

The Transatlantic Trade and Investment Partnership: Dispute Settlement Mechanism¹

Martyn de Bruyn

Northeastern Illinois University

The European Union and the United States are negotiating the Transatlantic Trade and Investment Partnership (TTIP). Included in TTIP is the Investor State Dispute Settlement (ISDS) mechanism, which has caused significant public opposition, especially in Europe, to the trade deal. The fear among the opponents of ISDS is that investor protection will undermine the ability of the state to regulate public policy in the public interest. Specifically, the opponents fear that ISDS will reduce health and safety regulations, environmental protection, climate change policies, and even financial regulation to the lowest common (transatlantic) denominator. This article assesses whether ISDS can be sufficiently reformed to alleviate most of the public concerns, or whether it should be crossed out from the TTIP negotiation mandate. The article concludes that ISDS is so widely used in treaties signed by the European Union and its Member States, and by the United States, that it is unlikely that it will be crossed out from the final TTIP deal. However, significant improvements are needed to the ISDS mechanism and the arbitration process because without these additional safeguards for states and citizens it is unlikely that the European Parliament and the European Union Member States will approve TTIP.

Keywords: relations between the European Union and the United States, European Union, United States, Transatlantic Trade and Investment Partnership, transatlantic free trade area

The European Union (EU) and the United States have been negotiating the Transatlantic Trade and Investment Partnership (TTIP) since July 2013. This free trade agreement (FTA) between the two largest economic blocs in the world will likely have a significant impact on global trade and investment. The negotiations are organised by the Transatlantic Economic Council (TEC), which includes members of the office of the United States' Trade Representative as well as members of the European Commission, including the Directorate-General for Trade. Three advisory groups made up of significant stakeholders are also set up to guide the work of the TEC.

Martyn de Bruyn – Professor, Department of Political Science, Northeastern Illinois University, USA.

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These advisory groups are the Transatlantic Legislators' Dialogue, the Transatlantic Consumers Dialogue, and the Transatlantic Business Dialogue.

The European Union and the United States have recently concluded a number of bilateral trade agreements with smaller economic powers. The European Union signed FTAs with Chile, Mexico, South Korea, and South Africa, while the United States signed FTAs with Australia, Canada, Chile, Mexico, South Korea, and Singapore.² The United States is also negotiating a Trans-Pacific Partnership (TPP) with eleven nations in the Asia-Pacific region. The stalled negotiations, held under the auspices of the World Trade Organisation (WTO), to produce a global trade deal have led to this growth of bilateral and interregional trade deals. The negotiations on TTIP are somewhat unique in that they are between equal partners who have already relatively modest restrictions in trade in the form of protective tariffs. Although there are structural economic differences between the European Union and the United States (in particular Europe has much higher long-term unemployment and is spending significantly less on research and development), this trade deal is nonetheless significant for economic growth and job creation on both sides on the Atlantic.³

The purpose of this article is to discuss whether the Investor State Dispute Settlement (ISDS) mechanism has a place in TTIP. The TTIP that is currently being negotiated includes ISDS as a protection for investors against state appropriations. Virtually all investor agreements provide investors protection against the following provisions: discrimination; expropriation; unfair or inequitable treatment; restrictions on capital transfers.⁴ States are expected to treat foreign investors equally to their national counterparts. Expropriation of private property, including indirect expropriation, meaning that investments are reduced in value due to policy decisions by the state, is prohibited. Investors cannot, however, simply take their case to the court because their profits have been reduced by a regulatory change by a state; they have to demonstrate that these investment provisions have been breached. The proponents of ISDS argue that investor protection is necessary to create a stable environment in which individuals and corporations feel confident about the investments they make. The opponents of ISDS argue, however, that it will subject the state to the risk of many lawsuits that effectively undermine the state's ability to regulate businesses. In particular the provision concerning 'unfair or inequitable treatment' is sufficiently broad and vague that investors have used it frequently and it is hard for arbiters to come

² European Commission, http://ec.europa.eu/enterprise/policies/international/facilitating-trade/free-trade/index_en.htm (accessed on 22 November 2014). Office of the United States Trade Representative, <http://www.ustr.gov/trade-agreements/free-trade-agreements> (accessed on 22 November 2014).

