Modalities for investment protection and Investor-State Dispute Settlement (ISDS) in TTIP from a trade union perspective

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Abbreviations

BIT	Bilateral Investment Treaty
CETA	Comprehensive Economic and Trade Agreement (EU-Canada)
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
ILO	International Labour Organisation
ISDS	Investor-State Dispute Settlement
MFN	Most Favoured Nation
NAFTA	North American Free Trade Agreement
NGOs	Non-governmental organisations
OECD	Organisation on Economic Cooperation and Development
TTIP	Transatlantic Trade and Investment Partnership (EU-US)
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

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I. Introduction and Background

The impact of international treaties protecting foreign investment on a state's ability to regulate and intervene in the economy from a public interest perspective has been the subject of academic debates since the late 1990s.[1] However, it was the debate surrounding an investment protection chapter in the planned Transatlantic Trade and Investment Partnership (TTIP) between the European Union and the United States which moved this issue to the centre of a heated public debate.

In the light of the increased critique of investment protection in the TTIP, especially provisions establishing a system of Investor-state dispute settlement (ISDS), the European Commission decided in January 2014 to launch a public consultation on investment protection in the TTIP.[2] Between 27 March and 13 July 2014, members of the public were invited to reply to a set of thirteen questions addressing specific elements of the investment chapter in TTIP. These questions were illustrated and explained using examples of text taken from the recently negotiated Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada.[3] The consultation generated almost 150,000 online contributions. The largest number of replies came from the United Kingdom, Austria and Germany. Most contributions were submitted by individuals and in many cases were submitted collectively through coordinated actions. 569 organisations, including many NGOs, also responded.[4] The responses to the consultation have not yet been published as the European Commission is still reviewing and analysing the results. According to the Commission, the responses will be analysed during the coming months and a report on the results will be published towards the end of 2014.[5]

Irrespective of the conclusion drawn by the Commission on the basis of the consultation, the debate about the impact of investment protection in the TTIP on regulatory autonomy is set to continue. The present study will therefore address the issues raised during the consultation in a broader context and discuss in particular the impact of investment protection on social and labour regulation and the autonomy of the social partners in regulating these matters through collective agreements.

The study begins with a general assessment of the system of investment protection and ISDS in international agreements (II.). This is necessary even though the EU consultation document did not specifically invite answers to the general question as to whether such a system was desirable. However, any attempt at a thorough analysis of the pertinent issues would be incomplete without discussing this general question first. The study will go on to address specifically the necessity of investment protection in a EU-US agreement (III.). The study then moves on to cover specific aspects of the system of

1 *Titi,* The right to regulate in international investment law, 2014.

2 European Commission, Commission to consult European public on provisions in EU-US trade deal on investment and investor-state dispute settlement, 21 January 2014, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1015.

3 Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP), http://trade.ec.europa.eu/consultations/index.cfm?consul_id=179.

4 European Commission, Preliminary report (statistical overview), Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP), 18 July 2014, http://trade.ec.europa.eu/doclib/docs/2014/july/tradoc_152693.pdf.

5 Investment protection and ISDS in TTIP – EU starts reviewing survey results, 14 July 2014, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1127.

investment protection and shall offer up a discussion on the problems and possible solutions to particular elements of investment protection. These parts of the study follow the structure of the consultation document which in turn follows the general structure of a bilateral investment treaty (BIT) or an investment protection chapter in a free trade agreement such as NAFTA or the proposed TTIP. Consequently, the study addresses a number of substantial elements (IV.) as well as aspects of ISDS (V.). Part VI of the study discusses elements that are missing from the EU approach. The study concludes with a summary of its main findings and recommendations (VII.).

