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The Voice of
German Industry

Position Paper: The “I” in TTIP

Why the Transatlantic Trade and Investment Partnership Needs an Investment Chapter

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Executive Summary

In mid-2013, the Member States of the European Union (EU) mandated the EU Commission to negotiate an investment chapter in the Transatlantic Trade and Investment Partnership (TTIP) with the United States. However, on January 21, 2014, in response to a flood of public criticism, the Commission temporarily suspended the negotiations. On March 27, it kicked off a formal consultation process, asking business and civil society for comments on investment protection and market access in TTIP. At the center of public concern stands the investor-state dispute settlement mechanism (ISDS). ISDS allows foreign investors to bring a claim against the government of their host State if TTIP investment protection standards are breached, for example in the event of discriminatory treatment or direct and indirect expropriation. The questions raised by governments, business, and civil society concerning ISDS are legitimate and need to be addressed. At the same time, international investment agreements (IIAs) are essential contracts that allow investors to hedge against political risks and, as such, promote global investment flows. IIAs are both in the interest of the foreign investor and the host State.

While in the past IIAs have been concluded mostly between industrialized countries and developing nations in the form of bilateral investment treaties (BITs), there are a number of reasons to include investment chapters in trade agreements between countries with advanced legal systems such as the EU and the United States.

1. Market Access for Investment

Investment flows are the backbone and motor of the transatlantic marketplace. However, in many sectors, such as aviation, shipping, and communications, investors from abroad face considerable market access barriers in the United States. TTIP will not remove all these barriers. However, by extending investment protection to the pre-establishment phase of an investment, by prohibiting certain performance requirements for market access, and by addressing market access for investment in a services chapter, an investment chapter in TTIP will serve as starting point for more open investment relations between the EU und the United States.

2. Settling Investment Disputes

Although there are few known cases of transatlantic investment disputes, the possibility for future conflicts cannot be ruled out. Well-established international rules for settling investment disputes will create a level playing field among investors in Europe and the United States. Neither federal nor state law in the United States fully protects foreign investors against discrimination. Furthermore, it is not guaranteed that national courts will apply international trade and investment law. Quite the contrary, national courts are known to favor national law. There is also evidence that U.S. courts, especially civil juries, can exhibit biases against foreign investors. In the case of investment disputes, foreign investors may be at a disadvantage if their only recourse is to rely on national courts to enforce TTIP investment rules. With ISDS, investors would have a second (and less politicized) avenue to settle disputes with a State.

3. Reforming Investment Protection and ISDS

IIAs have proven themselves time and again as important tools for driving international investment. Nevertheless, there is a need for reform in order to secure the legitimacy of IIAs and ISDS in particular. This is more important than ever as some countries have already terminated some of their IIAs (South Africa, Bolivia, and Ecuador) or are seriously considering doing so (for example India and Indonesia). A transatlantic agreement on investment would be an important signal to these countries, while withdrawing from investment protection would set a bad precedent.

A TTIP investment chapter should provide adequate protection to an investor, while also maintaining the State's right to regulate in areas such as public health, consumer protection, and the environment. Clear definitions of terms such as "investment" must be established. Furthermore, ISDS needs to be transparent, frivolous claims should be blocked, the quality of arbitrators guaranteed, and an appeal mechanism should be included. Much of this can already be found in more recent BITs, and, more importantly, in recent U.S. investment protection agreements. Accordingly, TTIP would also be an opportunity to improve existing IIAs between EU Member States and the United States. Many of these date back to the early 1990s – well before the United States reformed its own model BIT.

4. Strategic Dimension

In light of increasing global investment and the overall depth of the EU-U.S. investment relationship, the TTIP negotiations are a unique opportunity to reform

the system of IIAs and set high investment standards for the future. Thus, the negotiations have a strong strategic dimension. Third countries are likely to look to TTIP when negotiating free trade agreements (FTAs) and BITs.

Whereas trade in goods and services is subject to World Trade Organization (WTO) regulations, there is no comparable multilateral body of law for foreign direct investment (FDI), neither for market access nor for the protection of investment. The IIA landscape is a patchwork of very different bilateral and plurilateral agreements. As there is currently little appetite to incorporate investment in ongoing multilateral trade negotiations, TTIP could be an intermediate step in establishing global investment rules, countering the spaghetti bowl of diverging BITs. The EU Commission therefore needs to draft the investment chapter very carefully, keeping in mind that exclusion of certain sectors and carveouts will also likely be picked up by third countries in future FTAs and BITs.

In addition, common principles will strengthen the bargaining power of the EU and United States vis-à-vis third countries, including China, with which both are currently negotiating BITs. This does not so much concern the inclusion of ISDS in BITs – China has an interest in a well-functioning dispute settlement procedure as well. Rather, a common position on investment protection will help to establish norms and standards (both for pre- and post-establishment) which the EU and United States deem important, but which China might be less interested in.

By signing IIAs only with countries with insufficient legal systems and signs of bad governance, the EU and the United States would forego the opportunity of creating a gold standard for investment treaties. Furthermore, discriminating between countries based on their legal system would also prove politically difficult.

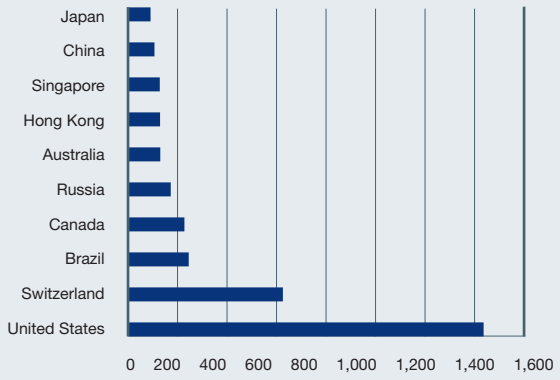
Foreign Direct Investment in the Transatlantic Marketplace

The United States and the European Union (EU) are the drivers of global investment. Both are the world's largest sources and destinations of FDI. In 2012 the stock of FDI in the EU was US$ 7.8 trillion; the stock of European FDI abroad reached over US$ 9.8 trillion.[1] In the same year the stock of FDI in the United States amounted to US$ 3.9 trillion; the stock of U.S. FDI abroad totalled nearly US$ 5.2 trillion.[2] As the following section will highlight, investment is a cornerstone of the transatlantic economic relationship. This is illustrated by the impressive figures of investment flows and stocks between the two economies.

EU Investment in the United States

The United States is the EU's most important destination for its direct investment abroad: As of 2011, the EU had outward stocks of €1,421.3 billion invested in the United States, a figure that grew 11.5 percent from 2010. Figure 1 depicts the destinations of EU FDI (measured in stocks) as of the end of 2011. Figure 2 compares the 2011 EU FDI stocks in the top ten receiving countries.

Fig. 2 **EU FDI stocks in the top ten countries** (€ billion, 2011)



Source: Eurostat, *Top Ten Countries as Extra EU-27 Partners for FDI Positions*, <http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/File:Top_ten_countries_as_extra_EU-27_partners_for_FDI_positions,_EU-27,_end_2009%E2%80%9311_(EUR_billion)_YB14.png> (accessed 16 April 2014).

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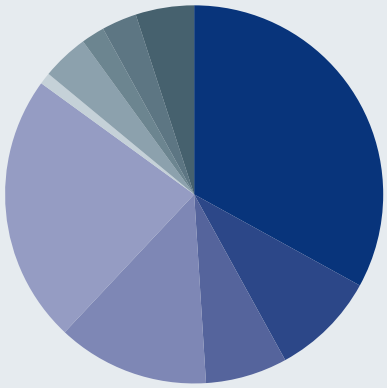
Fig. 1 **Location of EU outward FDI stock as of 2011**



- **North America** (of which the US accounts for 29%) 33%
- **Central America** 9%
- **South America** 7%
- **Asian Countries** 13%
- **Non-EU Europe** (including Russia) 23%
- **North Africa** 1%
- **Central and South Africa** 4%
- **Near and Middle East** 2%
- **Oceania and Polar Regions** 3%
- **Non-allocated stocks** 5%

Source: Eurostat, *Foreign Direct Investment Statistics*, via <http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Foreign_direct_investment_statistics> (accessed 10 March 2014).

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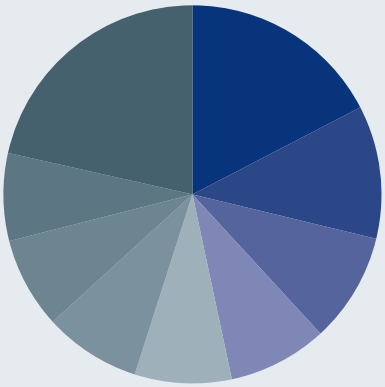
Fig. 3 **Inward direct investment position in the United States by top source countries** (year-end 2011)



- **United Kingdom** ..... 17.4% (US$ 442.2bn)
- **Japan** ..... 11.4% (US$ 289.5bn)
- **Netherlands** ..... 9.4% (US$ 289.3bn)
- **Germany** ..... 8.5% (US$ 215.9bn)
- **Switzerland** ..... 8.3% (US$ 211.7bn)
- **Canada** ..... 8.3% (US$ 210.9bn)
- **France** ..... 7.8% (US$ 198.7bn)
- **Luxembourg** ..... 7.5% (US$ 190.4bn)
- **Other** ..... 21.5% (US$ 547.7bn)

Source: Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, Bureau of Economic Analysis, July 2012, p. 25, <http://www.bea.gov/scb/pdf/2012/07%20July/0712_dip.pdf>.

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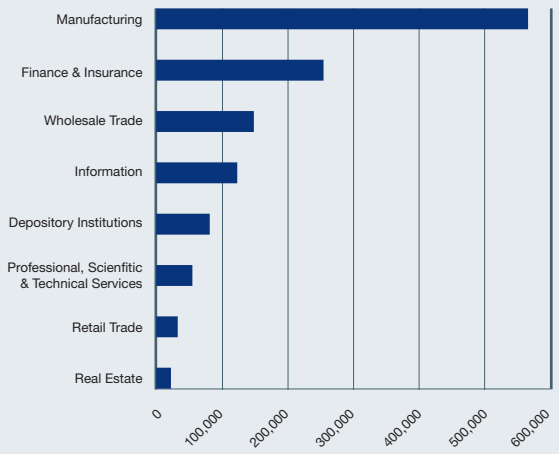
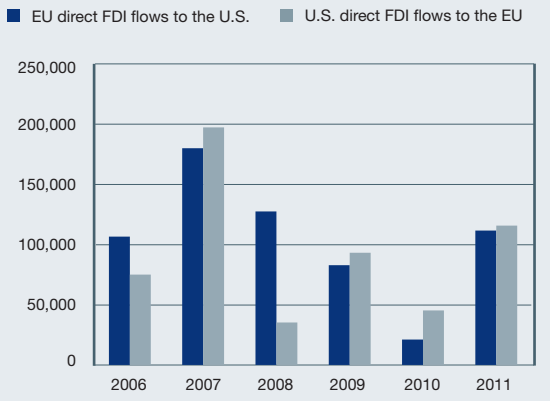
In 2011, the United Kingdom held the largest share of all U.S. inward stocks at US$ 442.2 billion, or 17.4 percent of inward stock. The other main European investors in the United States came from the Netherlands (9.4 percent) and Germany (8.5 percent). Investment coming from EU countries is mostly in manufacturing, finance/insurance, wholesale trade, and the information sector.[3] Figure 3 shows the breakdown of the main countries from which the United States receives its FDI.

Fig. 4 **EU investment in the United States by sector** (US$ millions, 2011)



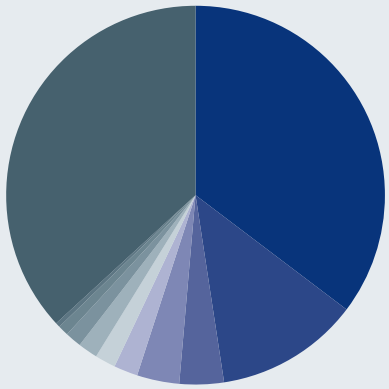
Source: Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, Bureau of Economic Analysis, p. 34.