³ D. Tentori, M. Zandonini, 'The Future of the Transatlantic Economic Relationship: Opportunities and Challenges Towards the TTIP', *Transworld Working Papers*, 2014, 35, <http://www.transworld-fp7.eu/?p=1547> (accessed on 13 October 2014).

⁴ European Commission, DG Trade, *Investment Protections and Investor to State Dispute Settlement in EU agreements*, 2013, http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf (accessed on 30 November 2014).

to a sound and consistent judgment on this provision. Furthermore, the opponents argue that ISDS undermines democracy as it shifts decision making power away from democratically elected national politicians to unelected arbiters who make up the dispute settlement panels. In the following section I will first discuss the benefits of TTIP and then the challenges caused by reducing non-tariff barriers to trade.

1. The benefits and challenges of TTIP

While the rest of the world is catching up, the trade between the European Union and the United States still accounts for nearly one third of the world's trade flows. According to the European Commission, a successful implementation of TTIP could boost the European Union's economy by EUR120 billion and the economy of the United States by EUR 90 billion.⁵ Additionally, the trade agreement is expected to lead to the creation of 13 million new jobs in the United States and the European Union.⁶ There are three main issues negotiated within TTIP: market access, the regulatory regime, and rules. TTIP will provide increased market access for European and American businesses through the elimination of tariffs and non-tariff barriers to trade such as regulations and rules. Tariffs are already low (around 4 per cent), with the exception of agricultural products (18 per cent), and thus most potential gains will be made in regulatory policy, such as the harmonisation of health and safety standards, and provisions to allow for competitive access to public procurement.⁷ The elimination of non-tariff barriers to trade would reduce unnecessary difficulties, expense and duplication. For example, in the automotive industry the European Union and the United States have different but similar safety requirements on lights, door locks, brakes, steering, seats, seatbelts, and electric windows. Eliminating these different standards would reduce costs for all manufacturers active on the American and European automotive markets. Changing the rules on public procurement would allow European airline companies to offer domestic flights in the United States, which is currently prohibited. Removing barriers to trade in the automotive and airline industries would lead to more competition and lower costs for consumers. Common sense seems to suggest that if national interests prevail and little is accomplished to reduce non-tariff barriers to trade, the benefits of TTIP will likely remain limited.

Reality is, however, often more complex than what common sense seems to suggest. At some level these non-tariff barriers to trade are harder to overcome because they are not simply matters of trade efficiency, but they reflect commonly agreed upon values that are deeply rooted in society. Health and safety standards cannot be adjusted

⁵ European Commission, <http://ec.europa.eu/trade/policy/in-focus/ttip/about-ttip/> (accessed on 10 October 2014).

⁶ Office of the United States Trade Representative, <http://www.ustr.gov/about-us/press-office/fact-sheets/2013/june/wh-ttip> (accessed on 10 October 2014).

⁷ S. Pfotenhauer, 'Trade Policy is Science Policy', *Issues in Science and Technology*, 2013, pp. 85–88.

