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TRANSATLANTIC TRADE AND THE CASE FOR INVESTMENT PROTECTION

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SUMMARY:

The most controversial element of the Transatlantic Trade and Investment Partnership (TTIP), the comprehensive agreement that had been envisaged by the United States and the European Union, was the proposed mechanism of investment protection or investor-state dispute settlement (ISDS). This mechanism, which is a standard feature of many trade and investment agreements, allows foreign investors to commence proceedings before an international arbitration panel to claim damages if public authorities of the host state violate certain basic legal guarantees. In recent years, however, the system has come under heavy criticism from experts and civil society organizations on account of its alleged pro-corporate bias. In response, the European Commission has proposed to replace investment arbitration with an arrangement called the Investment Court System (ICS), which has now been adopted in the Comprehensive Economic and Trade Agreement (CETA) between the European Union and Canada. Moreover, a number of countries have recently started to discuss the idea of creating a single permanent multilateral investment court (MIC) that would deal with investment disputes in a more centralized fashion. Despite these innovative developments, a broad section of public and expert opinion remains hostile to the idea of investment protection and its future accordingly remains uncertain.

A closer look at the actual practice of investment dispute settlement today reveals that most of the public criticism is unfounded. However, if the United States and the European Union continue with negotiations to enhance their trade and investment framework, it is essential that the rationale for the introduction of such a mechanism in transatlantic trade relations is fully explained. Governments have so far been mainly on the defensive in public debate, largely assuming that the benefits of the ISDS system can be taken for granted. To gain greater public acceptance, it would therefore be necessary to replace the defensive approach in the presentation of investment protection — the "negative case" — with a "positive case" and demonstrate why international investment dispute resolution makes sense for developed economies with sophisticated legal systems.

In the context of transatlantic economic relations, investment protection can provide a framework for impartial assessment of legislative, administrative, or judicial decisions that adversely affect foreign investors. In particular, it can provide (i) a remedy against discriminatory treatment of foreign companies, (ii) a remedy against decisional anomalies, notably in the light of important regulatory and institutional differences between Europe and the United States, and (iii) a remedy against recognized institutional weaknesses in the respective legal systems that have important economic ramifications. However, taking into account the acknowledged deficiencies of the existing ISDS mechanism, the establishment of a permanent decision-making body rather than the continuation of the ad hoc arbitration system should be pursued as the most viable policy option. Moreover, proposals to establish a multilateral international investment court should be explored as the long-term objective.

Introduction

The negotiation of the Transatlantic Trade and Investment Partnership (TTIP), a comprehensive trade and investment deal between the United States and the European Union, has been one of the most important projects in the development of international trading rules in recent decades. The envisaged agreement was supposed to be ambitious and comprehensive in nature — covering not just tariff reductions but also non-tariff barriers and a number of related issues like government procurement and regulatory cooperation — in order to tap the remaining potential for enhancing economic growth in European and U.S. economies. According to a study commissioned by the European Commission, an ambitious TTIP deal could increase the size of the EU economy around €120 billion (or 0.5 percent of GDP) and that of the United States by €95 billion (or 0.4 percent of GDP).[1] Even before the presidential elections, however, the political viability of trade agreements like TTIP in the United States was highly questionable, especially given the frequent criticism of trade agreements during the election campaign. On the European side, on the other hand, TTIP was mainly challenged by the perception of trade agreements — and TTIP in particular — as instruments of "neoliberal" politics, allegedly involving risks to European social, health, and environmental standards and disproportionate influence of business interests in the making of public policy.[2] Formally, TTIP talks have been suspended in early 2017, but European policymakers hope that enhanced trade arrangements with the United States remain on the negotiating table and there are some indications on the U.S. side that this possibility remains open.[3]

> *"It is possible that in the future transatlantic investment flows will be covered by an umbrella of legal guarantees with a potentially far-reaching scope."*

The difficulties surrounding TTIP can be contrasted with the more encouraging story of the Comprehensive Economic and Trade Agreement (CETA), the deal agreed between the European Union and Canada in 2016 after seven years of lengthy negotiations. The CETA agreement has now been approved by the European Parliament but still needs to be ratified by the parliaments of the Union's member states to take effect because it has been deemed to be a "mixed agreement," that is, one that also covers subjects that fall under national competence. However, even the process of the signature of this agreement by the European Union (which is the first stage of conclusion) stumbled into a serious obstacle when the Belgian region of Wallonia expressed its opposition on account of the allegedly insufficient protection of the public interests at stake. In the end, a major political crisis was averted after painful last-minute talks by attaching a separate interpretive declaration to the text of the agreement.

Several topics have dominated public concerns about TTIP and CETA, but there can be little doubt that the most controversial of them is the proposed framework of "investment protection," a system of legal guarantees that can be invoked by investors to commence arbitral proceedings against the state and claim damages where state action has violated one of the obligations in the agreement. On this issue, TTIP negotiations seem to have reached a stalemate, though it should be noted that both the European Union and the United States have in principle supported the inclusion of investment protection in the agreement. It thus remains to be seen whether and how the trade negotiators on the two sides of the Atlantic will pursue this item in the years ahead. The CETA text, on the other hand, already includes such a system, albeit in a reformed version. If and when the relevant provisions of CETA become applicable, an interesting transatlantic legal architecture will emerge because many U.S. companies have Canadian subsidiaries and would accordingly be able to, in some cases at least, use the mechanism to defend their rights in Europe, provided they use Canadian companies to make the investments. It is therefore quite possible that in the future transatlantic investment flows will be covered by an umbrella of legal guarantees with a potentially far-reaching scope.