Fig. 5 **FDI flows between the United States and the EU** (in € million)



Source: Eurostat, *International Trade and Foreign Direct Investment*, Eurostat Pocketbooks 2013 edition, pp. 84/87, <http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-FO-12-001/EN/KS-FO-12-001-EN.PDF>.

Fig. 6 **Inward direct investment position in the EU by top source countries** (€ billion, year-end 2011)



United States	1,344.30
Switzerland	467.3
Japan	144.2
Canada	137.6
Brazil	77.8
Singapore	67.3
Hong Kong	63.9
Russia	53.1
Australia	34.3
China	15
Other	1,402.00

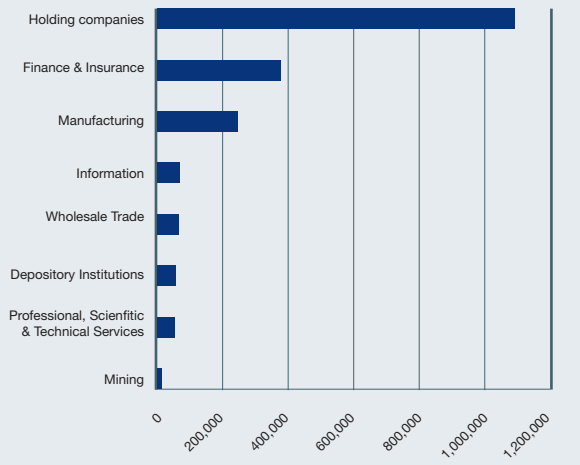
Source: Eurostat, *Top Ten Countries as Extra EU-27 Partners for FDI Positions* (accessed 22 May 2014).

U.S. Investment in the EU

Looking in the other direction, the United States is by far the most important investor in the EU. U.S. investment in the EU reached €1,344.3 billion in 2011, or 35 percent of EU foreign inward stocks. In second place, after the United States, Switzerland was the largest holder of EU inward stocks, with €467.3 billion or 18 percent of EU stocks as of 2011. Japan and Canada both came in next, holding roughly 4 percent of inward EU FDI stocks each (see figure 6).[4]

The United States has invested the most in the financial services and holding companies sector, followed by manufacturing (particularly in the manufacture of computer, electronic, and optical products).[5]

Fig. 7 **U.S. investment in the EU by sector** (US$ millions, 2011)



Source: Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, Bureau of Economic Analysis, p. 32.

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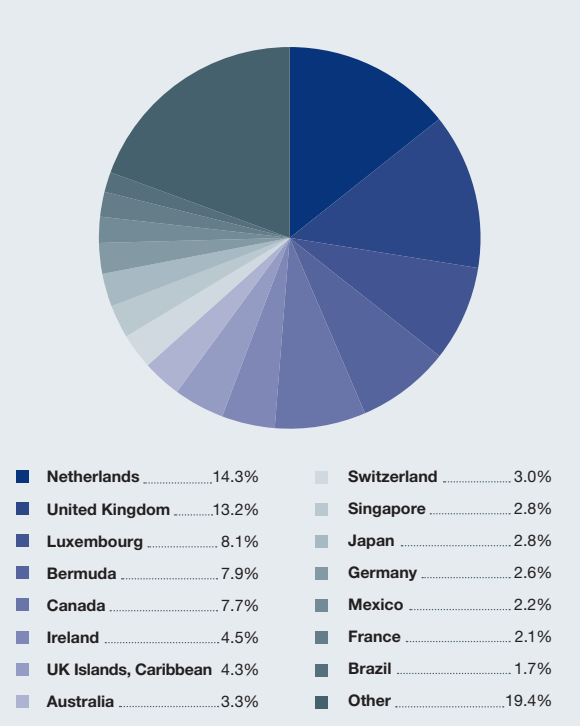
Fig. 8 **Figure 8: Location of outward U.S. direct investment abroad** (year-end 2011)



Source: Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, p. 21.

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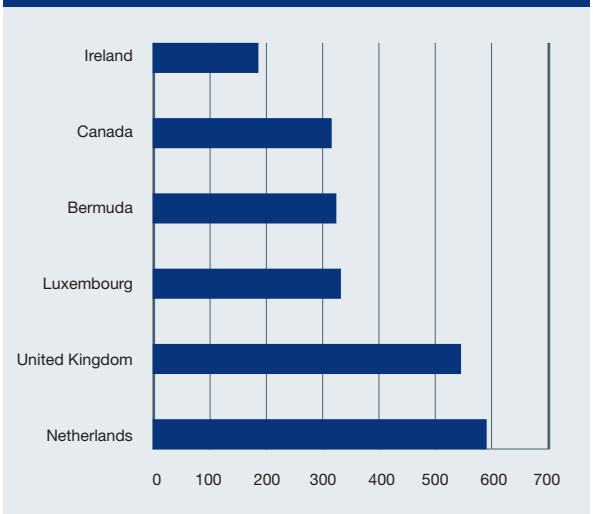
In terms of individual EU countries, as of 2011, the most important destinations for U.S. investment (measured in stocks) were the Netherlands, followed by the United Kingdom, as seen below in figure 8. Most of the investment in the Netherlands was in the form of holding companies, which also invest further into other countries.[6]

Looking specifically at Germany, where the U.S. had about US$ 106.9 billion in stocks in 2011, U.S. investment flowed mainly into manufacturing, followed by non-bank holding companies, then finance, and wholesale trade.[7]

Despite the swift increase in U.S. and EU investment in China over the past decade, the EU-U.S. investment relationship has proven its strength and resilience. China's inconsistent regulatory environment and market access restrictions serve to highlight the importance of the transatlantic investment relationship. Furthermore, although global multinationals are eager to serve consumers and harness lower labor costs in developing countries, global companies set up their headquarters in the EU and the United States. Both transatlantic partners are important locations for research and development, as well as production. For this reason, anchoring standards that reflect common transatlantic values should be a priority.

Fig. 9 **The top destinations for U.S. FDI** (US$ billion, year-end 2011)



Source: Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, p.32.

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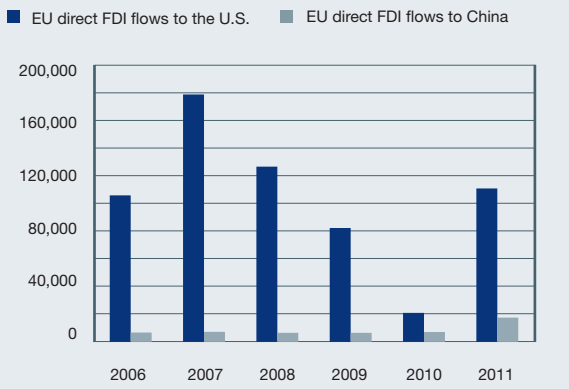
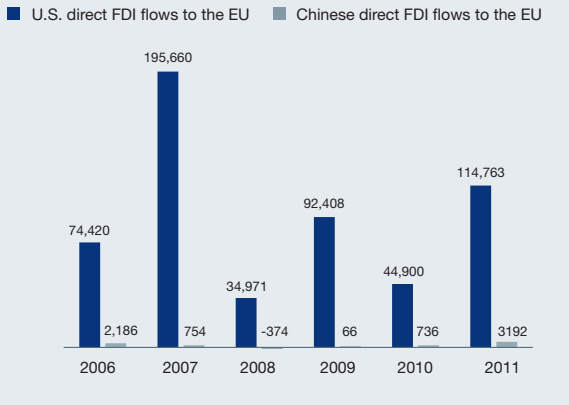
Fig. 10 **EU FDI flows to the United States and to China** (€ million)



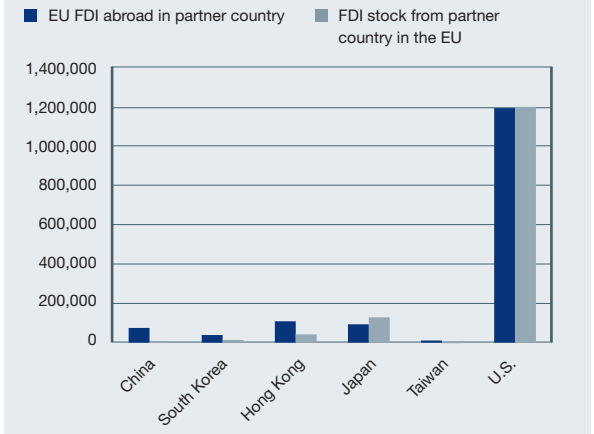
Source: Eurostat, *International Trade and Foreign Direct Investment*, pp. 84/85.

Fig. 11 **Chinese and U.S. FDI flows into the EU** (€ million)



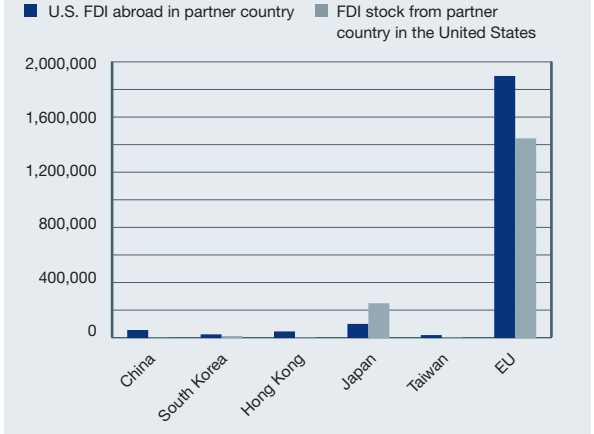
Source: Eurostat, *International Trade and Foreign Direct Investment*, pp. 87/88.

Fig. 12 **EU FDI stocks abroad in partner country; FDI stocks in the EU by partner country** (€ million, 2010)



Source: Eurostat, *International Trade and Foreign Direct Investment*, pp. 90-94.

Fig. 13 **U.S. FDI stocks abroad in partner country; FDI stocks in the United States by partner country** (US$ million, 2010)



Source: Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, pp.31/33.

[1] UNCTAD Stat, *Inward and Outward Foreign Direct Investment Stock*, via <http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx> (accessed 22 May 2014).
[2] Ibid.
[3] Office of the United States Trade Representative, *European Union*, <http://www.ustr.gov/countries-regions/europe-middle-east/europe/european-union> (accessed 12 March 2014).
[4] Eurostat, *Foreign Direct Investment Statistics* (accessed 10 March 2014).
[5] Eurostat, *Foreign Direct Investment Statistics* (accessed 10 March 2014).
[6] Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, p. 21.
[7] Bureau of Economic Analysis, charts for *"U.S. Direct Investment Abroad"*, via <http://www.bea.gov/international/di1usdbal.htm> (accessed 13 March 2014); Kevin B. Barefoot and Marilyn Ibarra-Caton, *Direct Investment Positions for 2011*, p. 32.

Barriers to Investment

Despite the strong economic connections between the EU and the United States, many barriers still exist in investment, preventing potential investors from realizing the full value of their businesses. The OECD classifies investment barriers into three different types: restrictions on foreign ownership of equity capital; mandatory screening and approval procedures which raise the cost of entrance; and operational restrictions, including nationality requirements for board members, discriminatory government regulations on inputs, and restrictions on the repatriation of profits. The United States has restrictions in nine sectors: Shipping, aircraft, mining, energy, lands, communications, banking, government contracting, and investment company regulation.[8] Most of these restrictions involve requirements that the purchaser or provider be under domestic ownership or operated by U.S. citizens. For example, under U.S. law, 75 percent of the voting interests of U.S. airlines must be held by U.S. citizens. Under EU law, non-EU investors are limited to a 49 percent share. Further aspects of U.S. investment restrictions are detailed in box 1.