in the same way a tariff can be reduced without directly affecting cultural sensitivities regarding risk adversity and environmental stewardship.⁸ Disagreements between the United States and the European Union on food safety (genetically modified organisms and hormone injected meat), climate change policy and personal data protection illustrate how difficult it is for governments to alter national norms for the sake of efficient international trade. One only has to look at the World Trade Organisation's dispute settlement gateway to see that most disputes between the United States and the European Union are in the same sensitive national policy areas that are now considered for harmonisation in TTIP. Of the nineteen cases brought by the United States against the European Union (formerly the European Community), only three deal directly with tariffs imposed by the European Union on American export products. The other cases deal with non-tariff barriers in agriculture, steel, aviation, and the enforcement of intellectual property rights. Similarly, of the thirty-two cases brought against the United States by the European Union, only four deal directly with tariffs.⁹ The success of TTIP will depend, in large measure, on success in harmonizing standards in exactly these disputed areas. Harmonisation of standards, for example in the area of food security, will not only create more opportunities for transatlantic trade but it will also affect the sovereignty of states to let elected officials, and not-for-profit businesses, determine what health risks they find acceptable for their citizens. For example, the societal norms regarding genetically modified (GM) foods in the United States and the European Union are polar opposites. In the United States, government officials believe that unless negative health effects of GM foods can be scientifically proven, there are no reasons not to include GM foods in the food supply. In many cases, GM foods are considered superior to non-GM foods as they are manufactured to grow under less hospitable circumstances and are less susceptible to disease. In the European Union, the precautionary principle prescribes that GM foods have to be proven not to produce negative health effects. Whereas in the United States the burden of proof lies with the government to show that GM foods are not safe for human consumption, in the European Union the burden of proof lies with the manufacturer of GM foods to show that there are no negative health effects from consuming GM foods. Another key difference is that the European Union expects researchers to show long-term effects of regular consumption of GM foods, while in the United States the short-term health effects are considered sufficient proof for products to be considered safe. In 2003, the United States referred the European Union's moratorium on GM foods to the Dispute Settlement Body (DSB) of the World Trade Organisation. The WTO DSB panel as well as the appellate body concluded in 2006 that the European Community's actions were inconsistent with WTO regulations. The panel argued that there was no scientific evidence that the risk of GM foods merited the European moratorium as defined under

⁸ Ibidem, p. 2.

⁹ World Trade Organization, http://www.wto.org/english/tratop_e/dispu_e/dispu_by_country_e.htm (accessed on 24 November 2014).

the WTO Sanitary and Phytosanitary (SPS) agreement.¹⁰ Under the threat of extra annual tariffs on European goods, the European Union negotiated a transition period during which the moratorium could be lifted.

In addition to these different approaches to food safety, actual experience with food safety crises also plays an important role in the determination of health and safety standards. When the United Kingdom struggled with bovine spongiform encephalopathy (BSE) or ‘mad cow disease’ in the late 1980s, the European Union enacted a ten-year ban on the export of British beef. Subsequently, in the early 1990s, the rules on the use of antibiotics, hormones and protein supplements for cattle have been tightened and the import of beef that contains artificial growth hormones was banned. After complaints by the United States and Canada, arguing that the ban imposed an unfair trade restriction, the World Trade Organisation Dispute Settlement Body in 1997 decided against the European Union. When the WTO Appellate Body confirmed the earlier decision, the United States and Canada imposed extra annual tariffs on European goods. The ‘beef wars’ and the GM foods dispute between the European Union and the United States (and Canada) show that food security is very sensitive to local standards, cultural traditions and past experience. The WTO’s decision did not take these differences in health and safety standards, in cultural traditions, and the past experience with BSE into account when deciding whether the ban on the use of artificial hormones in beef constituted an unfair trade restriction.

The European Union was not even able to request the United States to label its hormone treated beef because according to the SPS agreement, as long as the exporting country’s food provides the same level of health and environmental protection, it cannot be asked to comply with additional measures. This decision has been somewhat ironic because many American producers have introduced negative labelling with the packaging explicitly stating that the beef has not been treated with artificial growth hormones. Health, safety and environmental regulations are not merely barriers to trade. The hormone treated beef and the GM foods cases show that non-tariff barriers to trade, such as health, safety and environmental regulations, are far more difficult to harmonise than the simple reduction or elimination of tariffs. In some cases, such as safety regulations in the automotive industry, harmonization of standards produces clearly a win-win situation for states, businesses, and consumers. In other cases, such as food safety, environmental regulation, climate change policy, chemical safety, and the regulation of financial services, the benefits of harmonisation are not so clear cut, and there is significant suspicion among consumer advocacy groups and environmental organisations that it will lead to a reduction of standards to the lowest common denominator. Additionally, international treaties, such as TTIP, that seek to harmonise these regulations also restrict the sovereign power of individual

¹⁰ World Trade Organization, http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds291_e.htm (accessed on 27 November 2014).

states to protect the health of its citizens and the environment in which they live.¹¹ The introduction of Investor State Dispute Settlement (ISDS) into TTIP adds another layer of complexity to this problem.