II. General assessment of investment protection and ISDS

Although a number of elements of the current system of investment protection in international law can be traced back to the Friendship, Navigation and Commerce Treaties of the 19th and 20th centuries, the first modern investment treaty which became the model of many treaties was the 1959 Bilateral Investment Protection Treaty between Germany and Pakistan. Most substantive elements of contemporary investment protection law can be found in this agreement. In the decades to come, the number of investment agreements grew with increasing speed and reached a total of more than 3200 agreements by the end of 2013.[6] However, it was not until the late 1980s and early 1990s that a specific type of dispute settlement was introduced in investment treaties which allowed the investor, i.e. the foreign company, directly to file a complaint against the host state and seek arbitration between the investor and the state. The establishment of this system of investor-state dispute settlement turned investment agreements which had hitherto been mere tools of commercial diplomacy into legally enforceable instruments. Once the potential of ISDS proceedings had been realised by foreign investors the number of cases grew exponentially proving the tremendous popularity of this approach.[7]

International agreements with investment protection, in particular with ISDS, establish a system of legal remedies which gives foreign investors a special right to sue directly the state in which they invested based on the allegation that the state violated the substantial terms of the investment treaty. The unique features of this system are:

- No mediation of the investor through its home state: The investor does not have to rely on activities of the home state, i.e. the state where the investor is registered or headquartered, to begin arbitration against the host state. In a system of interstate dispute settlement such as the WTO system, private actors always need to convince their home state to raise a complaint on their behalf.

- Alternative to the national system of legal remedies: the investor may choose whether to sue the host state in local courts or whether to move directly to ISDS. There is generally no requirement to resort to the domestic legal system before turning to an international tribunal. Traditionally the so-called exhaustion of local remedies is a precondition for an international court or tribunal to hear a case.[8] It is also a central element in accessing human rights courts.

- Exclusive access for foreign investors: Invetor-state dispute settlement is only available to investors protected under an international investment agreement. Even if they directly compete with the foreign investor, domestic companies have no standing in such proceedings. This may even lead to a distortional effect on the competitive relationship between foreign and domestic enterprises.

- Awards are pecuniary damage only: investment tribunals typically award compensation in the form of damages. They do not require a state to withdraw or change the measure that violated the investment agreement. Usually, international courts and tribunals issue verdicts which state a violation of international law and require the responding state to change its measures or policy.

- Ad hoc composition of tribunals: Unlike domestic and international courts, investment tribunals are constituted for each individual case and are usually composed of highly specialised lawyers from international law firms.

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6 UNCTAD, Investing in the SDGs: An Action Plan – World Investment Report 2014, p. 114-115.

7 UNCTAD, Investing in the SDGs: An Action Plan – World Investment Report 2014, p. 124.

8 *Crawford/Grant,* Local Remedies, Exhaustion of, Max Planck Encyclopedia of Public International Law, February 2007, para 5, http://opil.ouplaw.com/home/EPIL.

- Confidentiality of the proceedings and the outcome of the case: in line with general practice in commercial arbitration, proceedings of an investor-state arbitration tribunal have traditionally been confidential unless the parties agreed otherwise. This means that not all cases are known, awards are not always published and in many cases the proceedings themselves are not open to the public.

This short overview already indicates that there are a number of fundamental problems associated with investor-state arbitration. They concern the fact that ISDS places at a structural disadvantage domestic investors who have to seek remedies in the domestic legal system only and cannot opt to bypass local courts if they consider them to be inefficient or unfavourable to the cause of the investor. In addition, the general procedural elements of arbitration such as the ad hoc composition of the tribunals and the confidentiality of the proceedings disregard the inherently public nature of the subject of the disputes. Usually, the matters adjudicated by an investment tribunal concern issues of administrative and legislative regulation through laws, regulations and individual decisions. The judicial review of such measures based on individual rights is inherently a matter of public law. Consequently, it should be guided by principles of the rule of law, due process and judicial proceedings.[9]

From a theoretical perspective, the fundamental problem of ISDS is the fact that it combines elements of an arbitration system with elements of a judicial review system. Arbitration as a tool of dispute settlement has its roots in ancient history and has been a useful and successful method of solving legal disputes in a variety of different settings. However, the basis of successful arbitration is the free consent of the two parties to the process. The consent usually concerns one or more disputes that have arisen or may arise between the two parties.[10] In short, arbitration is "a consensual procedure" to settle disputes.[11] Usually, the consent is given in a specific contract or treaty or the consent is based on an ad hoc agreement. In both situations, consent to arbitration is given in the light of a specific contract or treaty with a specific party or in the light of a specific dispute. Consequently, consent to arbitration rests on the assumption that the parties know each other before they consent to arbitration. ISDS, however, is based on the state party's prior consent to any claim a current or potential investor may file. In essence, the state parties to an investment protection agreement with ISDS consent to arbitration with an unknown number of investors who may have invested or may invest in the future in their countries. Whilst the investor will always know who the other party of the arbitration is (the state), the state will only know who the other party is when the complaint is registered because consent to arbitration is given a priori in the investment treaty.