Although the Treaty of Lisbon established FDI as an EU competency, the Treaty left some practical aspects undefined, allowing Member States to maintain their own restrictions on foreign investment. Areas where restrictions can be found include banking, insurance, property ownership, investment funds, maritime, air transport, and broadcasting, amongst others.[9] For example, Greece and Spain impose high limits on equity participation in airport operations. The purchase of land in Greece and Cyprus for non-EU citizens is often blocked. In Italy, an incentive scheme for solar energy production favors plants built using components made in the EU. Other countries, such as the Czech Republic and Ireland, limit the foreign equity participation in their transportation sectors.[10]

An overlooked but arguably the most important competitive advantage for both the EU and the United States in the global economy is the sale of services. However, due in part to slow liberalization of services under the WTO's General Agreement on Trade in Services (GATS), the portions of the services sectors in both the EU and the United States that remain protected (electricity, transportation, distribution, and business services, etc.) amount to 20 percent of transatlantic GDP.[11] Meanwhile, the sale of services by foreign affiliates out of both regions has exploded over the past decade. EU investors in the U.S. services industry make up a large portion of U.S. services exports. FDI thus can be seen as a catalyst for the liberalization of services trade.

In light of both the strength and importance of EU-U.S. investment flows, as well as the barriers to investment that both sides still face, a TTIP agreement that includes a strong investment chapter is the next step in helping both economies secure future growth. However, as the next section will explain, plans for an investment chapter in TTIP have come under harsh criticism in recent months.

Box 1 **Investment Restrictions in the United States at the Federal Level**

Shipping: In merchant shipping, vessels larger than 5 tons are only eligible for documentation if they are owned by a U.S. citizen or by a company or association with controlling interests held by U.S. citizens.

Aircraft: Aircraft is eligible for registration and operation in the United States if it is owned by a U.S. citizen or permanent resident, or by a corporation in which the president and two-thirds or more of the board of directors are U.S. citizens. 75 percent of the voting interests must also be in the hands of U.S. citizens. There are also restrictions on the insurance of aircraft.

Mining: Mineral deposits and deposits of coal, phosphate, sodium, potassium, oil, oil shale, and gilsonite may be explored and purchased by U.S. citizens and those intending to become U.S. citizens. Citizens of other countries may be allowed to take stock ownership in leases of land if their country's laws extend similar privileges to U.S. citizens.

Energy: Only U.S. citizens and domestic corporations can receive licenses to construct, operate, or maintain power facilities. Foreign citizens and corporations cannot purchase nuclear facilities.

Lands: While there are not many federal restrictions on land ownership for foreign citizens or corporations, U.S. citizenship is neces-

sary to make claims to disputed or unresolved lands and to obtain permits for grazing on public lands.

Communications: Licenses for radio stations cannot be granted to a foreign government or a representative of a foreign government. There are no restrictions on the investment in newspapers or magazines, although extra measures are often applied, such as registration with the Attorney General and, in some cases, labeling requirements.

Banking: Bank holding companies are restricted in their operations. The allowed operations include banking or managing or controlling banks and subsidiaries, limited non-banking activities, and activities that are financial in nature.

Government Contracting: The construction or repair of public buildings must be done with materials produced in the United States. In addition, foreign companies cannot merge with or acquire U.S. companies performing contracts for the Department of Defense or the Department of Energy that require a certain level of security clearance. If the company to be acquired was awarded a contract exceeding US$ 500 million in the previous fiscal year, the purchase or merger is prohibited. However, this measure can be waived by the Committee on Foreign Investment in the United States (CFIUS).

Investment Companies: The Securities and Exchange Commission (SEC) must approve the sale of securities by a foreign company. This approval is based on the feasibility to enforce federal securities law against the company, as well as a consideration of the public interest.

[8] Michael V. Seitzinger, *Foreign Investment in the United States: Major Federal Statutory Restrictions*, Congressional Research Service, June 13, 2013, <https://www.fas.org/sgp/crs/misc/RL33103.pdf>.

[9] Office of the United States Trade Representative, *2013 National Trade Estimate Report on Foreign Trade Barriers: European Union*, 2013, <http://www.ustr.gov/sites/default/files/European%20Union_0.pdf>.

[10] World Bank, *Investing Across Borders 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies*, Investment Climate Advisory Services of the World Bank Group, 2010, p. 14, <http://iab.worldbank.org/~/media/FPDKM/IAB/Documents/IAB-report.pdf>.

[11] Daniel S. Hamilton and Joseph P. Quinlan, *The Transatlantic Economy 2014, Annual Survey of Jobs, Trade and Investment between the United States and Europe*, vol. 1/2014, Center for Transatlantic Relations Johns Hopkins University, p. 4, <http://transatlantic.sais-jhu.edu/transatlantic-topics/transatlantic-economy-series.htm>.

[12] Ibid.

In light of both the strength and importance of EU-U.S. investment flows, as well as the barriers to investment that both sides still face, a TTIP agreement that includes a strong investment chapter is the next step in helping both economies secure future growth.

IIAs and ISDS under Scrutiny

IIAs (including ISDS) are important tools for investors to hedge the political risks of investing abroad. IIAs usually provide four central guarantees to investors. Firstly, and most importantly, they protect the investor against discrimination. According to national treatment (NT), an investor of the treaty partner may not be treated less favorably than a domestic investor. The principle of most favored nation (MFN) treatment stipulates that the host government may not discriminate between foreign investors from a treaty partner vis-à-vis an investor from a third country. Secondly, IIAs protect investors against expropriation, including indirect expropriation, without compensation. Expropriation – may it be for public purpose or otherwise – is not permissible without prompt, adequate, and effective compensation. As ISDS tribunal decisions show, however, not every government action constitutes indirect expropriation. Indeed, the bar for what qualifies as such has been set rather high. A diminution of the value of foreign-owned property is not sufficient proof that indirect expropriation took place. Rather, substantial interference with the investment must be demonstrated. In order to distinguish between public regulations which do not require compensation to an investor and those which need to be compensated, three criteria are usually applied by tribunals: the character of a measure; proportionality of the measure; and the degree of interference with the investment. Often, the reasonable investment-backed expectations of investors are also taken into consideration when determining whether indirect expropriation has taken place, noting that the investor expects legal and regulatory certainty and coherence.[13]

Thirdly, the principle of fair and equitable treatment protects investors from arbitrary and unfair treatment. Examples of unfair and non-equitable treatment include an investor being unable to access domestic courts, being put under political pressure, or the implementation of opaque and arbitrary government decisions. Over the last decades, the principle of fair and equitable treatment has grown in importance as ISDS tribunals become increasingly hesitant to rule on the matter of expropriation. Fourthly, IIAs guarantee the free transfer of capital.[14]

Most of the 3,196 IIAs worldwide (Germany has 131 active BITs) include ISDS to settle investment conflicts. ISDS allows a foreign investor access to an international tribunal in the event that his/her investment is (directly or indirectly) expropriated, if he/she is discriminated against, or treated unjustly and unfairly. In most cases, the IIA does not require that the investor takes the case to domestic courts first. ISDS tribunals have come to consider the right for a State to regulate when reaching decisions. However, newer BITs are more specific in their language, including passages to explicitly preserve governments' right to regulate. Tribunal decisions are binding and final. An appellate mechanism similar to that of the WTO dispute settlement body does not yet exist.

It was already in 2012 that EU Trade Commissioner Karel De Gucht and now-U.S. Trade Representative Michael Froman agreed on a list of shared principles in international investment between the EU and the United States. The list of principles included: The maintenance of an open, non-discriminatory investment climate; competitive neutrality between private and state-owned entities; legal certainty and strong protection for investors and investments; a dispute settlement process that includes ISDS; strong rules on transparency and public participation in the development of regulations for investment; responsible business conduct for multinational enterprises; and a narrowly-defined review process for investments that might be a risk to national security.[15]

Civil society and non-governmental organizations in Germany in particular, ranging from consumer protection groups to environmental NGOs and labor unions, have increasingly voiced concerns about IIAs and ISDS. The reasons cited are highly varied, ranging from general opposition to FDI and globalization, to precise concerns about the consequences of ISDS for a State's ability to regulate for the public good.

Firstly, some groups on both sides of the Atlantic are opposed to FDI and the spread of global multinational enterprises across the globe. Global organizations like the Association for the Taxation of Financial Transactions and Aid to Citizens (ATTAC) argue for an alternative to what they view as a focus on consumerism and productivity for securing economic development. Other organizations see FDI by big companies as being generally harmful to sustainable development.

Secondly, ISDS is also seen as a tool that gives special rights to foreign companies over domestic companies. In a collaborative paper by the Heinrich Böll Foundation and research organization Ecologic Institute, the authors point to the option of an investment treaty

without ISDS. Australia's government has recently decided not to incorporate ISDS into its IIAs with advanced countries, with the intention of avoiding giving foreign investors the option of an extra forum for arbitration, when domestic investors do not have this option.[16]

Another argument is that the EU Member States and the United States already have sufficient rule of law and functioning court systems, and thus ISDS is not needed. A paper by the Corporate Europe Observatory pointed to the large amount of FDI between the United States and the EU as a sign that investors are already comfortable enough with the legal systems on both sides of the Atlantic, and ISDS is thus not needed. The American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) in the United States makes a similar argument.[17]

Pointing to an alleged U.S. claim culture, other critics are worried that TTIP will unleash a flood of claims by U.S. investors against the EU and its Member States in response to regulations intended for public purposes. This fear has been fueled in particular by one of the two[18] historical cases brought against Germany by Vattenfall, an energy company and investor in nuclear power plants that is wholly-owned by the government of Sweden. Vattenfall initiated an ISDS case against Germany at the International Centre for Settlement of Investment Disputes (ICSID) in 2012, claiming billions of euros in response to the forced shutdown of Germany's oldest nuclear power plants. Vattenfall owned two of the oldest nuclear power stations in Germany, which were decommissioned immediately when legislation passed in 2011 that amended the country's nuclear power regulations. While the case is still pending, critics of ISDS are concerned that such cases lead to high payments to investors and lawyers with tax payers' money, and could cause States to hesitate implementing regulations for the public good in the first place.

The case filed by tobacco company Philip Morris against Uruguay is another cause for consternation among critics of ISDS. After Uruguay passed regulations for the design of cigarette packaging, the company initiated ISDS proceedings on the basis of the BIT between Uruguay and Switzerland, where Philip Morris is currently headquartered. Philip Morris Asia brought a similar claim against Australia through the Australia-Hong Kong BIT, under United Nations Commission on International Trade Law (UNCITRAL) rules. A decision is pending on both cases.

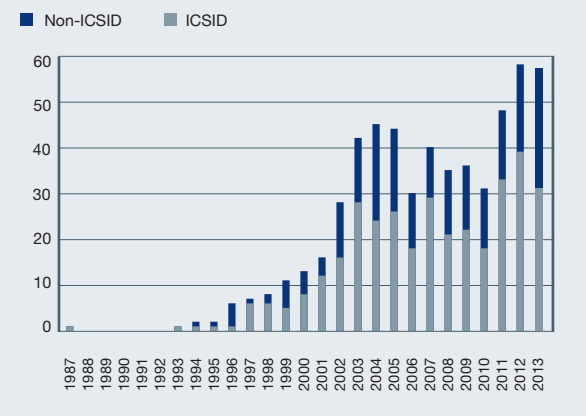
The Philip Morris cases lead critics to warn against both regulatory chill as well as regulatory freeze. In the case of the former, States will not enact regulation for fear of a possible ISDS case (anticipatory regulatory chill) or in reaction to a concrete ISDS case (reactionary regulatory chill). In the case of regulatory freeze, States would not implement any new regulation regarding matters over which they have previously lost an ISDS case.

Also worrisome to critics has been the rapid increase in the number of ISDS cases within the last decade, as viewed in figure 14.[19] Given the magnitude of transatlantic investment flows, some observers are expecting a high number of investment disputes to emerge. The law professor Markus Krajewski, for example, made the following calculations: U.S. investment in Canada totaled approximately US$ 351 billion in 2012. On average, an annual one to two U.S. investors have brought a case against Canada on the basis of the investment protection chapter in the North American Free Trade Agreement (NAFTA). U.S. investment in the EU totaled approximately US$ 3.7 trillion in 2011, i.e. about ten times as much as U.S. investment in Canada.[20] Accordingly, Krajewski expects that U.S. investors will initiate an average 10 to 20 cases against the EU or EU Member States annually.[21]

Many groups therefore reject ISDS in its entirety. The Green Party, both in the German Bundestag as well as in the European Parliament, for example, has announced that it would vote down a TTIP agreement that includes ISDS. Others, including the German government, support IIAs and ISDS in general but argue that ISDS is not necessary in TTIP given the high quality of the legal systems of both transatlantic partners.

