The current Transatlantic Trade and Investment Partnership (TTIP) negotiations have put investor-to-state dispute settlement (ISDS) under the spotlight. This procedural mechanism enables investors to bring a case against a country that hosts their investments in front of an international arbitral tribunal. Investor claims are made on the basis that the country has violated the rights granted to them under public international law. Such rights include protection against discrimination, direct and indirect expropriation, and unfair and inequitable treatment. ISDS was therefore created on the basis that investment protection is not always enforceable in the domestic legal system. Its primary goal is to allow investors to rely on a sufficient level of legal certainty to invest while making sure that a government will not seize or depreciate their investment arbitrarily. However in practice, the mechanism contains significant loopholes which might put countries’ right to regulate in jeopardy. Environmental and health regulations could be challenged by companies seeking to protect their investments. Opponents to ISDS argue that it is toxic and undemocratic because it enables private interests to prevail over the public interest.

The possible inclusion of ISDS in TTIP has led to such a polarised debate that the European Commission decided to postpone this chapter of the negotiations in order to carry out a public consultation on the issue which closed on 13 July 2014. Even though the public debate concentrates on whether or not to include ISDS in the final agreement, the Commission intends to primarily use the consultation to find ways to modernise this flawed and controversial mechanism which is already used worldwide. TTIP could then be used as a blueprint for future agreements. In this context, it is imperative to examine which challenges are posed by ISDS and determine the extent of TTIP’s possible contribution to tackling these challenges.

A common, flawed and controversial mechanism

TTIP has increased its notoriety but ISDS is far from being a novelty. According to the Commission, there are already over 3,400 agreements worldwide containing provisions to protect investments which include 1,400 bilateral agreements entered by EU member states. The United Nations Conference on Trade and Development (UNCTAD) indicates that from 2008 to 2012, EU investors were involved in 53% of ISDS cases. UNCTAD data also shows that out of the total 568 registered ISDS cases, 57 were initiated in 2013, just below the record 62 cases of 2012.

The fact that these cases are growing comes with some concern as the Commission itself admits, in the public consultation text on TTIP and ISDS, that ISDS procedures contain flaws such as lack of transparency, inconsistencies of arbitral awards, high costs of procedures and the existence of parallel and frivolous claims. The EU Trade Commissioner Karel De Gucht stated that "some existing arrangements have caused problems in practice, allowing companies to exploit loopholes where the legal text has been vague".

One of the main arguments of the opponents to ISDS is that investors could use this mechanism to challenge health, environmental and social regulations on the grounds that they suffer from arbitrary and abusive treatment and are victims of ‘indirect expropriation’. The most cited example is the case brought by Philip Morris International against Australia for their plain-packaging laws for tobacco products. Similarly, Lone Pine...
Resources launched a procedure to challenge Quebec's moratorium on hydraulic fracturing. However, the final impact of these cases on public regulations remains to be seen as they are still ongoing and claimants are not guaranteed to succeed.

Even if they are unusual, high amounts which are sometimes awarded do not shed a positive light on ISDS. Last year saw an award of $935 million in the Al-Kharafi vs Libya, the second highest amount in history (behind the 1.77 billion of the 2012 Occidental vs Ecuador case). The company claimed that the Libyan government illegally cancelled a project approval and a 90 year land leasing contract for the construction and operation of a tourism complex. In the end $900 million in lost profits were awarded to the company which only initially invested $5 million. UNCTAD pointed this out as a "highly unusual development" contrary to previous rulings because the enterprise had no track record of profitable operations, which made it impossible to determine future profits with sufficient certainty. The costly procedures, with an average of $8 million, also carry certain risks. For example, the concept of "regulatory chill" is used to describe a situation where the simple threat of legal action from an investor deters a government from passing laws.

These procedural flaws, loopholes and controversies show that it is necessary, if not to question the mechanism altogether, at least to find ways to improve the system.

**STATE OF PLAY**

**TTIP will not be the miracle cure**

The Commission has received a negotiating mandate by member states to include investor-to-state dispute settlement (ISDS) in the negotiations. This inclusion is viewed as a way to improve the mechanism and strike a better balance between investment protection and member states' right to regulate. The aim of the ongoing public consultation is to find ways to achieve this goal rather than to determine whether or not to include ISDS in TTIP. However this question remains at the core of the public debate.