This structural ambiguity of ISDS is not the main focus of the public opposition and academic critique of the system. Instead, the potential or actual impact of ISDS on national regulations and regulatory space are at the heart of the current debate. Due to the open and broad wording of the substantive provisions and their equally broad interpretation by investment tribunals, the subject matter of investment disputes is not restricted to direct expropriation and open discrimination, but also to regulatory measures. As a consequence, governments may be faced with large claims for compensation, which may lead to a "regulatory chill" effect. In addition, investment claims can be used as instruments to influence administrative proceedings in favour of the investor. They may also become an additional burden in the domestic legislative process. As investment disputes concern actions or omissions of the state and not of private actors, collective bargaining or agreements of the social partners could not become a direct target of ISDS. However, an investor might claim that the omission of state action in this context could be a violation of an investment agreement. Hence, ISDS may also have an indirect effect on labour regulations based on collective agreements.

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9 *Van Harten,* Investment Treaty Arbitration and Public Law, 2007.

10 See e.g. Article 7 of the UNCITRAL Model Law on International Commercial Arbitration: "disputes … between them" i.e. between the parties of the agreement to consent to arbitration.

11 *Bower,* Arbitration, Max Planck Encyclopedia of Public International Law, February 2007, para 1, http://opil.ouplaw.com/home/EPIL.

III. Necessity of investment protection in TTIP or CETA in particular

Even if one does not share the general critique of investment protection and ISDS one may question whether investment protection is necessary in an agreement between the EU on the one side and the US or Canada on the other side. Proponents of this approach such as the European Commission or the United States Trade Representative do not argue that the Canadian, US, or EU legal systems do not provide sufficient legal protection to businesses. While there may have been individual court cases in which the foreign identity of an investor may have had a negative impact on the outcome of the case, there is certainly no widespread and systemic disregard of the rule of law in either of these legal systems.

It is also not very likely that US or Canadian investors have been deterred from investing in the EU or that European investors have been deterred from investing in the US or Canada because of the lack of an investment protection agreement between the two sides. Hence, even the traditional argument in favour of investment agreements in a North-South context does not seem convincing in the EU-US or EU-Canada context.[12]

While many observers agree with these positions, they nevertheless insist on the inclusion of investment protection in an EU-US agreement in particular for two reasons: first it is argued that including an investment chapter with the elements suggested in the consultation document would be a major step in the process of reforming investment law while excluding investment protection from the TTIP would be a major setback for the entire system. In essence, this argument claims that a reformed investment protection chapter in TTIP would have a systemic benefit for the investment protection regime in general. The second position holds that without investment protection in TTIP, the EU cannot ask for investment protection in other negotiations e.g. with China or India. This position is based on the idea that the EU must display political evenness vis-à-vis its trading partners in international investment and trade negotiations.

Neither argument is convincing: first, it should be noted that most reforms proposed by the EU in the consultation document have already been implemented in other investment agreements and model BITs (such as the Canadian model BIT) or are being discussed in various forums including UNCTAD's Investment Framework for Sustainable Development. It is unlikely that excluding an investment protection chapter from the TTIP or the CETA would significantly impede the reform of the system. In fact, excluding investment protection from these agreements might even support those reforms because this would indicate that investment protection chapters are not always the best and only solution.

Second, even if one assumes that an investment chapter in agreements with other trading partners is necessary, investment protection in the TTIP is not a prerequisite. In fact, trade and investment relations between European and North American OECD countries traditionally did not involve investment protection agreements. In addition, countries such as Australia have shown that a country can credibly exclude investment protection from a trade agreement with one country (e.g. the US-Australia FTA) and still include it in an agreement with another country (e.g. the Korea-Australia FTA). There is no plausible reason why the EU could not follow a similar path. In fact, it might even be possible that in negotiations with China, China itself will insist on ISDS in an investment agreement even if TTIP contains no investment protection chapter or at least no ISDS.