The arguments brought forward and the fears voiced are not new. They appeared during the early years of NAFTA – often from exactly the same individuals and with identical wording. The criticism, however, fails to acknowledge two important developments.

Fig. 14 **Number of all ISDS cases since 1987, separated between ICSID and non-ICSID cases**



Source: UNCTAD *Database of Treaty-Based Investor-State Dispute Settlement Cases* (Pending and Concluded), via <http://iiadbcases.unctad.org/> (accessed 28 February 2014); UNCTAD, *Recent Developments in Investor-State Dispute Settlement* (ISDS), April 2014, p. 4, <http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf>.

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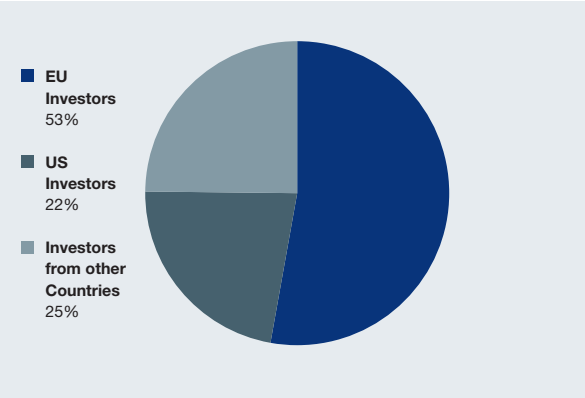
One, international investment law has since evolved. A host country's right to regulate – the main bone of contention – has been recognized by numerous tribunals and has been incorporated in many investment protection agreements.

Two, there is no evidence of the anticipated regulatory chill. Neither the United States nor Canada have refrained from passing legislation aimed at pursing legitimate public policy objectives. The United States' Toxic Substances Control Act (TSCA), a law administered by the Environmental Protection Agency to regulate the market entrance of new commercial chemicals, has never been the source of an ISDS claim, for example. The same goes for the EU and its chemical regulation REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals) that protects human health and the environment from risks posed by chemicals. It shows that the EU is not afraid to pass far-reaching legislation despite the possibility of ISDS cases.

In addition, and even more importantly, TTIP is unlikely to unleash a flood of investment disputes. Notably it is European investors who make the most use of the ISDS mechanism. Added up together, the number of ISDS cases initiated by EU investors is 300, far surpassing the 127 brought to date by U.S. investors.[22]

Fig. 15 **Percentage of ISDS cases initiated by investors from the EU, the United States, and other countries** (all cases up through 2013) [23]



Source: UNCTAD, *Investor-State Dispute Settlement: An Information Note on the United States and the European Union*, June 2014, p. 8, <http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d4_en.pdf>.

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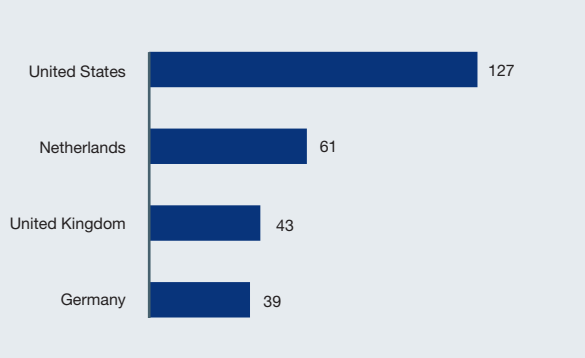
Fig. 16 **Number of ISDS cases initiated by the top four countries through 2013** [24]



Source: UNCTAD, *Investor-State Dispute Settlement: An Information Note on the United States and the European Union*, p.8; UNCTAD, World Investment Report 2014, June 2014, p. 125, <http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf>.

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While there is a global trend upward in ISDS cases, it is quite in line with growing global FDI, which is increasingly going to developing countries and economies in transition. An increase in ISDS cases proportional to the rise in FDI is thus to be expected.[25]

However, it is worth noting that in contrast to the global trend of an increasing number of ISDS cases, the number of cases under NAFTA has not risen from year to year. Rather, claims filed against the United States, Canada, or Mexico fluctuate during any given year from one to nine, as an empirical study conducted

by Tietje and Baetens (2014) shows. Cases brought by U.S. investors also do not show an upward trend from year to year. The success rate of investors under NAFTA against the State is also not higher than on the global scale. Quite the contrary, investors have only won in 25 percent of the cases while the State prevailed in 62.5 percent of the cases (12.5 percent were settled). Globally, investors have, according to the United Nations Conference on Trade and Development (UNCTAD), won 31 percent of the claims while the State prevailed in 43 percent of the 274 ISDS cases concluded between 1993 and 2013.[26]

EU Member States have seen 117 ISDS cases initiated against them, with the Czech Republic being the most frequent respondent. The majority, or 88 ISDS cases, has been initiated by a fellow EU Member State, through the Energy Charter Treaty or a BIT. Furthermore, the IIAs that the United States already has signed with EU Member States have not resulted in a large number of ISDS cases by U.S. investors. U.S. investors have initiated 9 ISDS cases against EU Member States. The respondents in these cases were Poland (4 cases), Romania (3 cases), the Czech Republic (1 case), and Estonia (1 case).[27] While many cases are pending or unknown, the Czech Republic, Estonia, and Romania have each won cases brought against them by a U.S. investor.[28] A U.S. investor has never filed an ISDS case against Bulgaria, Croatia, Slovakia, Latvia, or Lithuania, although it has IIAs with these countries which specify the ability of an investor to bring disputes to an international court.[29]

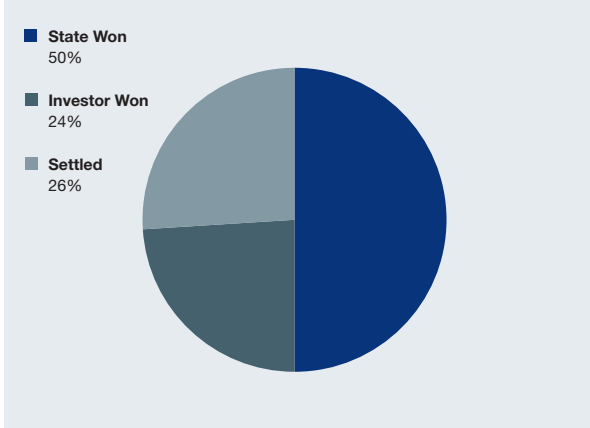
Box 2 **Which EU Countries Already Have an IIA with the United States?**

Poland	signed in 1990
Czech Republic	signed in 1991
Slovakia	signed in 1991
Romania	signed in 1992
Estonia	signed in 1994
Bulgaria	signed in 1992
Latvia	signed in 1995
Croatia	signed in 1996
Lithuania	signed in 1998

Source: U.S. Department of State

Not only is a flood of claims against the EU by U.S. investors unlikely, but fears of a regulatory chill or freeze are also exaggerated. The BITs between the abovementioned countries and the United States show that investment protection and ISDS do not necessarily induce regulatory freeze, as each EU country implemented far-reaching reforms during their accession process to the European Union. Cases under NAFTA also show similar results. Tietje and Baetens (2014), acknowledging that regulatory chill or freeze is difficult to prove empirically, do not find any conclusive evidence that States halted, curtailed, or rolled back environmental regulations or regulations with regard to the environment or natural resources under NAFTA in anticipation of possible ISDS cases or in reaction to a concrete threat of an ISDS case. Analyzing twelve cases under NAFTA and the Central American Free Trade Agreement (CAFTA), they find that cases which succeeded in ISDS arbitration did not directly challenge any government's authority or ability to regulate in the public interest. Rather, the cases involved contractual, tax, or export control issues. In cases in which an investor directly challenged a State's regulation, the investor has not won. Lastly, the two authors do not find evidence that a government has changed its position towards a regulation out of fear of a possible ISDS case.[30]

Fig. 17 **Results of ISDS cases initiated against an EU Member State** (all cases through 2013)



Source: UNCTAD, *Investor-State Dispute Settlement: An Information Note on the United States and the European Union*, p. 7.

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Box 3 U.S. Investors Challenge EU Member States

In 2001, *Noble Ventures*, a U.S. company specializing in consulting services specific to the steel industry, brought an ISDS claim against Romania under ICSID rules. Noble Ventures had bought Resita Steel Works in 2000 for US$ 4 million, and took on the plant's debt, relying on a debt rescheduling plan agreed upon in the contract. The debt rescheduling plan was halted by the new government after elections, and Noble Ventures was unable to operate the steel plant as planned. The government terminated the purchase in 2002, basing its action on a clause in the privatization contract that it could be cancelled if the investor was not able to make two installments in a row. The tribunal decided in favor of Romania, and dismissed Noble Venture's claims in 2005.

U.S. investor *Alex Genin* brought a case against Estonia to the ICSID in 1999. Genin was the owner of Eastern Credit Limited, Inc., which owned A.S. Baltoil, a principle shareholder of the Estonian Innovation Bank (EIB). Problems arose after EIB had invested in an insolvent local Estonian bank, which had discrepancies on its balance sheet that before had not been known. EIB sought to recover compensation from the Bank of Estonia, which is Estonia's central bank. After a series of investigations in which the Bank of Estonia began conducting background investigations on the shareholders of EIB, including Mr. Genin, the Bank of Estonia revoked EIB's banking license. The tribunal decided that Estonia did not violate the BIT during the sale of the insolvent bank or by revoking EIB's banking license.

[13] Christian Tietje and Freya Baetens, *The Impact of Investor-State-Dispute Settlement in the Transatlantic Trade and Investment Partnership*, Study prepared for the Minister of Foreign Trade and Development Cooperation, Ministry of Foreign Affairs, The Netherlands, Ecorys, Rotterdam 2014, p. 49.

[14] Lauge N. Skovgaard Poulsen, Jonathan Bonnitcha and Jason Webb Yackee, *Costs and Benefits of an EU-US Investment Protection Treaty*, LSE Enterprise 2013; Christiane Gerstetter and Nils Meyer-Ohlendorf, *Investor-State Dispute Settlement under TTIP - a Risk for Environmental Regulation?*, Heinrich-Böll-Stiftung, Berlin 2014.

[15] European Commission, "EU and US Adopt Blueprint for Open and Stable Investment Climates", April 10, 2012, <http://trade.ec.europa.eu/doclib/press/index.cfm?id=796>, (accessed 27 July 2014).

[16] Christiane Gerstetter and Nils Meyer-Ohlendorf, *Investor-State Dispute Settlement under TTIP – A Risk for Environmental Regulation?*, Heinrich Boell Stiftung and EcoLogic, December 31, 2012, p. 21.

[17] Corporate Europe Observatory, *A Transatlantic Corporate Bill of Rights*, October 2013, p. 6, <http://corporateeurope.org/sites/default/files/attachments/transatlantic-corporate-bill-of-rights-oct13.pdf>.

[18] According to the UNCTAD database, there are three cases. The third, from an Ashok Sancheti, was terminated for reasons unknown before reaching arbitration.

[19] For an analysis of current ISDS trends see: Stormy-Annika Mildner, Christoph Sprich, *Protecting European Investment abroad: A Roadmap for Improved International Investment Agreements*, BDI Position Paper, 2014.

[20] This paper uses Eurostat figures for FDI in 2011, while Krajewski cited a figure from the United States Trade Representative website and thus quotes a different figure.

[21] Markus Krajewski, *Zu Investitionsschutz und Investor-Staat-Streitbeilegung im Transatlantischen Handels- und Investitionspartnerschaftsabkommen (TTIP)*, Gutachten im Auftrag der Bundestagsfraktion Bündnis 90/Die Grünen, 2014.

[22] UNCTAD, Investor-State Dispute Settlement: *An Information Note on the United States and the European Union*, June 2014, p. 8, <http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d4_en.pdf>.