1 Centre for Economic Policy Research, *Reducing Transatlantic Barriers to Trade and Investment,* March, 2013.

2 Ferdi De Ville, Gabriel Siles-Brugge, *TTIP: The Truth about the Transatlantic Trade and Investment Partnership*, Wiley, 2015.

3 "Wilbur Ross says he's 'open to resuming' talks on mega-trade deal with Europe," CNBC (31 May 2017).

This paper evaluates some of the main criticisms of the investment protection mechanism that have been raised in the public debate in the last two years when the public controversy over TTIP and CETA reached its height. The basic argument is that if the idea of establishing this system in transatlantic trade relations is further pursued, authorities must do more to convince the public that it is really necessary. Governments in Europe and the United States should therefore build a "positive case" for investment protection based on an understanding of complex legal and institutional issues that arise in the context of trade and investment transanctions between advanced economies. It is also submitted that supporting a permanent mechanism of investment dispute adjudication would make this case much more persuasive.

History of Investment Protection

Investment protection — publicly often referred to by its procedural arm as investor-state dispute settlement (ISDS) — is not a novelty introduced by TTIP or any other currently negotiated trade agreement. As an institutional practice, it has existed for over fifty years and is now included in around three thousand international bilateral or multilateral investment or trade treaties as a means of encouraging foreign investors to invest abroad, especially in countries where the legal protection of property and contractual rights is deemed to be weak. In the last two decades, however, an increasing number of investment protection claims have also been lodged against developed countries where the legal protection of foreign business interests is normally ensured by public courts.

For the United States, the most important existing international treaty framework is Chapter 11 of the North American Free Trade Agreement (NAFTA) concluded with Canada and Mexico, which has been in existence for over two decades. In Europe, the most often invoked ISDS provisions are found in bilateral investment treaties concluded by formerly socialist East European countries after the transition to a market economy, though it should be noted that nearly all European states have applicable investment agreements in their rulebooks. Internationally, the most important legal instrument with investment provisions is the Energy Charter Treaty, which is intended to protect investments in the energy sector, but such a multilateral arrangement is an exception to the rule. As a general matter, the legal framework that governs ISDS remains fragmented and in some respects incoherent.

Provisions that govern investment protection are generally similarly worded and can be divided into two parts — substantive guarantees and dispute resolution procedures. The latter generally involves dialogue, negotiation, and, failing that, the possibility of an investor bringing a claim against the host state to a neutral panel of arbitrators, which can adopt a legally binding and enforceable decision. While the harshness of criticism levied against ISDS that has become commonplace in recent years might suggest that this procedure is frequently used to further the interests of multinational companies against states who introduce environmental or labor regulation,[4] data shows that recourse to investment protection is actually quite rare, with the total number of investment cases decided since the practice began now reaching around seven hundred.[5] The paucity of ISDS proceedings can probably be explained by the strict conditions that apply for liability to be found, the high cost of arbitration and the uncertainty regarding the outcome. Nevertheless, the number of ISDS cases has risen in recent years because international investment flows have increased significantly. In 2015, seventy ISDS claims were brought before different international arbitral bodies,[6] and this figure is likely to increase in the future.

The best-known forum for ISDS disputes, responsible for processing about two-thirds of cases worldwide, is the Washington-based International Centre for Settlement of Investment Disputes (ICSID), which is part of the United Nations system attached to the World Bank, and which registered 45 and concluded 51 cases in the fiscal year 2016.[7] Some of better known disputes are the Vattenfall case brought under the Energy Charter Treaty against Germany, in which a Swedish energy company is demanding compensation from Germany for the loss incurred

4 George Monbiot, "The TTIP trade deal will throw equality before the law on the corporate bonfire," *The Guardian*, January 13, 2015.

5 United Nations Conference on Trade and Development (UNCTAD), Investor-State Dispute Settlement: Review of Developments in 2015, June 2016, p. 1.

6 Ibidem

7 International Centre for Settlement of Investment Disputes (ICSID), *Annual Report 2016*, p. 3.

as a result of the decision to phase-out nuclear energy, and the Keystone XL case brought under NAFTA by a Canadian company against the United States for failing to approve the construction of the Keystone XL pipeline, which was withdrawn after the pipeline was approved by the new federal administration. An interesting fact to note is that while certain East European countries, Canada, and Mexico have lost a number of ISDS disputes, the United States has never lost an investment protection dispute under the NAFTA system.

Substantive Guarantees

The main objective of investment protection is to prevent the state hosting the investment from treating foreign investors in a manner that can be considered objectively unacceptable or unfair under an international standard. Though the formulations differ somewhat, investment protection principles generally prohibit "expropriation" (including "indirect expropriation," meaning a reduction of value through legal measures) of an investment, require "fair and equitable treatment" by administrative and judicial authorities, prohibit the state from discriminating against foreign investors based on their foreign nationality, and oblige them to allow repatriation of their profits. If a country that has signed up to a treaty with investment protection provisions violates — with legislation, administrative decision, or even a judicial ruling — one of these principles, the investor concerned can initiate arbitration (ISDS). If the arbitral tribunal determines that the action or a series of actions by the state has amounted to a breach of the host state's treaty commitments, it can order that the state pays appropriate compensation to the investor. Critics often describe ISDS as a system that allows companies to "challenge" public acts, but this is patently false. In fact, the payment of damages proportionate to the loss incurred is the only remedy, which means that investment protection is clearly distinguishable from legal proceedings in national courts that allow individual measures to be annulled.