2. The Investor State Dispute Settlement mechanism

Investor State Dispute Settlement (ISDS) mechanisms have become a standard feature of free trade agreements such as the North American Free Trade Agreement (NAFTA). The European Union and its Member States are party to around fourteen hundred agreements that provide for ISDS. Under ISDS an investor from one Member State can bring a claim for lost revenue on account of government regulation against another Member State before an international arbitral tribunal. In some cases a foreign investor first has to exhaust its options in a domestic court before obtaining access to ISDS, however, in the case of NAFTA this requirement has been waived for the sake of expediting the decision making process. ISDS is only available to foreign investors and it does not provide states with corresponding rights, i.e. the state is (or is not) required to pay compensation but is not eligible to receive compensation from the investor. The justification for ISDS is that the judicial system of most states is not reliable enough to protect the rights of foreign investors, especially in cases of direct expropriation of private property. This is not a problem in the United States, or the European Union, however. The reason for including ISDS in TTIP has been that national courts, which usually have original jurisdiction, would potentially be biased against foreign investors and independent arbitration panels provide them with more security.¹² From the start of negotiations in July 2013, there has been growing civil society resistance to ISDS and its inclusion in TTIP. The fear is that health and safety standards, environment protection, as well as workers' rights and other social rights regulations are most likely challenged through ISDS as they can potentially negatively affect future corporate profits. The European Commission announced a moratorium on ISDS in early 2014 and organised a public consultation period to address the concerns regarding ISDS as voiced by civil society organisations.

The current WTO dispute settlement mechanism is only state-to-state, and private corporations cannot challenge states directly. ISDS is different in that private corporations can take direct action against states if they find that domestic regulations within states where they hold investments negatively affect their profits. In contrast to the WTO dispute resolution process, ISDS provides individual private investors and corporations with the same status as sovereign states, empowering them to seek

¹¹ L. Wallach, P. Woodall, *Whose Trade Organization: A Comprehensive Guide to the World Trade Organization*, New York: The New Press, 2004; J. Stiglitz, *The Free-Trade Charade*, 2013, <http://www.social-europe.eu/2013/07/the-free-trade-charade/> (accessed on 10 November 2014).

¹² Stop TTIP Campaign, <http://stopttip.net/investor-state-dispute-settlement-isds/> (accessed on 10 November 2014).

enforcement of the terms of an international treaty. Furthermore, ISDS operates outside the domestic court system and behind closed doors. Citizens and the media lack information about what is being litigated and whether legal precedents are taken into consideration. The Transatlantic Consumer Dialogue (TACD), as one of the advisory groups of the Transatlantic Economic Council, came out with a resolution on TTIP in October 2013 in which it recommended to exclude ISDS from TTIP.¹³ The main reason for this recommendation is the fear that regulations in the areas of food safety, climate and energy policy, and consumer privacy will be undermined by ISDS as it provides corporations with a mechanism to challenge state policies without any input from individual citizens. TACD believes that the rights of consumers cannot be adequately protected under a system that prioritises investor rights over the rights of citizens.¹⁴ Additionally, TACD argues that the judicial system on both sides of the Atlantic is sufficiently robust to ensure that foreign investors have access to fair and equitable dispute resolution in the host country.¹⁵ ISDS allows private investors and corporations to challenge domestic regulations at international tribunals even after litigation in domestic courts has failed. The two international tribunals used for previous ISDS cases were the World Bank's International Centre for Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL). Conflict of interest rules about who can serve as arbiter at these international tribunals are insufficient and the costs of arbiters are usually split between the investor and the state, which can amount to a significant burden for a developing state.¹⁶ The fact that the TACD, as one of the advisory groups of the TEC, has come out publicly against ISDS reflects the significance of societal scepticism on the ability of governments to balance the interest of investors with the public interest.