[23] Figures have been updated since the BDI's March 2014 position paper, *Protecting European Investment Abroad*, to reflect the most recent official UNCTAD statistics.

[24] Figures have been updated since the BDI's March 2014 position paper, *Protecting European Investment Abroad*, to reflect the most recent official UNCTAD statistics.

[25] Roderick Abbott, Fredrik Erixon and Martina Francesca Ferracane, *Demystifying Investor-State Dispute Settlement*, ECIPE Occasional Paper, No 5/2014, pp.7/8, <http://www.ecipe.org/media/publication_pdfs/OCC52014__1.pdf>.

[26] Christian Tietje and Freya Baetens, *The Impact of Investor-State-Dispute Settlement in the Transatlantic Trade and Investment Partnership*, p. 77.

[27] UNCTAD, Investor-State Dispute Settlement: *An Information Note on the United States and the European Union*, p. 9.

[28] UNCTAD Database of Treaty-Based Investor-State Dispute Settlement Cases (Pending and Concluded) (accessed 4 March 2014).

[29] UNCTAD Database of Treaty-Based Investor-State Dispute Settlement Cases (Pending and Concluded) (accessed 4 March 2014). The texts of the BITs are found online, except for the text for the Lithuania-U.S. BIT, which could not be found online.

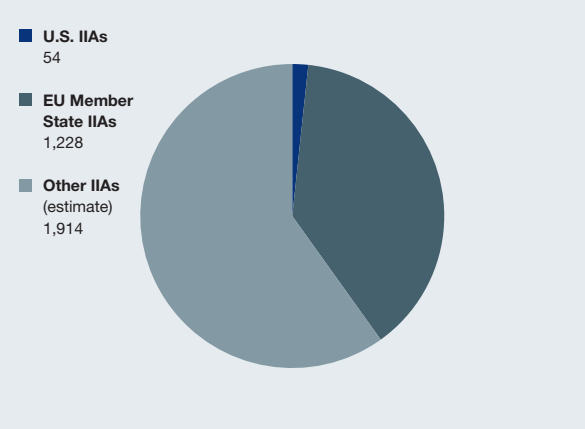
[30] Christian Tietje and Freya Baetens, *The Impact of Investor-State-Dispute Settlement in the Trans-atlantic Trade and Investment Partnership*, p. 75-91, 92.

Bilateral Investment Treaties and International Investment Agreements: EU vs. U.S. Models

EU Member States have 1,228 extra-EU BITs and 198 intra-EU BITs currently in force, bringing the total number of active IIAs to 1,426.[31] With the signing of the Lisbon Treaty of 2009, however, the competency for regulating international investment moved from the Member States to the EU level. While the Commission has not yet signed an IIA with another State, the negotiations for the Canada-EU Comprehensive Economic and Trade Agreement (CETA) are completed and include an investment chapter. In addition to discussions with the United States, the Commission is currently negotiating agreements which include investment protection with India and Singapore. Furthermore, the EU is negotiating a BIT with China. So far, three negotiation rounds have taken place (as of July 2014).

There is currently no model for an EU IIA. Nevertheless, the EU Commission has provided discussion papers detailing the priorities of an EU IIA, which have been included in CETA. In response to public concern about an investment chapter in TTIP, in late March 2014 the Commission also made parts of the investment chapter of CETA public for review. The areas targeted for reform according to the consultation are outlined in box 4. The reforms focus on protecting the State's right to regulate for the public good and reforming the ISDS process.

Fig. 18 **Total number of active IIAs of the EU** (extra-EU only)**, the U.S., and other countries**



Source: UNCTAD, *Investor-State Dispute Settlement: An I nformation Note on the United States and the European Union*, p.3.

The United States has 54 active IIAs, the majority of which are BITs (40 active). The remaining are FTAs with investment provisions.[32] The United States negotiates IIAs based on its 2012 model BIT. The U.S. model BIT has undergone several reforms, including in 2004, after heavy use of the ISDS under NAFTA demonstrated that the scope of investment protection was too broadly defined. The 2004 version narrowed both the definition of investment that would be covered, as well as the minimum standard of treatment. It also defined in greater detail the provisions for using ISDS, added rules for greater transparency of laws and case proceedings, and introduced environmental and labor standards into its preamble.[33]

Box 4 **The EU Approach and Objectives in Reforming Investment Protection in CETA and TTIP**

1. Limit the scope of investment protection through reformed definitions of "investor", "investment", and "covered investments".
2. Preserve the right to regulate in a non-discriminatory way, and prevent the importation of ISDS using most-favored nation clauses.
3. A more precise definition of fair and equitable treatment, and the protection of only an investor's "legitimate expectations."
4. More precise definitions of expropriation and indirect expropriation.
5. Transparency provisions for ISDS, following UNCITRAL rules.
6. Limit multiple claims and provide incentives to use domestic courts in investment disputes.
7. Improve arbitrator ethics, conduct, and qualifications.
8. Reduce frivolous claims and claims without legal merit.
9. Include procedures to address ISDS claims relating to prudential measures adopted by a State.
10. Allow parties to the treaty to give guidance in the event that there is confusion in the interpretation of the treaty.
11. Introduce the option for the parties to establish an appellate mechanism.

Source: European Commission

On April 20, 2012, Washington unveiled the 2012 model U.S. BIT. This newest version modified rules for dealings with state-owned companies, expanded possibilities for U.S. businesses to "participate in the development of standards and technical regulations" in the host country, and included new standards for transparency in governance. Tighter prohibitions of performance requirements were implemented to prevent a host country from placing particular requirements on foreign investors (for example access to particular technology). The 2012 model BIT also defines new labor and environmental standards, for example prohibiting States from suspending environmental and labor laws to attract foreign investors.

There are both similarities and differences between the approach taken by the United States in its model BIT and the general patterns in EU Member States' BITs. BITs of EU Member States have tended to be less detailed, while the current U.S. approach includes more detail attempting to preserve government policy space.

The next section highlights key aspects of the U.S. model BIT, the German 2008 model BIT, and parts of the CETA text that have been published in a consultation document by the EU Commission. Some information that can be found in leaked CETA texts is also included.

[31] UNCTAD, *Investor-State Dispute Settlement: An Information Note on the United States and the European Union*, p. 3.
[32] UNCTAD, I*nvestor-State Dispute Settlement: An Information Note on the United States and the European Union*, p. 3.
[33] Shayerah Ilias Akhtar and Martin A. Weiss, *U.S. International Investment Agreements: Issues for Congress, Congressional Research Service*, April 29, 2013, pp. 9-10, <http://fas.org/sgp/crs/row/R43052.pdf>.

Comparing the German 2008 Model BIT, the U.S. 2012 Model BIT, and the CETA Text

Preamble

A preamble sets the tone for an IIA. It can help guide the arbitrators in an ISDS tribunal in cases where there is uncertainty. In the German model BIT, the preamble is succinct, highlighting the importance of favorable conditions for investors and economic cooperation. In the U.S. model, these aspects are also mentioned, in addition to an emphasis on a stable investment framework, the "means of asserting claims and enforcing rights with respect to investment", and the protection of health, safety, and the environment. The CETA preamble goes further to underscore the State's right to regulate, as well as multilateral obligations. It mentions a commitment to sustainable development, the right of a State to pursue legitimate public policy goals, the importance of environmental and labor protection, the OECD guidelines for multinational enterprises, and WTO obligations.

Definition of Investment

The German BIT, the U.S. model, and CETA all use a broad, asset-based definition of 'investment', covering investments directly or indirectly controlled by the investor. This includes portfolio investments as well. In CETA, claims to money solely for the commercial contract of the sale of goods are excluded. The U.S. model takes a slightly weaker approach with regard to portfolio investment, stating they are "less likely to have" the characteristics of an investment.

Furthermore, the CETA text limits covered investments to investments that have already received the appropriate approvals and are made in accordance with the law of the host country. This limits coverage to investments beyond the initial planning stage, meaning an investor must already have the appropriate permits or meet other initial requirements under national law. Neither the U.S. nor the German model includes this limitation on defining the investments that are covered.

Definition of Investor

The U.S. model and CETA text define an investor as a person or an enterprise who "attempts to make" or "seeks to make", is making, or has made an investment in the territory of the other party. That CETA includes "seeks to make" indicates that investors trying to make an investment are also covered by the treaty. This signals that coverage under the agreement extends to investments that are in the pre-establishment stage. The German model, on the other hand, does not reference an investor as someone who is seeking or attempting to invest, but rather just a natural person or enterprise established in the country of the other party.

The CETA text furthermore includes exceptions to what counts as an investor, in an attempt to block the applications of the treaty to "shell" or "mailbox" companies. The text explains that the company must have "substantial business activities", and cannot be simply a representative office of an enterprise. Neither the U.S. nor the German model stipulates such exclusions to their definition of investor.

Definition of Expropriation and Indirect Expropriation

The U.S. model BIT grounds its definition of direct and indirect expropriation in customary international law. The U.S. model then goes on to detail that the protection against expropriation does not apply when the measure by a State is taken for the public purpose, in a non-discriminatory manner, under payment of compensation, and in accordance with due process of law and minimum standard of treatment. Compulsory licenses granted in relation to intellectual property rights in accordance with the WTO's Agreement on Trade-Related Intellectual Property Rights (TRIPS) are excluded from coverage. Indirect expropriation is to require a fact-based inquiry that considers (in an open list) the economic impact of the government action, the extent to which a government measure interferes with an investor's "reasonable investment-backed expectations" for his or her investment, and the character of the government action. It provides for the assumption that non-discriminatory regulatory actions by a party that are designed and applied to protect legitimate public policy objectives do not constitute indirect expropriation. These objectives might include measures to protect public health, for public safety, and for the environment.

The CETA text has a similar definition of expropriation and the same list for what does not count as expropriation (including the exclusion of intellectual property rights under TRIPS). Defining indirect expropriation, CETA takes a similar approach with the same open list (considering the economic impact of the measure, the extent a government action interferes with reasonable, investment-backed expectations, and the character of the action). However, CETA also adds the additional requirement that the "duration of the measure" be considered when determining whether a measure qualifies as indirect expropriation.

Furthermore, non-discriminatory regulatory actions to protect legitimate public welfare do not count as indirect expropriation. An important distinction is that CETA does not mention customary international law as a guideline for defining these terms.

Both the U.S. and the CETA texts also detail how to calculate the amount of compensation required in the event of expropriation, taking into account the fair market value of the investment including interest. Both texts represent a large divergence from the German model, which, while it prohibits direct and indirect expropriation, does not define these terms.

Definition of Fair and Equitable Treatment

Many ISDS cases are initiated through claims citing a breach of fair and equitable treatment. Like expropriation, the U.S. model also grounds its definition of fair and equitable treatment in customary international law from the outset. It goes on to state that this "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."

The CETA text, on the other hand, includes a closed list of actions that can be defined as in breach of fair and equitable treatment. These include the denial of justice in criminal, civil, or administrative proceedings, denying due process, manifest arbitrariness, targeted discrimination, and abusive treatment such as coercion, duress, and harassment. The parties to the treaty can agree to expand the list at a later date. CETA also states that only the "legitimate expectations" of the investor can be guaranteed under this clause, thus leaving the tribunal to interpret whether a State had made a specific representation to the investor that it later violated. The German model, while including the guarantee of fair and equitable treatment for an investment, does not define this term.

Most-Favored Nation

Most-Favored Nation (MFN) clauses guarantee that an investor of a contracting party cannot be treated less favorably than or be restricted from any advantages given to an investor from a third party. The U.S. model keeps this clause simple, while making the exception for government procurement, subsidies, and grants. The German model makes exceptions for public security, partners in an economic or customs union, situations where double taxation is to be avoided, tax exemptions for investors resident in the country, and ease of entry and work permits.

CETA, while including exemptions for parties that are part of a customs union and double taxation, includes a clause aimed at preventing "treaty shopping" for ISDS. Thus, investors may not use MFN to claim access to ISDS provisions under a treaty to which their home country is not party. However, access to substantive provisions in other treaties is not curtailed. There are also exceptions that allow the parties to take measures protecting health, the environment, and consumers. Lastly, CETA refers to GATS Article XIV (as applies to services, telecommunication, etc.) and GATT Article XX as the frameworks for exceptions for the protection of human, animal, or plant life or health and natural resources.