The Commission has already put forward concrete proposals for improvements including the prohibition for investors to present two claims at the same time in front of different tribunals, provisions requiring all litigation costs to be paid by the losing party and the creation of an appellate mechanism in order to bring more consistency and legitimacy to the process. However, even if these propositions are translated successfully in the final agreement, TTIP will not provide a miracle cure.

The direct effect of the inclusion of ISDS in TTIP would be to create new obligations for EU member states that do not already have similar provisions in bilateral agreements with the US. This would add another layer to the overall ISDS system. The only immediate improvement would be for the nine states that concluded Bilateral Investment Treaties (BITs) with the US prior to their accession to the EU; including Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, and Slovakia. Clauses in TTIP could indeed terminate and replace these agreements. In light of this, the positive impact will be fairly minimal and will not solve existing flawed mechanisms, starting with intra-EU BITs.

**Anachronistic Bilateral Investment Treaties**

In the last two years, 31 intra-EU ISDS cases were based on BITs. Most of these treaties are between 'new' and 'old' member states and, similarly to the US-EU BITs, were concluded in the pre-accession phase in the 1990s. For example, the Postová banka vs Greece case launched last year, in which a Slovak bank and a Cypriot investor claim they suffered losses of €275 million due to retroactive and unilateral changes brought by the 2012 Greek Bondholder Act, which was taken as a crisis countermeasure, is based on the Greece-Slovakia BIT and Cyprus-Greece BIT respectively concluded in 1992 and 1993. Central and Eastern European countries are usually the respondent states as 65% of all recorded claims made against them up to the end of 2012 were based on intra-EU BITs, the most sued being Czech Republic with 16 out of a total of 27 recorded cases. This country, which paid €840 million to investors up to 2012, was also the state against which most cases were brought in 2013.

In 2006, the Commission pronounced itself in favour of the termination of intra-EU BITs arguing that they clash with the single market and are discriminatory under EU law as only certain member states can engage in ISDS procedures. The proposal met with opposition by the majority of 'old' member states, including the Netherlands, Germany, Belgium and the UK, who have also denied Czech Republic's request to terminate its intra EU BITs. This
sends the wrong signal, as member states should be committed to modernising the system by avoiding unnecessary overlaps. The termination of these anachronistic treaties, which are contrary to EU integration principles, would constitute a welcomed first step.

The Energy Charter Treaty in the shadows

TTIP will have no direct effect on the ISDS provisions contained in the Energy Charter Treaty. Yet, EU investors have launched 80% of all ISDS cases under this treaty including the Swedish energy company Vattenfall, who is bringing Germany to court over its policy to phase out nuclear power after the Fukushima disaster. Even though this case is ongoing, Vattenfall had already used this treaty in 2009 to challenge environmental restrictions related to the water use of their new coal-fired plant, asking more than €1.4 billion in compensatory damages. The case was finally settled amicably when the German Government agreed to introduce less stringent environmental rules in favour of the corporation. In 2013, the Energy Charter Treaty was also used by renewable energy companies to initiate procedures to challenge regulations in Spain and Czech Republic.

Regardless of the type of energy produced by the claimants, disputes under the Energy Charter Treaty imperatively need to be addressed as they might have an impact on the energy policies of member states. This is all the more crucial in a period where energy security imperatives might create an opportunity for a more coherent and ambitious energy and climate policy at EU level. This is not an easy task as an amendment to this treaty would require a three quarter majority of all 52 contracting parties.

The Commission’s other argument for including an improved ISDS mechanism in TTIP is to set a blueprint for future agreements. This is mainly a strategic consideration as it would be harder to negotiate investment protection provisions with future partners if ISDS was to be excluded from the transatlantic agreement. They might feel that they are treated as ‘second class’ partners, implicitly considered by the EU as less reliable than the US. The EU is negotiating Free Trade Agreements with India and Japan and an investment agreement with China. However, there is a need to go beyond EU agreements when it comes to tackling the inconsistencies of ISDS and setting up a “gold standard”. ISDS is a complex multi-layered systemic challenge requiring a multilateral solution.

PROSPECTS

A multilateral remedy for a systemic challenge

Reforming ISDS at multilateral level has already been tried unsuccessfully in the past, including in the framework of the World Trade Organization (WTO). Yet, achieving this objective is paramount as the evolution of the system is at a crossroads. There is a risk of fragmentation because ISDS provisions are negotiated not only bilaterally but also within the framework of mega regional negotiations such as TTIP and the Trans-Pacific Partnership (TPP) both of which involve the US. TTIP and TPP could, on the contrary, provide an impetus to look for a global consensus with the EU and the US at the helm. The transatlantic partners not only accounted for around 30 % of FDI inflows and 47% of FDI outflows globally last year but also for 75% of registered disputes. There is also a window of opportunity as one half of all BITs will end or have to be renegotiated by 2018, but the multilateral process, which will be long and difficult, needs to be initiated as soon as possible.