> *"Investment protection standards prohibit unfair treatment of investors but do not prevent legitimate regulatory or legislative changes, as is sometimes alleged."*

For a breach of investment protection guarantees to be found, the violation in question must be very serious, so it is not enough that the investor merely disagrees with the decisions or legislative changes concerned. Essentially, to establish a violation, an investor must show that he has been subject to unacceptable treatment on the part of the host state that cannot be justified by public interest considerations. Given that outright expropriations or grossly unfair administrative procedures occur very rarely in modern legal systems, investment protection claims nowadays typically concern unforeseen changes to regulatory frameworks in regulation-sensitive areas like energy or telecoms, or poor administrative practice in the issuing or withdrawal of licenses, permits or authorizations. Investment protection standards, in short, prohibit unfair treatment of investors but do not prevent legitimate regulatory or legislative changes, as is sometimes alleged.

The advantage of ISDS — and perhaps the most forceful argument in its favor — is that it allows an investor to obtain legal redress against the authorities of a foreign country directly without having to ask his own government to raise the matter with the state concerned and thereby to cause diplomatic conflict. This is what distinguishes "investor-state dispute settlement" from "state-to-state dispute settlement," another international treaty mechanism that could be used to settle disputes but is understandably more difficult to apply when the interests and legal problems of individual companies are involved. By agreeing to investment protection guarantees, states can assure investors that any serious complaints will be treated impartially under international rather than national law, and before an international authority rather than before the courts or administrative bodies of the state in question. In this way, the issue can be handled without bias and without any constraints imposed by the legal system of the country concerned. In this sense,

ISDS is not dissimilar to existing international legal regimes (notably in the area of human rights) that allow individuals to submit complaints to international bodies or courts.

Dispute Resolution

The standard format for the resolution of investment disputes in past decades has been ad hoc arbitration, usually by tribunals composed of three arbitrators, of which one would be chosen by each party and one by both of them or, failing that, by an independent authority. This has the advantage of ensuring independence and impartiality, and the system is well adapted to the situation where disputes between investors and states are few and far between. However, arbitration proceedings do have certain drawbacks. The most important of them is the fact that arbitral panels are composed of only three members and that they do not form a permanent body but are instead established on an ad hoc basis, which increases the risk of aberrational rulings and the unpredictability of decisions. Arbitration also tends to be very expensive, because parties have to pay the full cost of arbitrators and lawyers. Moreover, a claim has been made by ISDS critics that in practice a rather small group of arbitrators tends to appear in the majority of investment dispute proceedings, creating the sense that a very closed circle of elite lawyers controls the entire process.[8]

To remedy some of these problems, both the United States and the European Union have in recent years supported reforms to the ISDS procedure, notably by proposing improvements such as more transparency, the ability of third parties to file "amicus curiae" briefs, ethical codes for arbitrators, and a prohibition of the use of shell companies to obtain ISDS jurisdiction. Many of these ideas have also been reflected in a recently agreed international convention that seeks to improve the procedural regime governing ISDS procedures.[9] A more radical idea appeared in 2015, when the European Commission, following the demands of civil society and the European Parliament, initiated a discussion about the possibility of replacing ISDS with a mechanism called the Investment Court System (ICS), resembling the process that is currently used by the members of the World Trade Organisation to solve their trade disputes.

Under the proposed procedure, persons sitting on individual panels would be selected from a shortlist of fifteen judges previously agreed by states, and there would also be an appellate body to ensure consistency of decisions and avoid aberrational rulings. Transparency would be ensured with open hearings, while the abuse of the system would be prevented with procedural rules on frivolous claims and a prohibition of initiating parallel claims in national courts. The permanent character of ICS would, in the view of the European Commission, significantly alter the framework of investment disputes and eliminate many of the disadvantages associated with ad hoc arbitration. The main practical risks and downsides of ISDS would thus be avoided while the overall idea of investment protection would be maintained, so the benefit of providing legal certainty to investors would be preserved. The ICS proposal is the version of investment protection included in CETA and now constitutes the official European Union proposal for investment chapters in the trade agreements it seeks to negotiate.

Moreover, the CETA experience has also led to a further development with the announcement by the European Commission — as well as by EU trade ministers and Canadian authorities — that further efforts will be devoted to the establishment of a fully-fledged multilateral investment court (MIC), open to other countries that could in the future replace bilateral ICS solutions. An international discussion of this idea began at the end of 2016, but it is far too early to tell whether it will catch on. A permanent investment court with an independent legal entity that would replace ad hoc arbitrations and the existing web of investment agreements could be a practical answer to the legitimacy crisis that ISDS is currently experiencing. Nevertheless, this solution will require a lot of technical work and immense political commitment, which cannot be assumed. In particular, in the United States, the most important trading partner of both the European Union and Canada, the idea of developing ISDS into a permanent/multilateral body does not seem to have created much enthusiasm so far.