National Treatment

Each of the three agreements include wording that guarantees that investments in the territory of each State will be accorded the same treatment, regardless if they are undertaken by domestic or foreign investors. Both the CETA text and the U.S. model include that the treatment of the foreign investor should be compared to other "like situations" or "like circumstances" of domestic investors. Both also make the following exclusions: Obligations under TRIPS, government procurement, subsidies and grants, formal requirements for information, and non-conforming measures. CETA makes extra exceptions, listing in addition exceptions in accordance with GATT Article XX and GATS Article XIV. These apply in particular to exceptions for environmental measures to protect human, animal, or plant life or health and the conservation of natural resources. CETA also reserves the right to take prudential measures in the financial services area under this article.

The German model also guarantees national treatment, with different exceptions than CETA and the U.S. model. These exceptions include: Measures taken for public security, partners in a customs union or economic union, measures to avoid double taxation, extension of tax exemptions that are only for investors resident in the territory, and the ease of entry and work permits.

Umbrella Clause

Many European BITs contain umbrella clauses, meaning that any contractual promise a State makes to an investor is also protected under the IIA. The German model is no exception, and includes this clause. The U.S. model extends protection to contractual agreements in different articles throughout the text but does not feature a stand-alone umbrella clause. The CETA text does not include any form of an umbrella clause.

Right to Regulate

Addressing the right to regulate is a recent development that has not turned up in many BITs of EU Member States. In the German model, the only references are the above mentioned exceptions for MFN and National Treatment. In the U.S. model, several exceptions are carved out of different articles that preserve the State's policy space. These include articles focusing on the environment, labor, transfers, performance requirements, non-conforming measures, and essential security. There are also safeguard clauses for measures taken in response to a financial crisis. The aforementioned definition of indirect expropriation excludes measures taken to protect public health, environment, and safety. Furthermore, the preamble also lays out the protection of health, safety, and the environment.

Looking at CETA, the preamble strongly sets the tone for a State's right to regulate (see above discussion of the preamble). There are also carve-outs for MFN treatment and National Treatment (as mentioned above), the audiovisual sector, the financial services sector (and prudential exceptions), and in the definitions of expropriation and fair and equitable treatment. Furthermore, the leaked CETA texts indicate exceptions to market access for purposes such as public zoning and conserving natural resources. Canada commented in the leaked document that performance requirements in order to meet health, safety, and environmental goals should be allowed.

Market Access and Performance Requirements

Market access based on performance requirements is handled similarly in the CETA text and the U.S. model. A party cannot condition market access or the continuance of an operation on certain requirements. These include, for example, requirements for export levels, domestic content provisions, preferences for goods or services produced or delivered in the territory of the investment, the value of imports as compared to foreign exchange flows, the transfer of technology, etc. However, under both agreements, the State reserves the right to enforce compliance with requirements to locate production, provide a service, train or employ workers, construct or expand facilities, or carry out research and development. Government procurement is excluded from the articles addressing performance requirements.

In CETA, the following measures restricting market access are acceptable: measures intended for zoning and land use, for fair competition in the fields of energy, transportation, and telecommunication, for restricting ownership to ensure fair competition, for conserving and protecting natural resources, for limiting authorizations under technical or physical constraints (such as in telecommunications), and for requiring that a certain percentage of workers in an enterprise have a specific educational background or profession.

Both the U.S. model and CETA text reserve the ability to restrict market access in procurement, subsidies, and government grants. CETA goes further to exclude the audiovisual sector.

General Transparency

The U.S. model BIT includes a section covering general transparency, outlining the way that parties to the treaty are to announce the proposal of new regulations and be involved in standard-setting. This is not addressed in the German model BIT. In the consultation texts for CETA, there are also no stipulations for general transparency.

Transparency in ISDS

While the text of the German model BIT has no requirements for the transparency of ISDS proceedings, the U.S. model BIT has been reformed to include several provisions to improve the transparency of ISDS procedures. These include requiring that certain documents related to proceedings are public, the tribunal can accept submissions from parties that are not involved in the dispute, and the hearings are made public. However, there is also a safeguard provision included to allow parties to keep sensitive documents and information from being open to the public. The CETA consultation text bases transparency procedures for ISDS cases on the new transparency rules of UNCITRAL, which call for similar transparency procedures. Like the U.S. model, these include public accessibility to documents, public hearings, and the

ability of non-parties to file submissions to the ISDS procedures. Like the U.S. model, there is also a provision to allow the tribunal to protect confidential information.

Relationship between Domestic Courts and ISDS

The U.S. model BIT, the German model, and CETA include no provisions that domestic courts must be exhausted before an investor turns to an international tribunal. The CETA model, however, goes further to regulate where and when investors can file their ISDS claims. The investor is prohibited from bringing a case to a domestic court and an international tribunal at the same time. The investor must first show proof that the case was concluded or the investor withdrew the claim before proceeding to an ISDS tribunal. If a claim is brought under another international agreement and under CETA at the same time, these two courts must communicate to avoid conflicting decisions. There is also a "fork in the road" provision that once an investor has brought a case to an international tribunal, he or she can no longer revert to domestic courts. However, there is an exception for when the "State has deprived an investor of control of the locally established enterprise, or has otherwise prevented the locally established enterprise from fulfilling the requirements." Lastly, recourse to mediation is possible at any time.

The U.S. model and the CETA text specify similar time frames for ISDS procedures. In the U.S. model, the investor must wait 180 days after the event (for example, the expropriation) before submitting a claim to arbitration. There must be 90 days in between when a claimant has notified the respondent of its intent to submit the claim to arbitration, and when the claim is submitted. In CETA, the investor must wait 180 days after the submission of a request for consultations before he or she can submit a claim, and 90 days after the submission of a notice to the respondent.

Selection of Arbitrators

Neither the U.S. nor the German model BIT set out regulations for arbitrators. However, the U.S. text specifies that the Secretary General of ICSID will step in and appoint tribunal members if the two parties have not established the tribunal within 75 days of the date the claim is submitted.

The CETA consultation text, however, introduces several reforms to address the concerns that have arisen in the quality and impartiality of the arbitrators selected for ISDS tribunals. First, a Committee on Services and Investment is to be established between the parties, which will introduce a code of conduct to set standards for the independence and impartiality of arbitrators. A list of individuals who meet the qualifications of the code of conduct and can therefore serve as the third arbitrator in a tribunal (in addition to the two selected respectively by both parties) will be produced. In addition, parties can challenge one another's selection of arbitrator. As in the U.S. model, the ICSID Secretary General will appoint the remaining arbitrators if a tribunal is not constituted within 90 days of the submission of a claim.

Frivolous Claims

The German model BIT does not address how to process unjustified or "frivolous" claims. The U.S. model BIT allows the host State to file an objection that a claim is without merit, allowing the tribunal to temporarily suspend proceedings while the objection is considered. CETA allows for this as well, in addition to other measures. The CETA text also allows for the tribunal to review and dismiss claims that are without legal merit or unfounded as a matter of law. The most important reform that CETA implements is the "loser-pays" rule, meaning that whoever loses the ISDS case should bear the cost of arbitration for both sides.

Appellate Mechanism

The German model BIT makes no mention of an appellate mechanism; decisions reached by an international tribunal are to be considered binding and final under domestic law. The U.S. model leaves a paragraph open for a future appellate mechanism, if the parties to the treaty decide to create one. The CETA text also leaves a space for an appellate mechanism, to be established at a later time. The text makes the initial suggestion that this mechanism can be implemented within 90 days of the issuance of an award.

Why the "I" Belongs in TTIP

Market Access for Investment

Investment flows are the backbone and motor of the transatlantic marketplace. However, in many sectors such as aviation, shipping, and communication, investors from abroad face considerable market access barriers in the United States. TTIP will not remove all these barriers. However, by extending investment protection (including National Treatment, MFN, and fair and equitable treatment or FET) to the pre-establishment phase of an investment, by prohibiting certain performance requirements for market access, and by addressing market access for investment in a service chapter, TTIP will serve as starting point for more open investment relations between the EU und the United States. More investment opportunities would allow companies to expand production, promising more jobs and economic growth.

Market access disputes should be subject to dispute settlement procedures. Companies that have expended time and money to obtain the correct national permits in order to carry out their investment should have avenues for recourse if their next steps towards establishment are blocked for illegitimate reasons. However, market access is often covered in other parts of a trade and investment agreement and tends to affect whole industries or groups of investors. Therefore, instead of using ISDS, the option to bring market access cases to State-State dispute settlement should be explored. Under State-State dispute settlement clauses, both parties to the treaty are involved in consultations on the interpretation and application of the treaty.

Settling Investment Disputes

Even in countries with a strong legal system such as the United States, investors take on a risk by moving assets abroad. Today, there are few known cases of transatlantic investment disputes. The possibility for future conflicts, however, cannot be ruled out. Investors must be given a chance to seek recourse in the event of direct or indirect expropriation, discriminatory policies, or unfair and unjust policies. Neither federal nor state law in the United States, however, fully protects the foreign investor against discrimination. Fair and equitable treatment of investors is not guaranteed under the U.S. Constitution. Furthermore, it is not guaranteed that national courts will apply international trade and investment law[34]: Quite the contrary, national courts are known to favor national law. There is also some evidence that U.S. courts, especially civil juries, can be biased against foreign investors.[35] In the event of an investment dispute, foreign investors can thus not fully rely on national courts to enforce TTIP investment rules.

Naturally, it is not just U.S. courts that pose a challenge for foreign investors. Lengthy procedures in EU court systems are financially straining on small businesses. Speedy resolutions of investment disputes thus carry great economic value for companies without vast resources to undergo drawn-out proceedings. In addition, setting aside resources to navigate the 28 different legal systems of the EU Member States can be a burden that prospective foreign investors are not willing to shoulder. With ISDS, both EU and U.S. investors would have a second, streamlined avenue with which to settle disputes with the State.

Reforming Investment Protection and ISDS

IIAs have proven to be effective instruments to reduce political risk for investors and to foster investment flows. Nevertheless, there is a need for reform to secure the legitimacy of IIAs and ISDS. This is more important than ever, as some countries have already terminated IIAs (South Africa, Bolivia, and Ecuador) or are seriously thinking about doing so (for example India and Indonesia). A transatlantic agreement would be an important signal to these countries. Likewise, leaving out investment protection would set a bad precedent.

Strategic Dimension

In light of increasing global investment and the overall depth of the current EU-U.S. investment relationship, the TTIP negotiations are a unique opportunity to reform the system of IIAs and set high standards for investment for the future. Thus, the negotiations have a strong strategic dimension.[36]

Whereas trade in goods and services is subject to WTO regulations, there is no comparable multilateral body of law for FDI, neither for market access nor the protection of investment. The IIA landscape is a patchwork of very different bilateral and plurilateral agreements. There are no consistent, universally valid norms and standards for market access or the protection of cross-border investments. Only the trade-related aspects are regulated in the WTO's Agreement on Trade-Related Investment Measures (TRIMs Agreement). Efforts to conclude a Multilateral Agreement on Investment (MAI) under the umbrella of the OECD collapsed in the late 1990s. In the

WTO's Doha Round, investment regulations were initially part of the negotiations but were then taken off the agenda at the request of the developing and newly industrialized countries in 2003. As there is currently little appetite to incorporate investment into ongoing multilateral trade negotiations, TTIP could be an intermediate step in establishing global investment rules, countering the spaghetti bowl of diverging BITs. Third countries are likely to look at TTIP as a model for their trade and investment agreements. The EU Commission thus needs to be very careful in the reforms it implements. A bad investment model would set a negative precedent for future trade and investment agreements.

In addition, common principles will strengthen the EU and U.S. bargaining power vis-à-vis third countries, including China, with which both are currently negotiating BITs. This does not so much concern the inclusion of ISDS in BITs, as also China has an interest in a well-functioning dispute settlement procedure. Rather, a common position will help to establish norms and standards in BITs (both for pre- and post-establishment) which the EU and United States deem important, but China might be less interested in.