The original intent of ISDS was to provide for investor protection in the case of direct expropriation of private property by governments in states where there was not adequate recourse to the domestic court system. More recently, national regulations that are deemed to undermine future expected investor profits are challenged as indirect expropriations or violations of minimal standards of treatment.¹⁷ The scope of ISDS has broadened without increasing the transparency or accountability of the dispute settlement process. Not only the scope but also the number of ISDS cases has increased exponentially over the last decade. Between 1950 and 2000, fewer than 50 cases were litigated, while by the end of 2012, this number increased to over

¹³ Transatlantic Consumer Dialogue, *Resolution of Investor-State Dispute Resolution in the Transatlantic Trade and Investment Partnership*, Doc No: Trade 15/13, <http://test.tacd.org/wp-content/uploads/2014/01/TACD-TTIP-Resolution-on-Investor-State-Dispute-Resolution-in-the-Transatlantic-Trade-and-Investment-Partnership.pdf> (accessed on 27 November 2014).

¹⁴ *Ibidem*, p. 1.

¹⁵ *Ibidem*, p. 2.

¹⁶ *Ibidem*.

¹⁷ *Ibidem*, p. 3.

500 cases.¹⁸ According to the United Nations Conference on Trade and Development (UNCTAD), 2012 saw 58 newly registered ISDS cases, the highest number in a single year so far.¹⁹ European investors were behind 60 per cent of those cases initiated in 2012.²⁰ Treaties that have generated the most ISDS cases are the North American Free Trade Agreement and the Energy Charter Treaty.

3. Can ISDS be salvaged for TTIP?

The 2009 Treaty of Lisbon empowered the European Commission (EC) to formulate a common investment policy for inclusion in free trade agreements. Despite opposition by some Member States and some Members of the European Parliament, TTIP negotiations include ISDS. With the installation of the new European Commission under President Jean-Claude Juncker, the issue of ISDS came again to the forefront. Juncker is known to be a sceptic of ISDS, while his trade commissioner Cecilia Malmström has supported ISDS. Trade ministers from fourteen European states signed a letter addressed to Mrs. Malmström stating: ‘The Council mandate is clear in its inclusion of investor protection mechanisms in the TTIP negotiations; we need to work together on how best to do so.’²¹ Commission President Juncker, in his address to the European Parliament on the final approval vote of his full Commission, and in an apparent rebuke to the letter by fourteen European trade ministers, stated: ‘The negotiating mandate foresees a number of conditions that have to be respected by such a regime as well as an assessment of its relationship with domestic courts. There is thus no obligation in this regard: the mandate leaves it open and serves as a guide.’²² The debate on the inclusion of ISDS in TTIP will continue as the Commission needs to consider that while it negotiates the treaty, it will have to be approved by the Council of the European Union, the European Parliament and the national parliaments.

In 2013, the European Commission DG Trade came up with some possible improvements for ISDS. These improvements include a specific affirmation of states’ rights to regulate public policy. Not all regulatory policies can be challenged in arbitration panels, and the specific conditions under which access to arbitration panels is granted need to be specified in the trade agreement. The right of the state to

¹⁸ Ibidem.

¹⁹ European Parliamentary Research Service, *Investor State Dispute Settlement: State of Play and Prospects for Reform*, 2014, [http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI\(2014\)130710_REV2_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI(2014)130710_REV2_EN.pdf) (accessed on 30 November 2014).

²⁰ European Commission, DG Trade, *Investment Protections and Investor to State Dispute Settlement in EU Agreements*, 2013, http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf (accessed on 30 November 2014).

²¹ P. Spiegel, ‘Leaked Letter: 14 Ministers Take On Juncker over Trade’, *Financial Times*, 23 October 2014, <http://blogs.ft.com/brusselsblog/2014/10/23/leaked-letter-14-ministers-take-on-juncker-over-trade/> (accessed on 30 November 2014); Letter to Trade Commissioner Malmström, <http://blogs.ft.com/brusselsblog/files/2014/10/ISDSLetter.pdf> (accessed on 30 November 2014).

²² P. Spiegel, op.cit.

regulate public policy in the interest of the public was also included in the European Commission's negotiation mandate.²³ The Commission also recommends a much more specific definition of the concepts of indirect expropriation and fair and equitable treatment.²⁴ The provisions that determine whether an investor has sufficient ground for challenging state regulations need to be unambiguously and consistently applied by arbitration panels.