8 Corporate Europe Observatory, "Profiting from injustice," November 2012, p. 8.

9 United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration, adopted by the United Nations General Assembly on December 10, 2014.

Critique Against Investment Protection

Given the widespread backlash against the forces of globalization and criticism of the role of business in society, especially since the financial crisis of 2008, it is not surprising that investment protection has generated a passionate public debate in the context of negotiating agreements like TTIP and CETA. Although it was virtually unknown outside international trade law circles until a few years ago — with the possible exception of the (unsuccessful) negotiation of the Multilateral Agreement on Investment between 1995 and 1998 — it is now one of the major targets of anti-globalist movements and many progressive academics. The situation has changed dramatically in the last couple of years after a series of high-profile ISDS claims alerted the public to the risks that investment arbitration entails and when, almost in parallel, a new generation of comprehensive trade agreements began to be negotiated by the United States and the European Union. By the time TTIP talks entered into a more advanced phase, the campaign against ISDS was already in full swing and often dominated the TTIP debate. It was therefore not surprising that when the European Parliament voted on a resolution on TTIP in 2015, political groups could not agree on the approach to the issue of investment protection and the vote was postponed to find an acceptable wording that called for the replacement of ISDS with a new system that includes an appellate mechanism.[10]

Despite the uncertainty regarding the future of TTIP, it has become clear by now that the mechanism of investment protection is highly controversial and is strongly opposed by broad sections of the public. In Europe, the most scathing critiques have come from journalists and nongovernmental organizations like the Corporate Europe Observatory and Greenpeace, joined by trade unions, consumer protection associations, and many academics.[11] In the United States, nongovernmental organizations like Public Citizen, senator Elizabeth Warren, and Nobel Prize-winning economist Joseph Stiglitz have all rallied against it, as have voices on the libertarian right.[12] Several open letters written by experts in different fields have also been sent to Congress to argue against and in favor of investment protection,[13] and the trend seems to continue even after the CETA signature crisis. In December 2016, for example, 40 academics, including well-known economists Thomas Piketty and Dani Rodrik, signed a special "Namur Declaration" urging the European Union to change its trade negotiation strategy and demanding the elimination or reform of investment dispute mechanisms.[14]

The Argument of Equality

The most important complaint against ISDS is that with this mechanism, foreign investors obtain an unwarranted privilege — an extraordinary legal right to commence legal proceedings against governments for measures that may negatively affect their investments. The mechanism is not available to domestic investors, is asymmetric in the sense that states can only be sued but cannot reciprocally sue investors, and may lead to significant financial liabilities for taxpayers. Technically, this is all true of course, but with a bit of knowledge of the context, it makes perfect sense. Any international court or legal system with enforcement powers — most notably the European Court of Human Rights — work in much the same way by opening a new legal avenue not hitherto available in order to ensure international review of a contentious legal situation and award compensation if necessary. An investment protection system does not, therefore, impinge on democracy or the rule of law any more than any other system of supervised international obligations. The basic idea of investment protection is rather to ensure impartiality in the review of the application of legal rights, which only an independent international body can do — not as a "private court," as is sometimes alleged, but as a public one.

Indeed, in situations where there is an important dispute that has a transnational character, it is only natural that the forum charged with deciding it should be international as well. Investment protection creates a new procedural right for investors, but in

10 European Parliament resolution of 8 July 2015 containing the European Parliament's recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP), (2014/2228(INI)).

11 Corporate Europe Observatory, "The Zombie ISDS," February 17, 2016; Letter signed by 101 law professors, "Legal Statement on investment protection and investor-state dispute settlement mechanisms in TTIP and CETA," October 2016.

12 Simon Lester, "The Rhetoric and Reality of ISDS," Cato Institute, November 10, 2015.

13 Letter of 220 law and economics professors urging Congress to reject the TPP and other prospective deals that include investor-state dispute settlement, September 7, 2016; Open letter to Congress about investor-state dispute settlement, April 20, 2015.

14 Namur Declaration, December 5, 2016.

terms of substance, the underlying substantive right does not differ fundamentally from the protection of property and due process rights already recognized in international human rights law. It simply takes a further step in extending the protection to "investments," a concept that better encapsulates economic entitlements in the modern economy. The real purpose of ISDS as a public policy is thus to set up the possibility of ad hoc international adjudication in an area where there is no international court yet. Investment dispute tribunals in effect act as a kind of mini constitutional courts, reviewing national decisions and practice on the basis of very narrowly tailored principles, as reflected in the language of the specific treaty, with the gist of disputes usually revolving around the issues of retroactivity and investors' expectations.

Some critics claim that the mechanism is not really necessary. However, recent ISDS practice shows that especially in economic sectors characterized by a strong element of public regulation, even in Europe and North America, investors do sometimes face unforeseen and difficult situations due to state action that is highly prejudicial but is not perceived as problematic by local authorities or the general public.[15] For instance, different administrative bodies adopt different positions about permits or subsidies at different points in time or governments fail to respect commitments made by their predecessors. In the Micula case, an ISDS tribunal found that Romania breached the fair and equitable treatment standard contained in the bilateral investment agreement between Sweden and Romania when it removed subsidies and incentives introduced in 1998 to encourage investment in economically disadvantaged regions of the country.[16] Investment protection therefore establishes a kind of "strict liability" of states for the conduct of their authorities in relation to foreign investors. However, as practice shows, critical situations in which investment rights can usefully be invoked are very rare. Because substantive legal guarantees in trade agreements provide for high thresholds, investment protection claims are likely to be submitted only when the decisions at stake deviate substantially from accepted legal and constitutional practice. Investment protection is not (and has never been) an insurance policy against unfavorable legislation or administrative decisions. It does not provide "parallel courts" but rather "courts of last resort."