The EU and the United States would be foregoing an opportunity to create a gold standard for investment treaties if they were to sign IIAs only with countries with insufficient legal systems and signs of bad governance. In addition, discriminating between countries based on their legal system would also prove politically difficult. The case of Mexico illustrates this point: Mexico is an OECD country with a well-established legal system, and yet it has still been the fourth most frequent respondent in past arbitration proceedings.

[34] Stephan Schill, "Internationaler Investitionsschutz und Verfassungsrecht", in: *Verfassungsblog* 14 April 2014, <http://www.verfassungsblog.de/en/internationaler-investitionsschutz-und-verfassungsrecht/>.

[35] Christian Tietje and Freya Baetens, *The Impact of Investor-State-Dispute Settlement in the Transatlantic Trade and Investment Partnership*, p. 8.

[36] Roderick Abbott, Fredrik Erixon and Martina Francesca Ferracane, *Demystifying Investor-State Dispute Settlement*, ECIPE Occasional Paper, No 5/2014, <http://www.ecipe.org/media/publication_pdfs/OCC52014__1.pdf>.

Recommendations

Given the common values shared between the United States and the EU, the TTIP negotiations are a chance to incorporate reforms into a blueprint for a new IIA that supports global growth. They are also a chance for the EU Member States to update their current IIAs with the United States. As developing countries start expanding their shares in the global economy, it will not be just EU and U.S. investors taking advantage of IIAs that offer inadequate protection to States to uphold their regulatory abilities.

In light of these issues, reforms are needed to create an investment agreement that adequately reflects the modern needs of both States and investors. These include defining central terminology, establishing a mechanism to prevent frivolous claims, improving the transparency of the procedures, creating an appellate mechanism, and securing the quality of the ISDS arbitrators. The ability of States to pursue legitimate public policy goals protecting health, labor, and the environment should be guaranteed. Simultaneously, investors must receive adequate protection.

Preserving a Meaningful Definition of Investor and Investment

The EU Commission aims at limiting investment protection to those investments which have been made in accordance with the law of the host State. Such limitations will prevent abusive investment and, as such, are also desirable in TTIP. At the same time, the treaty text needs to be formulated in a way to prevent abuse of the so-called legality clauses by the State, which could use minor errors in formalities as grounds to deny investment protection or reactivate laws which have fallen out of use for the purpose of the arbitration.

From an investor's point of view, a broad definition of investment and investor is preferable to a narrow definition. This reduces the risk of being denied protection under an investment treaty. The asset-based definition of investment has proven to be effective over the last 20 years and should be maintained also in TTIP. The definition of investment should include portfolio investment, as not just the shares of a company should be protected, but all of its assets. However, it should be acknowledged that this can also create new challenges. In particular, not excluding treasury bonds from the scope of investment coverage could pose serious risks for European States, as the recent Euro crisis has shown.

As investors often face considerable market access barriers and discrimination during the pre-establishment phase of an investment, substantive provisions should apply to making an investment, including MFN and National Treatment. Furthermore, the treaty text should curtail allowing a party to condition market access or the continuance of an operation upon certain requirements. These include, for example, requirements for export volumes, domestic content provisions, preferences for goods or services produced or delivered in the territory of the investment, the value of imports as compared to foreign exchange flows, the transfer of technology, etc. Excluding pre-establishment from investor protection would furthermore risk making the treaty internally inconsistent. The main example here is that TTIP is very likely to contain a chapter on trade in services. One mode of supply of services is cross-border foreign investment. Without pre-establishment investment protection, an investment could be granted protection under the services chapter, but not under the investment chapter. This legal ambiguity should be avoided.

A TTIP investment chapter thus needs to be very carefully drafted regarding provisions for the pre- and post-establishment phase of an investment. Not differentiating clearly between obligations and carve-outs for the different phases of an investment could have a very harmful consequence: If a sector was excluded from disciplines on market access, a legal investment in this sector would also not be protected against State interference during post-establishment. This would lead to a deterioration of investment protection in comparison to existing BITs.

In an attempt to prevent individuals or entities from setting up shell or mailbox companies to gain access to ISDS under an investment treaty (so-called treaty shopping), the Commission has proposed to require a company to have substantial business activities in the country in which the claim is filed. BDI welcomes the Commission's attempt to curtail treaty shopping. However, available jurisprudence to define "substantial" is scarce and does not offer great insight into how tribunals might interpret this requirement. It could be advisable to further define this term.

Protecting Investors from Discriminatory Treatment

Non-discrimination – MFN and National Treatment – is the core of investment protection. Accordingly, TTIP should protect investors from EU countries sufficiently

against discrimination, both in relation to U.S. citizens as well as other foreign investors in the United States. Non-discrimination should apply to the pre- as well as post-establishment phase. Long lists of carve-outs should be avoided. General exceptions should be precisely defined to prevent misuse for disguised breaches of treaty obligations. At the same time, the State's sovereignty must be ensured. As such, the Commission must strike the right balance between a State's right to regulate and investors' need for protection.

The Commission aims at establishing a high standard of investment protection in TTIP. As a consequence, it is worried that new standards could be circumvented by investors gaining access to substantive and procedural provisions contained in other treaties through MFN (another form of treaty shopping). The Commission has therefore proposed to restrict MFN to substantive provisions, excluding access to ISDS in other treaties. While exceptions to National Treatment may be warranted, exceptions to MFN are hard to reconcile with the idea of an FTA and the need to create a level playing field for investors from Europe and from other third countries. Without MFN, European investors could be excluded from benefits which the United States extends to investors under other investment treaties. If the Commission wished to restrict access to other FTAs, this should be limited to truly procedural provisions.

Protecting Investors against Expropriation

As a matter of international law, but also of German constitutional law, expropriation may not occur except for a public purpose, on a non-discriminatory basis, and with prompt, adequate, and effective compensation of the investor. Investors also need to be afforded due process of law. Arbitral decisions taken under ISDS neither prevent the State from taking measures in the public interest, nor can they obligate the State to reverse measures taken. Rather, the tribunals decide whether or not the investor is entitled to compensation and the amount of compensation.

While prohibiting expropriation without proper compensation is a fundamental element of IIAs, the inclusion of indirect expropriation can blur the line between a country's right to regulate in the public interest (in terms of the environment, health, labor) and what qualifies as indirect expropriation. As a consequence, the Commission wishes to more precisely define indirect expropriation. While these efforts are laudable, the Commission needs to be careful not to introduce new uncertainties into the system. For example, introducing the term "legitimate public purpose" could grant tribunals the authority to weigh the legitimacy of the public interest for which a measure was taken. This could seriously infringe on States' sovereignty.

Strengthening Definitions in Fair and Equitable Treatment (FET) Clauses

The right to fair and equitable treatment is one of the central rights of investors. Without FET, an investment treaty is of little practical value. Defining the term too narrowly could render the protection of the investment ineffective. At the same time, a broad definition of FET can reduce States' policy space and expose the country to financial liability for pursuing legitimate policy objectives.

FET should be defined so that it protects the State's right to regulate, while also preserving investor protection. The CETA text limits the application of FET to very serious violations of treaty provisions, e.g. fundamental breach of the treaty, manifest arbitrariness, and targeted discrimination. While the Commission's aim is to increase certainty with these new terms, they could also lead to more uncertainty and seriously lower investment protection. One example of this risk is the term "manifestly". In practice, providing proof of manifestly arbitrary behavior would be very difficult. Furthermore, the term "manifestly" might imply that small breaches of the rules are acceptable under the treaty. It bears notice that cases of "light" arbitrariness can be just as harmful to an investor.

Moreover, the core content of FET is no longer included in the new definition. FET protects the individual from an imposition of an excessive burden and requires the State to exercise the principles of proportionality and legality. This core notion of the rule of law has been eliminated from the new definition. FET should stipulate that a State (i) may not violate the principles of proportionality and legality; (ii) may not impose an excessive burden on an investor without providing compensation, and (iii) must treat investors and investments in accordance with the international minimum standard.

Furthermore, TTIP should require arbitrators to take the legitimate expectations of investors into consider-

ation. CETA limits the protection of an investor's legitimate expectations to cases where such expectations are based on specific representations by the host State, which the investor had relied upon when making or maintaining the investment. This definition is too narrow and limits protection to situations where the State has assumed an explicit obligation vis-à-vis the investor.

In addition, the Commission's proposal to narrowly define FET by listing breaches of FET in a closed list poses some problems: Firstly, policymakers today will find it difficult to foresee all possible cases in which a measure might be unfair and inequitable. Secondly, as the legal environment changes constantly, the list would require regular revision. While in theory this is possible, in practice it is doubtful whether the parties to the investment agreement would ever exercise their right to amend the list, as finding agreement on amendments is likely to be difficult. Lastly, a closed list would also put U.S. and EU investors in a weaker position vis-à-vis investors from other countries, who enjoy stronger FET protection under other treaties.

Many European BITs contain umbrella clauses, meaning that a contractual promise a State makes to an investor is also protected under the IIA. The German model is no exception and includes this clause. The U.S. model and many U.S. BITs also contain forms of umbrella clauses as part of their dispute resolution provisions. While BDI acknowledges that not all breaches of contract between the State and the investor are actually a breach of the international treaty, a TTIP investment chapter should contain an umbrella clause for certain contractual breaches. The umbrella clause does not impose an excessive burden on a State, as the State is only held to fulfilling obligations it assumed voluntarily.

Ensuring the Right to Regulate and Investment Protection

The ability for a State to implement reasonable and appropriate regulations for the public good should be protected in IIAs. Clauses that allow the State to implement regulations for environmental, health, consumer, and labor protection, among others, should be included.

A place to do so is the preamble. Preambles are taken into account by tribunals when interpreting an investment treaty. In order to avoid a misunderstanding, the reference to the right to regulate must be combined with a clarification that it only exists within the limits of the rule of law. Most notably, the principles of proportionality, legality, and transparency need to be stressed. Furthermore, the text should underline that an excessive burden may only be imposed on an individual against compensation.

In addition, general exceptions in the treaty text, for example referring to GATT Article XX and GATS Article XIV of the WTO, can provide guidance for interpreting the States' right to regulate, and connect the investment treaty to internationally recognized standards. For instance, Canada has included reference to the abovementioned articles in its BITs since the late 1990s. Despite their growing use in FTAs and BITs (particularly in Asian BITs), there is little experience with the application of WTO rules to international investment law. Some guidance might be necessary to reduce uncertainty in the interpretation of said rules.

Increase Transparency in ISDS Cases while Protecting Trade Secrets

A main concern for critics is the alleged secretiveness of the arbitration process in ISDS cases. Full transparency is not possible, as companies often have trade secrets that must be protected. Yet there is room for improvement. Increasing transparency will strengthen the legitimacy and acceptance of ISDS.

As in CETA, TTIP therefore should base transparency procedures for ISDS cases on the new UNCITRAL transparency rules. These include public accessibility to documents and public hearings. There is also a provision that allows the tribunal to protect confidential information. While maximizing transparency, appropriate confidentiality needs to be granted for documents and discussions that either party identifies as requiring protection for essential security or commercial reasons.

The Commission also needs to take into account that broadening the scope of documents which have to be disclosed will increase the costs for companies. Pleadings in ISDS may amount to tens of thousands of pages for each pleading (including exhibits and attachments). If all pleadings and exhibits were to be disclosed, parties would have to spend tens of thousands of euros on redacting each document for confidential information. This could easily lead to a financial burden which small and medium-sized companies cannot shoulder.

Lastly, excessive transparency can pose a security risk for members of a tribunal panel and the witnesses. While this is not foreseen as a large problem in the U.S.-EU context, given the model character TTIP will have, this issue should also be regarded in the context of TTIP. TTIP should thus feature safeguard mechanisms. Furthermore, transparency rules should honor the legitimate right of experts and witnesses to the protection of their personal data.