One possibility would be to bring ISDS back on the table at the WTO. However, other routes could be explored. For example, the EU has already been active multilaterally by contributing to develop the Rules on Transparency of the United Nations Commission on International Trade Law (UNCITRAL). UNCITRAL is the second most used legal body for ISDS arbitrations system after the International Centre for the Settlement of Investment Disputes (ICSID). The new rules of transparency, which came into effect on 1 April 2014, will automatically apply to future treaties and enable non-disputing parties to access documents and hearings. Importantly, these provisions can be used in connection with other arbitration systems including ICSID. UNCITRAL is also currently working on the elaboration of a Convention that would make the new transparency rules applicable to all existing International Investment Agreement (IIAs). A similar process could very well be used by this organisation to elaborate another Convention that would include provisions to fix the other procedural flaws, maximize the states right to regulate and allow sustainable development principles to prevail. These new provisions should apply to both future and existing IIAs. Such an ambitious step would however, first require a mandate from UNCITRAL member states which include the EU, the US, China, Russia, Japan, Mexico and Canada. The presence of these two last countries is important as the ISDS instruments in NAFTA are widely used with 51 cases up to the end of 2013.
Possible implications of the absence of ISDS from TTIP

In the light of strong opposition from certain stakeholders, the exclusion of ISDS provisions from TTIP is a possibility. Even though it is very unlikely that this exclusion would be a deal breaker, such an outcome could have deeper implications for the EU and its actors.

Most of the questions in the Commission’s public consultation are to find ways to improve the mechanism, but there is still the possibility for respondents to give their opinion on the inclusion or exclusion of ISDS provisions from TTIP. The first question is therefore to see what the Commission will do in case a majority of stakeholders are in favour of exclusion and how this will affect the negotiating process with a partner who has clearly advocated for an inclusion through the voice of its trade representative Michael Froman. At this point the member states may have to step in and settle the matter, as they have given a mandate to the Commission to include ISDS in the agreement.

The absence of ISDS in TTIP could lead to a broader debate, as the agreement was also meant as an opportunity to set up an ISDS blueprint. Will TTIP then be determined as a standalone case or will it impact the overall EU approach on investment protection and, as such, have repercussions on future and ongoing negotiations? In this regard, the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada, which contains ISDS provisions and still needs to be ratified by the EU Parliament and EU Council, will provide a first indication.

The absence of ISDS from TTIP may have a negative impact on European businesses. They will indeed not be able to use this resort to protect their investments in the US while some of their international competitors could because of provisions already in NAFTA and possibly included in the TPP. As for those who oppose ISDS in general, its final exclusion from TTIP could be a short-lived victory because the overall system, along with its inconsistencies and overlaps, will endure. Furthermore, US companies would still be able to use ISDS against EU member states by setting up subsidiaries in countries, including in Europe, which have those provisions in their IIAs.

Finally, the influence of the debate on member states’ approach to ISDS remains to be seen. For example Germany, which is a precursor in this field and party to about 140 ISDS agreements, has expressed its opposition to include this mechanism in TTIP. The German Economy Minister and party-leader of the social democrats (SPD) Sigmar Gabriel wrote a letter to Karel De Gucht expressing this position and warning that Germany might not agree to a final deal should ISDS be included. This is a significant blow for ISDS proponents as the final TTIP deal will have to be ratified by member states in addition to the EU Parliament.

However, the argument used by Germany, according to which investors benefit from sufficient legal protection in national courts in the EU and the US, could have broader implications. If EU member states consider that their respective domestic courts provide a sufficient level of protection for investors, wouldn’t phasing out intra-EU ISDS mechanisms be a matter of consistency? 88 intra-EU investment arbitrations were recorded up to 2013. That year, 42% of all recorded cases were intra-EU disputes.

Regardless of the presence or absence of ISDS in the final agreement, TTIP has the merit of placing this mechanism under the spotlight. The current debate has contributed to reveal inconsistencies, which make it necessary to reform the system. In any case, the transatlantic agreement will not provide a miracle cure, but it represents an opportunity to start finding solutions at multilateral level, which could be the only way to deal with this systemic challenge in the long run.

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This text expresses his personal views.