> *"Investment protection is not (and has never been) an insurance policy against unfavorable legislation or administrative decisions."*

The Argument of Autonomy

A more delicate question is whether the mere possibility of ISDS proceedings, especially in the case of high-value claims, can seriously hamper the exercise of states' sovereign regulatory, legislative, administrative, or even judicial powers because state authorities might fear subsequent adverse rulings by ISDS tribunals. Considering that some ISDS cases (such as Vattenfall) are closely related to regulatory policy, this fear cannot be dismissed outright. However, while critics of ISDS like to list, in a selective fashion, the claims that have been brought in relation to regulatory policy, they usually omit to mention that the actual results of investment arbitration are very mixed. Although there may be quite a number of cases publicly presented as "challenges" to adopted public regulation or administrative decisions, few are actually successful, and they typically involve some element of retroactive effect rather than the content of regulation as such.

As an example, one can look at the notorious recent ISDS cases brought by Phillip Morris against Australia and Uruguay because of the introduction of cigarette packaging requirements, often cited as evidence of its detrimental effect on public policy.[17] When the claims were initiated, they served, to ISDS opponents at least, as proof that the mechanism could be used to derail legitimate policy decisions with important health objectives in order to increase corporate profits. However, by 2016 both cases were dismissed by arbitral tribunals (one on procedural and the other on substantive grounds), demonstrating that ISDS panels do take public concerns very seriously. Another recent case of this kind was Eli Lilly,

15 UNCTAD, Investor-State Dispute Settlement: Review of Developments in 2015.

16 International Centre for Settlement of Investment Disputes, Case No. ARB/05/20, Award.

17 Permanent Court of Arbitration, Philip Morris Asia Limited (Hong Kong) v. The Commonwealth of Australia, Case number 2012-12; International Centre for Settlement of Investment Disputes, Case No. ARB/10/7.

which involved a U.S. pharmaceutical company that complained about the invalidation of its patents by the courts in Canada.[18] The company alleged that the decisions of the Canadian courts had been arbitrary and sought CAN$ 500 million in compensation, a move that was showcased by ISDS critics as a blatant example of an unacceptable threat to legitimate decisions of public authorities. Nevertheless, in March 2017 the ISDS tribunal dismissed the company's claim, finding that the judicial interpretation of patent rules in the case at hand could not form the basis of investment protection claims. It is therefore not an easy matter even for large multinational companies to overcome the procedural and substantive hurdles that investment arbitration involves. In fact, there are no indications at present that any important public policy or regulation in either the United States or the European Union had been skewed or altered as a result of ISDS arbitration.

Due to the many concerns about the future of regulation under an investment protection regime, the European Commission introduced the idea of an explicit provision on the "right to regulate" into its trade negotiation strategy and has succeeded in persuading Canada to accept it in the CETA agreement. The aim of such a provision, which can be said to be implicit even in existing investment protection standards, is to shield public authorities from ISDS claims to a greater extent where the dispute arises after a legal regime in a policy area relevant to investment (such as environmental or social legislation) has changed. Critics counter that this novelty does little to alter the overall picture and they are half-right in the sense that it does not clarify when exactly states' exercise of prerogatives to modify their legislation should lead to compensation. But the kind of absolute legal stability imagined in this argument is in any case unattainable in any modern legal system that has to adapt the application of general principles to the myriad of situations that may arise in social and economic relations.

Admittedly, the introduction of an investment protection regime as envisaged in TTIP and CETA can plausibly be said to increase the risk of adverse rulings against states as the number of disputes submitted to arbitration tribunals will almost certainly increase, given that investment protection guarantees would cover a much larger proportion of foreign investment in the respective jurisdictions. However, it is important to recall that under existing arrangements, the number of ISDS claims is actually minuscule compared to the volume of investments. This is well demonstrated by the situation in Canada, where the stock of foreign direct investment from the United States in 2015 was CAN$ 387.7 billion,[19] while the total amount of damages paid pursuant to adverse ISDS rulings under NAFTA until then was CAN$ 172 million.[20] A legal apocalypse of the kind imagined by the critics of investment protection is therefore extremely unlikely even if the number of cases rises significantly and even if investors would systematically win, which, judging by the experience so far, does not happen to be the case. In fact, statistics shows that outcomes in ISDS are finely balanced.[21]

The Argument of Procedure

The most convincing complaints against ISDS are those that relate to the form of dispute resolution and the costs of proceedings. The system of ad hoc tribunals applied in ISDS practice can arguably be said to be somewhat outdated because it makes sense when only very few disputes are expected to take place. Once their number increases, however, it is systemically rational for international trade agreements to provide a more permanent and structured setting to solve disputes, as the European Commission seeks to do at present. A permanent investment court could, in particular, reduce the risks associated with granting decision-making powers to only three arbitrators and improve the quality and coherence of decisions. It could therefore lead to the creation of a stable and predictable case law detailing the obligations of states under investment protection agreements, so that policymakers and administrators would know in advance if any investment law issues are raised when they make their decisions. Investment protection rulings would thus no longer be an unpleasant surprise occurring several years after the events or decisions in question, but rather a predictable legal consequence in situations that are contrary to the basic precepts of fairness.