Multiple Claims and Relationship to Domestic Courts

In order to prevent contradictory results and to make domestic courts more attractive, the EU Commission wants to prevent simultaneous pursuits of the same case under national and international law (multiple claims). Accordingly, the CETA text prohibits the investor from bringing a case to a domestic court and an international tribunal at the same time. The investor must first show proof that the case was concluded or that the investor withdrew the claim before proceeding to an ISDS tribunal. If a claim is brought simultaneously under another international agreement and under CETA, these two courts must communicate to avoid conflicting decisions. This could serve as model for TTIP.

At the same time, TTIP should not require that national legal remedies first be exhausted. This would reduce international arbitration to a second-layer remedy. ISDS would become merely an appeal mechanism. As parties have to go through two or more levels of litigation, cases are likely to become lengthier and more costly, which would be a greater burden particularly for small and medium-sized enterprises. Given the problems which investors could face in domestic courts, this would also greatly reduce investor protection. As TTIP is to become a model for future IIAs, negotiators need to be mindful of the impact of a treaty text on investment security in countries with a less mature legal system than that of the United States.

A fork in the road approach, which prevents subsequent proceedings before international tribunals or national courts, is also problematic, as it is neither sufficient to strengthen the national courts, nor to increase the protection of investors. According to a fork in the road provision, an investor must choose between either settling a dispute before national courts in the host State or in international arbitration. The choice he or she makes is irreversible: The investor henceforth loses the right to submit the same case to the other forum. Therefore, when in doubt, an investor would likely seek investment protection under an investment agreement instead of pursuing local remedies, and the number of ISDS cases would be likely to rise. Without a fork in the road scheme, the investor could try the national courts first. Furthermore, having both options available to investors increases pressure on the State to modernize its court system.

Strengthening Requirements on Arbitrator Ethics, Conduct, and Qualifications

The integrity and a high standard of qualifications for arbitrators are essential to the effectiveness and legitimacy of the ISDS system. It should be noted that the standards established by international law, arbitral institutions, as well as national law and international soft law (such as the International Bar Association or IBA Rules) already provide for very high standards.

Nonetheless, the impartiality of arbitrators has been increasingly questioned by the public. Based on a survey of cases filed under ICSID, arbitrators are selected from a small group of lawyers specializing in international investment law. Some of the lawyers in these ICSID cases have served previously in ISDS cases as counsel to investors and (much less often) to States. There is an array of fears regarding the incentives of arbitrators to preserve the system through consistent rulings.

In reaction to these concerns, the EU Commission aims at tightening the rules on arbitrator ethics, conduct, and qualifications. Under CETA, a Committee on Services and Investment is to be established between the parties, which will introduce a code of conduct to set standards for the independence and impartiality of arbitrators. Furthermore, a list of possible arbitrators will be put together.

Regarding a code of conduct for arbitrators, it should be acknowledged that such rules already exist in soft law compilations such as the ones developed by the IBA. Arbitrators should be held to the highest standards of ethical behavior, including that no arbitrator may have a conflict of interest. This is central to both the effectiveness and legitimacy of investment treaties and should thus be also made explicit in a TTIP investment chapter.

In line with current practice, each disputing party should be allowed to choose an arbitrator for TTIP ISDS cases. Furthermore, each party should have the

opportunity to challenge the choice in arbitrator made by the opposing party, as is also currently common practice under ICSID rules and other investment agreements. This will ensure that the arbitrators enjoy the trust of both parties. The president of a tribunal could then be appointed by an independent body. It is questionable, however, whether a Committee on Services and Investment as foreseen in CETA is the right body to do so, as it will not be perceived as neutral. If TTIP is to provide for an entity that selects arbitrators, this should be a neutral body such as ICSID or the Permanent Court of Arbitration (PCA).

The idea of creating a pool for qualified tribunal presidents is to be welcomed in principle. However, the list should not be binding and should include a sufficient number of people to allow the investor and State to select suitable experts for specific disputes. In practice, even ICSID's list, which contains more than 400 candidates, has proven to be too small. A list of 15 arbitrators, as proposed under CETA, would neither give the investor nor the State sufficient choice. It is very likely that for many cases no arbitrators will be found on that list. Another problem is that a closed list of arbitrators, compiled by the parties to the treaty without input by the investors, would seriously undermine the principle of neutrality.

As far as qualifications are concerned, arbitrators must have experience in international investment law, bring along the necessary expertise for specific cases, and be impartial and follow the highest ethical standards. Given the necessary experience in international law, the wisdom of the Commission's proposal to draw on retired judges, as proposed for CETA, needs to be called into question. Another proposal might be difficult to put into practice: Single-hatting, meaning that arbitrators are excluded from serving as an expert or council in other cases. This would limit the number of arbitrators to choose from and could create a bias for retirees.

Reducing the Risk of Frivolous and Unfounded Cases

Arbitral procedures are expensive, and a State must pay out of public funds. To discourage an investor from bringing a meritless claim to an international tribunal, the Commission wants to establish a stronger mechanism for excluding "frivolous claims". This could involve a pre-screening process, as is done under ICSID. The ICSID Convention, Regulations and Rules contain specific rules about claims which are manifestly without legal merit. Furthermore, the so-called Oil Platforms test allows a tribunal to reject cases if the claimant has not made a prima facie case on the merits.

Claims brought before an arbitral tribunal should generally be subject to a preliminary review, corresponding (among others) to Rule 41(5) of the ICSID Convention, Regulations and Rules. This mechanism has proven effective and balanced in practice. TTIP should reference this rule while being careful that new mechanisms against unjustified or frivolous claims should not be phrased in such a way as to block justified claims from reaching arbitration. Just as claims need to be legitimate, preliminary objections should also not be frivolous. Unfounded objections to claims can become quite costly to companies. There should be a safeguard against them just as there is a safeguard against frivolous claims.

Entitling the winner of the proceedings to reimbursement of the costs of arbitration could, in theory, be a mechanism to reduce the risk of frivolous claims. At the same time, the loser-pays principle poses some risks and challenges: Firstly, the risk of high costs could deter small and medium-sized enterprises from using ISDS. A blanket approach to the loser-pays principle could also be counterproductive if it prevents legitimate claims (e.g. claims where the tribunal decides against the investor on disputed legal issues, or considers evidence to be insufficient for reasons outside the control of the investor). Secondly, it is often difficult to establish which party is the losing party of a dispute, as often one party wins with regard to some but not all claims. If the loser-pays principle is included in TTIP, the tribunal should at least be granted the discretion to allocate the costs among the parties in exceptional circumstances. Thus, the tribunal should apply principles of equity in cases in which ordering the unsuccessful party to bear the entire costs would be unjust. Lastly, to deter abuse and excessive procedural conduct, the costs need to be limited to the scope of reasonable costs.

Allowing Claims to Proceed (Filter)

The recent financial and economic crisis has underlined the necessity of enacting prudential measures to ensure the integrity and stability of financial markets. In contrast to the German and the U.S. model BIT, CETA provides for the establishment of a Financial Services Committee. This committee will be led by financial authorities from the governments of both parties to the treaty. In the event of an ISDS case based

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on prudential measures adopted for financial stability, this committee can review the case before it proceeds to a tribunal.

While a screening mechanism could help to preserve policy space, it could also interfere with the right to judicial review and endanger the fairness of proceedings. It also poses the risk that arbitration procedures will be politicized. Investors need access to independent, impartial, and objective dispute settlement. Placing a screening mechanism in the hands of a political committee brings disputes back into the political arena. Negotiators need to take into account that TTIP will serve as model for future IIAs. Filter mechanisms would be detrimental in IIAs with countries with weak governance and weak legal systems. To prevent that a filter mechanism is used to circumvent obligations under the treaty, it should be placed in the hands of the ISDS tribunal as a judicial body in order to protect the generally accepted principle of separation of powers.

Furthermore, the term "measures for prudential reasons" creates a broad scope for interpretation, and suggests that the impact on the investor is justified. However, such impacts can still be disproportionate, unreasonable, and unjustified. As a broad definition would open the door for misuse by governments, the term "measures for prudential reasons" should be carefully defined.

Guidance by the Parties (the EU and the United States) on the Interpretation of the Agreement

Outside guidance can help reduce the risk that the treaty text is interpreted in different ways by different tribunals and thus enhance predictability. However, outside guidance should not be used to circumvent the rules for the purpose of amending treaties. Amending or changing the treaty should lie in the hands of the contracting parties alone. Outside guidance should also not be used to circumvent the division of powers between the EU and its Member States (which would have to be involved in any process of formally amending a treaty) as well as the division of competencies between the EU's organs.

Thus, two norms have to be honored: According to non-retroactivity, interpretations are not to be disguised treaty amendments. Furthermore, the fundamental procedural rights of an investor should not be breached, i.e. an interpretation taking place in an ongoing case should not interfere with the arbitration at issue.

In any event, interpretations of the treaty should not be binding, as an interpretation in one case might not always be suitable in another.

Appellate Mechanism and Consistency of Rulings

As it now stands, decisions reached under ICSID and UNCITRAL rules are binding and final. An appellate mechanism could strengthen the administration of justice, increase the consistency of arbitral awards, and thereby the legitimacy of the investment arbitration system, provided the arbitrators are selected from a standing body free from conflicts of interest. BDI warns, however, against creating ad hoc appellate mechanisms, as this would do little to enhance consistency of rulings. Thus, an appellate mechanism should be multilateral in character. The appellate body could be a standing body of permanent members appointed from different States who would review awards decided by arbitral tribunals.

A downside of establishing an appellate body is that costs are likely to increase and cases will become longer. Just as there is a risk of frivolous claims, there is also a risk of frivolous appeals. The establishment of an appeal body also raises some practical questions, including the financing of such a mechanism and the selection of members of such a body.

One must note that previous attempts to establish such a mechanism have failed and that currently there seems to be little appetite for such a mechanism internationally. However, this should not deter the EU and the United States from lobbying for the creation of an appellate mechanism.

To conclude, a TTIP investment chapter must meet a careful balance between the State's right to regulate and an investor's need for protection. As third countries are likely to look at TTIP as a model for future FTAs and BITs, the treaty needs to be carefully crafted, taking into account not only political and legal circumstances in the EU and the United States, but also in third countries. The Commission needs to react to public criticism and strengthen the legitimacy of international investment arbitration. At the same time, investor protection needs to remain meaningful. An investment chapter without ISDS in TTIP would not only be of little use for investors, but also set a disastrous precedent for future FTAs and BITs.

Box 5 **Further BDI Publications on TTIP, Investment Protection, and ISDS**

Stormy-Annika Mildner, Christoph Sprich, *Protecting European Investment abroad: A Roadmap for Improved International Investment Agreements*, BDI Positon Paper, 2014, <http://www.bdi.eu/BDI_english/download_content/BDI_Protecting_European_Investment_Abroad.pdf>.

Stormy-Annika Mildner, Christoph Sprich, Elizabeth Johnson, *Background: Facts and Figures, International Investment Agreements and Investor-State Dispute Settlement*, 2014, <http://www.bdi.eu/bdi_english/download_content/BDI_Facts_and_Figures_International_Investment_Agreements(1).pdf>.

Stormy-Annika Mildner, Julia Howald, Fabian Wendenburg, *Myths, Facts, and Arguments*, BDI Position Paper, 2014, <http://www.bdi.eu/BDI_english/download_content/Mythen_Fakten_ENG.pdf>.

Fabian Wendenburg, *German Industry's Priorities for a Transatlantic Trade and Investment Partnership (TTIP)*, BDI Position Paper 2013, <http://bdi.eu/download_content/GlobalisierungMaerkteUndHandel/BDI_TTIP_Position_Paper_final.pdf>.

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The Transatlantic Trade and Investment Partnership, BDI Webpage, <http://www.bdi.eu/BDI_english/TTIP.htm>.

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Editorial Staff
Elizabeth Johnson
Dr. Christoph Sprich
Department for External Economic Policy

Editor
Dr. Stormy-Annika Mildner
Head of Department
Department for External Economic Policy

Design and Implementation
Sarah Pöhlmann
Department for Marketing,
Online and Event Management

Layout
Maria Dolecek

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