In addition to changing the rules of access to investment protection, the Commission also proposes changes to the actual arbitration system. The changes include the prevention of frivolous lawsuits by making the losing party pay all litigation costs, including those of the state. As the costs of arbitration are prohibitive, developing countries may opt to settle an ISDS challenge as a way to limit their losses. Investors may reconsider the benefits of starting an ISDS case if they can potentially be held liable for all litigation costs. The Commission also proposes to make the arbitration process more transparent and to make documents available to interested parties. The secret nature of ISDS cases has undermined public trust in arbitration panels because they are perceived as pro-business, awarding large sums of taxpayers' money to private investors. Lastly, the Commission wants to address the apparent conflict of interest in arbitration cases in a binding code of conduct. In many arbitration cases, arbiters are people who have acted as council to investors in other cases. This role swapping can lead to an apparent conflict of interest. The fact that a small number of specialised arbitration law firms handle over 60 per cent of the cases, both as council to investors and as arbiters, does not bode well for public confidence in their impartiality. In other words, arbitration has become a multi-billion EUR business that has a significant interest in opposing reform of the current arbitration system. To address these issues, the European Commission stated during public consultation on ISDS provisions in TTIP that it is willing to include an explicit reference to the states' rights to regulate in the public interest.²⁵

The European Parliament Research Service has also identified some areas of improvement for ISDS. New trade agreements should directly address transparency obligations.²⁶ Another possible improvement to the current system would be the introduction of an appeal process.²⁷ Lastly, the requirement to exhaust the domestic

²³ Council of the European Union, *Directives for the Negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America*, 2013, declassified on 9 October 2014, <http://data.consilium.europa.eu/doc/document/ST-11103-2013-DCL-1/en/pdf> (accessed on 30 November 2014).

²⁴ European Commission, DG Trade, *Investment Protections and Investor to State Dispute Settlement in EU agreements*, 2013, http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf (accessed on 30 November 2014).

²⁵ European Parliamentary Research Service, *Investor State Dispute Settlement (ISDS): State of Play and Prospects for Reform*, 2013, [http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI\(2014\)_130710_REV2_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI(2014)_130710_REV2_EN.pdf) (accessed on 30 November 2014).

²⁶ *Ibidem*, p. 6.

²⁷ *Ibidem*.

courts before arbitration can be introduced.²⁸ In a resolution on ISDS of 2011 the European Parliament acknowledged that in spite of the general positive experience with ISDS, significant improvements need to be made. Future trade deals that include ISDS need to also include clauses protecting the right of states to regulate policies in the area of national security, the environment, public health, and workers' and consumer rights.²⁹ It is clear that for ISDS within TTIP to be salvaged, very significant improvements have to be agreed upon before the European Parliament and all EU Member States are confident that their interests are sufficiently protected.

4. Concluding remarks

The main question here is how to strike a balance between protecting the rights of investors and the rights of governments to regulate policy areas in a manner that benefits the public good. The European Union and Canada have negotiated a comprehensive economic and trade agreement (CETA) that includes ISDS. According to the European Commission, many of the concerns about ISDS have been addressed in this treaty, as they will be addressed in future trade deals. Some well-known cases, such as *Vattenfall vs Germany*, have brought the issue of ISDS squarely to the publics' attention. *Vattenfall*, a Swedish energy company, has brought a claim against the German government under the Energy Charter Treaty after its 2011 decision to significantly speed up the phase out of nuclear power generation in the wake of the Fukushima disaster. While the outcome of the *Vattenfall* case is not yet known, public opinion on ISDS has become very negative, especially in Germany. The improvements to the ISDS mechanism as suggested by the European Parliament and the European Commission are significant and will protect states' rights to govern in the public interest as well as the rights of investors. It is unlikely that the 'I' in TTIP will be crossed out, especially when ISDS has been used so extensively in other European and American trade agreements. Citizen groups will, however, remain vigilant to ensure that health, safety and environmental regulations will not be reduced to the lowest common denominator for the sake of corporate profits. For TTIP to be successfully ratified by the European Parliament and individual European Union Member States, the ISDS mechanism and the arbitration process need to be significantly modified.

²⁸ *Ibidem*, p. 7.

²⁹ *Ibidem*.