18 International Centre for Settlement of Investment Disputes, Case No. UNCT/14/2.

19 Statistics Canada, Foreign direct investment, 2015.

20 Canadian Centre for Policy Alternatives, "NAFTA Chapter 11 Investor-State Disputes," 2015, p. 31.

21 International Centre for Settlement of Investment Disputes (ICSID), Annual Report 2016, p. 38; UNCTAD Investment Dispute Settlement Navigator, http://investmentpolicyhub.unctad.org/ISDS.

The same solution could also alleviate the problem of cost, which can at present be staggering when compared to those incurred in proceedings before permanent international courts. Arbitral arrangements generate expenses that typically run into several million for each case, on account primarily of the exorbitant price of legal representation.[22] For small countries, in particular, significant cost awards can represent a non-negligible and disproportionate public expense that seriously diminishes the credibility of the investment protection mechanism even where the merits of the adverse claims are justified. For example, in a recent ICSID case that it lost, Slovenia had to pay no less than $10 million in costs in a dispute with a value of $20 million.[23] A reform of existing ISDS procedures is therefore also necessary in order to curtail the unreasonably high expenses associated with dispute resolution, which would be advantageous for both the defendant states and the investors as potential claimants. The experience of international courts like the European Court of Human Rights, with a strenghtened role of the secretariat in the processing of cases and limits on the amounts that can be claimed for compensating the costs of legal representation, could offer helpful guidance in this respect.

> *"A reform of existing ISDS procedures is necessary in order to curtail the unreasonably high expenses associated with dispute resolution."*

The Case for Investment Protection

A closer look at the debate about ISDS and the actual legal practice of investment protection shows that most of the fierce criticism is misplaced and unfounded. It is largely based on unfair presentations of the practice of arbitration, misunderstandings of how the mechanism actually works, and, perhaps most importantly, overly dismissive attitudes to the risks faced by foreign investors when they commit their capital and technology abroad. The weakness of the most common critical claims made in the campaign against ISDS should not, however, detract from genuinely problematic issues that investment protection raises, especially in the perspective of a significant extension of the international investment regime envisioned in agreements like TTIP or CETA.

This qualification is important because it is one thing to check the credibility of claims made about ISDS against the — not insignificant, but nevertheless limited — experience with this instrument in the past and debunk the myths surrounding it, and quite another to explain why it should be introduced as a new legal obligation applicable to the legal systems of the United States, Canada, and the European Union, where few, if any, significant legal obstacles appear to be experienced by foreign companies at present. Moreover, from the point of view of established constitutional orders that guarantee judicial protection to all their citizens, a system of investment protection for foreigners can perhaps be seen as somewhat "unaesthetic," which explains why some professional associations of judges in Europe have voiced very strong reservations about it.[24] It is hard to deny, therefore, that with respect to trading and investment relations between mature democracies, arguments in favor of establishing ad hoc investment arbitration as a means of promoting investment are more difficult to make. If, as it is suggested, the likelihood of successful investment protection claims against European and North American states is very low, why should a trade agreement between them include investment provisions at all?

It is not sufficient to answer this question with general defensive arguments or by invoking legal certainty or the rule of law as incontestable objectives that would be promoted by investment protection and should, therefore, be desirable. Legal certainty is not an absolute value in any legal system because it is normally balanced against countervailing social and legal imperatives, which is why any legal rule or decision may require changes over time. The rule of law, a favorite phrase of ISDS defenders, is a rather vague concept that has no unequivocal meaning even in Western democracies. The constitutional

22 Corporate Europe Observatory, "Profiting from injustice," November 2012, p. 15.

23 International Centre for Settlement of Investment Disputes, Case No. ARB/05/24, Award.

24 Deutscher Richterbund, "Stellungnahme zur Errichtung eines Investitionsgerichts für TTIP," November 12, 2015.

traditions of European countries and the United States interpret it in different ways and rely on very different institutional solutions for that purpose, so the concept has no self-evident application in the context of foreign investment.

Neither can a strong justification be drawn from the past practice of bilateral investment agreements, especially given that certain recent trade deals — like the successful trade agreement between South Korea and the European Union — do not contain investment protection provisions. A more convincing argument can rather be developed by looking at comparative experience and demonstrating that a system of investment protection would likely bring certain benefits notwithstanding the risk of adverse rulings and payments of compensation. In other words, the prevailing "negative case" for ISDS should be supplemented with a "positive case" explaining why the public should agree, in the context of trade negotiations, to international legal guarantees that may expose governments to legal liabilities in the future.

The Rationale of International Review

Critics of investment protection often make the point that at present there is no evidence of increased investment following the establishment of ISDS regimes. This may be true, strictly speaking, but there is no evidence in the opposite sense either. Indeed, it would be very counterintuitive to consider that legal protection does not play some role in directing and encouraging investment flows. Economists, for instance, emphasize the importance of "institutional quality" as an economic determinant, pointing to the unpredictability of laws, regulations and policies, excessive regulatory burden, government instability, and lack of commitment as factors that play a major role in deterring foreign investment.[25] Capital seems to pay quite a lot of attention to legal security, as should be obvious from the location of the world's tax havens, but also from studies that confirm the link between investment treaties and investment.[26] Moreover, the significance of legal certainty can also be inferred from the practice of multinational companies, which tend to make great efforts when deciding where to establish headquarters, where to draw up contracts, and where to litigate. Legal stability is therefore not just an idea protected by the constitutional law of modern democracies, but also an intrinsic quality of law that increases economic efficiencies by facilitating rational business choices and long-term planning.

