTIP. It is possible to include provisions to filter claims, to allow for greater protection for the policy choices of states parties, and to utilize procedural safeguards such as more transparent arbitration rules. These risk mitigation options serve to enhance the benefits ISDS could have whilst

³⁷⁵ See <http://ec.europa.eu/trade/policy/countries-and-regions/countries/united-states/>

³⁷⁶ *Id.*

³⁷⁷ The TTIP could be employed as a model in future FTA negotiations between the EU and China as well as other countries; See House of Lords, European Union Committee, *The Transatlantic Trade and Investment Partnership*, 14th Report of Session 2013-14, at 53 (2014), available at: <http://www.publications.parliament.uk/pa/ld201314/ldselect/ldecom/179/179.pdf>

striking an appropriate balance between protecting foreign investment as well the public interest.

Annex A: FDI and trade: complements or substitutes?- a short literature review

Fontagné (1999) identifies three actors that are involved in empirical discussions, the home country ('investing country'), the host country ('receiving country') and possible 'third countries'.

For the home country, FDI may be seen as a substitute of trade, as firms may choose to invest and produce abroad rather than export the goods and services that are domestically produced. This may then hurt the 'home' economy due to lower employment and production. On the other hand, FDI leads to larger export possibilities to the affiliate abroad in terms of intermediate input goods.

Host countries' analysis follows the opposite pattern. More inward FDI leads to more employment and domestic production, though more input/ intermediate goods need to be imported. Both have opposing effects on the current account. It is nevertheless likely that the host country benefits from the technological know-how and good practices from abroad in the long run.

An important third group, specifically in the case of regional economic blocks, are 'third countries'. If these intermediate goods that are demanded by the host country as a result from FDI are supplied by firms from third countries, these may benefit from more FDI (often at the expense of the 'home' country's firms).

Blomstrom & Kokko (1994) find that FDI and trade are complementary for Sweden, the increased market share of the affiliate abroad and the corresponding demand for intermediate goods makes up for the lost export volume. Eaton & Tamura (1994) too find a complementary relationship between trade and FDI between Japan and the US. In an early analysis of the FDI-trade nexus in Central and Eastern Europe, Brenton et al. (1998) find that FDI does not influence the home country's trade pattern, thus suggesting a complementary relationship too. In a panel data analysis, Clausing (2000) reaches a similar conclusion for US firms. In a literature review, Greenaway & Kneller (2007) confirm this general finding and provide a discussion of this issue at greater detail.

In contrast, Mundell finds a substitution effect. He builds his argument on the basic 2x2x2 Heckscher-Ohlin-Samuelson model that predicts that international trade occurs due to a difference in factor rewards. FDI, or capital flows more generally,

will lead towards equalization of the reward on capital, which should decrease trade between countries. Bloningen (1999) blames the aggregation bias. He finds substitution between FDI and trade if one looks at one product sector at the time. His findings are confirmed by Swenson (2004), who argues that on a product trade and product FDI are substitutes indeed.

Earlier aggregate research may suffer from spurious regressions according to Head & Ries (2001). An exogenous increase in global demand for goods may be the cause of the rise in both exports and FDI for any given firm or country, 'statistical complementarity' as they call it. Moreover, heterogeneity between firms may lead to different results, as those firms with superior goods may find it easier to expand their overseas production facilities as well as export more as opposed to weaker firms. After controlling for firm fixed effects, overall they find that exports and FDI remain complementary. However, there is a degree of heterogeneity between firms, some firms are unlikely to be the supplier of intermediate goods after setting up production facilities abroad, they tend to display net substitution relations between exports and investments. In their later paper, Head & Ries (2004) conclude that one can find both substitution and complementarity in empirical analysis. The former is likely to be found in individual product category analyses and the latter will show up if one looks at vertical FDI relations (e.g. when intermediate goods are likely to be provided by the home country) and more aggregate/macro data.

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