An impartial review of the consistency of national legal practices with a country's international obligations is a means to achieve a certain degree of predictability and confidence in the judicial, administrative, and legislative process. The best example of the positive effect of such a review can be found in Europe, where legal professionals and the general public are long used to the external supervision of domestic legal decisions, which is almost never seriously questioned. The European Court of Human Rights hears appeals from individuals affected by measures of particular states and sometimes finds violations of basic legal principles like the right to due process or the protection of private property. An even more intensive scrutiny of national legal practices is performed by European Union institutions, including the European Court of Justice, which can influence national decisions and policies in areas ranging from justice to consumer protection or competition to the degree that is unknown anywhere else in the world. The European experience shows persuasively that even in developed legal

> ***"An impartial review of the consistency of national legal practices with a country's international obligations is a means to achieve a certain degree of predictability and confidence in the judicial, administrative, and legislative process."***

25 Christian Daude and Ernesto Stein, "The quality of institutions and foreign direct investment," Economics and Politics, Volume 19, Issue 3, September 2007.

26 Lindsay Oldenski, "What Do the Data Say about the Relationship between Investor-State Dispute Settlement Provisions and FDI?" Peterson Institute for International Economics, March 11, 2015.

systems, certain legal measures may occasionally be found to contravene internationally agreed legal principles. It also shows that legal systems can benefit from international assessment of their action because this allows them to claim higher legitimacy.

A plausible justification of investment protection must however also take a further step by explaining why only foreign — and not domestic — investors should benefit from it. The simplest reply to this challenge is that, by any realistic measure, foreign companies are simply not in a comparable situation with domestic ones when they access new markets and start economic operations. They lack the political clout or "voice" in the political process of the host country and the knowledge that is often necessary to build and develop a business in a certain locale. Even where they are initially enthusiastically encouraged to invest in order to provide local jobs, public opinion may over time become hostile, especially if unpleasant business decisions such as cost-cutting measures must be made.

In practice, economic and political effects of regulatory measures adopted by governments often tend to be different in the case of domestic entities, where the loss is borne by the local community (and, indirectly, the state adopting those same measures), and in the case of foreign ones, where the losses are suffered by foreign persons (and, indirectly, other states). This is notably true where the investor cannot easily withdraw an investment and is accordingly exposed for an extended period of time to the policies and decisions of another state. Foreign investors face particular risks in making business decisions that domestic investors do not, so concerns about possible discriminatory or inequitable treatment are not irrational, especially in times of frequent governmental intervention in the economy.

Regulatory decisions imposed by a foreign government can have important ramifications for the state of the investor, especially on account of reduced tax revenue, long-term business interests, and the responsibility of each state for its own nationals. The idea of investment protection therefore also responds to important public concerns and serves as a solution to the very real problem of potential direct conflict among states. Indeed, the 1965 United Nations convention that created ICSID was meant precisely to forestall situations where perceived ill-treatment of a foreign investor could lead to a serious deterioration of relations between states involved in important international transactions.

Perhaps most crucially, it is essential to remember that investment protection is a mutual guarantee, providing a certain assurance to the public that the treatment of individual investors will be fair and consistent with domestic practice in comparable situations. It should be understood as an exchange of reciprocal commitments to indemnify the investors of the opposing party in defined situations where the latter have suffered losses due to state action. In other words, the benefit that a state receives when it agrees to reciprocal investment protection is twofold: the protection of its own businesses in a territory over which it has no control or possibility of influence, and enhancement of its investment climate to attract foreign investment. This is why it is conceptually erroneous to see contemporary proposals to introduce investment protection mechanisms in trade agreements in terms of domestic law, as a kind of anomalous interference with established constitutional orders, or, even less charitably, as an unwarranted unilateral "gift" to multinational companies.

Legal, Institutional, and Regulatory Concerns

Three sets of concerns that investment dispute settlement could raise in the transatlantic context are especially important to consider. The first and the most obvious is the problem of discrimination, which is perhaps the most persuasive argument for establishing international standards of conduct. In the United States, for example, market access in a certain sector can be granted to foreign entities, but the latter may not have any legal redress for discriminatory treatment if non-discrimination obligations are not adequately implemented in internal law. The situation might be especially complicated in areas where the power to adjust internal rules, for example regarding the provision of services, lies with the states or with professional associations. Moreover, specific barriers to investment that could raise investment protection issues have also been identified in the documents of the United States Trade Representative and the

European Commission.[27] Against this background, the possibility of recourse to investment protection might create an incentive for administrative and political authorities at different levels to implement the non-discrimination obligation in practice even where this might not be expedient. Because this obligation does not change or affect the substance of internal rules and is technically very straightforward, its enforcement through investment protection should in principle not be objectionable.

The second area of possible contention is public regulation and taxation, especially in economically sensitive sectors. In fact, several recent examples on both sides of the Atlantic have shown how intricate and controversial individual legal decisions can be when looked at from the other side. The most prominent was the finding by the European Commission in August 2016 that Ireland granted selective tax benefits of up to €13 billion to Apple. In the view of the European Commission, these benefits were illegal under so-called "state aid" rules of the European Union because Apple effectively paid much less tax than other businesses, and as a consequence, the Commission determined that Ireland was obliged to recover the amount in question. Nevertheless, Ireland strongly opposed the decision and has in fact decided to challenge it in European Union courts. The Apple tax ruling — and more generally the European Commission's involvement in matters of international taxation — was however also fiercely criticized by U.S. authorities on account of the alleged retroactive nature of the contested decision.

> *"Several recent examples on both sides of the Atlantic have shown how intricate and controversial individual legal decisions can be when looked at from the other side."*

Conversely, European companies have also seen several major actions by the United States Department of Justice launched against them. A well-publicized case was recently brought against Volkswagen after the car emissions scandal, while a series of proceedings were also lodged against Deutsche Bank, including a major case in relation to its handling of the subprime mortgages. The Volkswagen and Deutsche Bank cases alone have resulted in settlements in the amounts of $14.7 billion and $7.2 billion respectively, which greatly exceed any fines or liabilities that could be imagined in Europe in comparable situations. Similar proceedings have been brought against other European enterprises, with further billions of dollars forfeited to the United States Government.

Considering that the amounts in question were very significant, it is quite possible that decisions like these would have given rise to investment protection proceedings if a transatlantic agreement with investment protection provisions had already been in force. Such proceedings would then have led to a review of the contested decisions before an international panel, which would then have to determine whether they are compatible with investment guarantees, in particular regarding the crucial issues of nondiscrimination and retroactivity. It is, of course, impossible to say in the abstract how an international tribunal would approach regulatory or administrative issues that affect U.S. and European companies, but it is probably safe to assume that, in terms of decisional criteria, the review would not deviate too much from existing practices. Violations would thus probably only be found in highly specific situations and only rarely. In the long run, the credibility of this review would hinge on whether it would ensure reciprocity in the treatment of the similar issues in Europe and the United States, as well as on the substantive outcomes where these are related to controversial issues like tax avoidance or environmental protection.

Thirdly, investment protection claims raised under transatlantic trade arrangements could also address certain institutional weaknesses of domestic legal and administrative systems that have already been identified by international bodies. In the United States, problems with the fairness of civil proceedings were for instance identified in the Loewen dispute, which concerned the complaint of a Canadian funeral home conglomerate that it had been discriminated and unfairly treated by state courts in Mississipi.[28]

27 European Commission, "Report on Trade and Investment Barriers and Protectionist Trends," COM(2016) 406 final, June 20, 2016); Office of the United States Trade Representative, "2017 National Trade Estimate Report on Foreign Trade Barriers."

28 International Centre for Settlement of Investment Disputes, Case No. ARB(AF)/98/3.

The pratice of the European Court of Human Rights has revealed significant problems with administrative competence and judicial performance in a number of European states. Some of these problems, such as the excessive length of judicial proceedings, can have very negative consequences for business entities, especially in sensitive areas like patents. The establishment of an investment protection system in transatlantic trade could accordingly provide legal redress to investors where this is actually needed and objectively justified from the perspective of legal certainty.

These considerations can provide a solid justification for pursuing further discussions on the development of an investment protection mechanism in transatlantic trade relations. However, taking into account the acknowledged failings of the current ISDS procedure and, in particular, the problems of coherence and cost, it can be argued that the future investment protection regime should take the form of an investment court rather than ad hoc arbitration. A permanent judicial institution composed of publicly appointed judges and including an appellate body could resolve many of the pressing problems of investment dispute settlement and lead to the creation of a body of predictable case law. It could, therefore, provide more clarity about the precise obligations arising under investment protection provisions and, in the medium and long-term, also reduce the need for investment protection procedures. At the same time, a permanent investment court could provide a less expensive machinery designed along the lines of other international courts that would avoid the extremely high costs of arbitration associated with legal representation. Such a solution is of course not without risks, especially if states appoint unqualified or inexperienced jurists to the court and the quality of decision-making consequently decreases. Nevertheless, with some effort most problems of this kind can be overcome, and the system could thus maintain the benefits of investment adjudication while avoiding the most controversial features of the current regime.

Conclusion

The mechanism of investment protection is an established but controversial practice in international law. If the United States and the European Union continue with trade discussions and maintain the aim of including this mechanism in their trade framework, they should re-examine its rationale and identify the objectives that are pursued. While it is true that most of the criticism of the current ISDS regime is misguided, the authorities on both sides of the Atlantic have not sufficiently explained why international investment dispute resolution makes sense between advanced economies with developed legal systems. The intrinsic value of legal predictability and international review of domestic legal measures are relevant and important, but strong arguments can also be found in the problems that arise in the coordination and alignement of different institutional and regulatory settings of advanced economies in which investments take place. The issues of non-discrimination, the important regulatory differences between Europe and the United States, and the acknowledged institutional problems associated with the respective legal systems that can have a significant impact on economic operators are sufficiently important to justify further discussions on the future of a transatlantic investment protection system. However, a permanent investment court rather than *ad hoc* ISDS arbitration should be the preferred form of this institution if it is to provide more predictability, reduce cost, and gain greater public acceptance.

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