12 It should be noted that there is no clear empirical evidence that investment agreements actually attract foreign investment even in developing countries, see *Hallward-Driemeier,* Do Bilateral Investment Treaties Attract FDI? Only a Bit … and They Could Bite, in: *Sauvant/Sachs* (eds), The Effect of Treaties on Foreign Direct Investment, 2009, p. 349-378.

IV. Substantial aspects of investment protection

1. Scope

The scope of an investment protection agreement or chapter defines which companies and which types of economic activities are protected by the agreement. This definition is of vital importance because it also determines who has access to ISDS. Usually, the scope is determined by definitions of the terms "investor" and "investment" at the beginning of an investment agreement or chapter.

a) Investment

The definition of the terms "investment" and "investor" according to the EU's approach is intentionally very broad.[13] The definition of investment is "asset-based" which means it is based on economic interests and values and not on enterprises.[14] Using an asset-based approach leads to a wide scope as it covers not only enterprises and equity participation in an enterprise but also debt instruments, interests arising from concessions and contracts, intellectual property rights and claims to money or claims to performance under a contract. The definition of investment is not restricted to long lasting foreign direct investment (FDI), but includes also short-term portfolio investment even if it is purely for speculative reasons.[15] A lasting or significant interest in a foreign enterprise is not a necessary element of the definition of investment.

It has been pointed out that such a broad approach also covers sovereign debt instruments even if they were only acquired by speculative investors. This could make it difficult to restructure government debt as investors could challenge measures which substantially decrease the value of government bonds ("haircuts").[16] This is not just a theoretical problem as investors in Greek government bonds are currently filing complaints against Greece on the basis of investment protection treaties.[17] A group of critical legal scholars has therefore argued that sovereign debt instruments should be excluded from the scope of an investment agreement or chapter.[18]

The EU's approach excludes investments which are not made in accordance with the applicable law at the time the investment was made (known as the "clean hands doctrine"). This is based in parts on existing international treaty and arbitration practice.[19] In the prominent *Yukos* case[20], the tribunal considered this to be a general principle of investment law: "In imposing obligations on States to treat investors in a fair and transparent fashion, investment treaties seek to encourage legal and bona fide investments. An investor who has obtained an investment in the host state only by acting in bad faith or in violation of the laws of the host state (…) should not be allowed to benefit

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13 Public consultation on modalities for investment protection and ISDS in TTIP, Consultation document, http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf, p. 3.

14 On the difference see UNCTAD, Scope and Definition, UNCTAD Series on Issues in International Investment Agreements II, 2011, p. 22.

15 *Geiger,* The Transatlantic Trade and Investment Partnership: A critical perspective, Columbia FDI Perspectives, No. 119, April 14, 2014, http://www.vcc.columbia.edu/content/fdi-perspectives.

16 *Bianco,* The Bitter End of Sovereign Debt Restructurings: The Abaclat v. Argentina Arbitration and the Eurozone Crisis, LIEI 2013, pp. 315–337

17 *Glinavos,* Haircut Undone? The Greek Drama and Prospects for Investment Arbitration, Journal of International Dispute Settlement 2014, p. 12.

18 Statement of Concern about Planned Provisions on Investment Protection and Investor-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP), https://www.kent.ac.uk/law/isds_treaty_consultation.html

19 UNCTAD, Scope and Definition (fn. 14), p. 36.

20 The Yukos case been hailed as a successful example of how investment arbitration can be used to limit the powers of a non-democratic government. However, it should be noted that the claimants of the case were not individuals who suffered from President Putin's arbitrariness, but commercial companies registered in Cyprus and the Isle of Man.

from the Treaty."[21] Consequently, activities which were illegal at the time the investment was made would not be protected by the agreement. In its consultation document, the Commission notes that this requirement would allow investment tribunals to refuse to grant protection to investments made in breach of domestic law.[22] Yet, it should be noted that the consequence of excluding investments which do not fulfil this requirement is obligatory and not within the discretion of the tribunal.[23]

b) Investor

The definition of an investor in the EU's approach is also relatively broad, but limited to enterprises with substantial business activities. This is a welcome clarification and restriction of the scope of the investment chapter as it would exclude companies which are only formally incorporated in the United States (or Canada in the case of CETA) but maintain no commercial presence in the US. As a consequence, "mailbox companies" would not be covered by the chapter on investment protection. However, it is unclear what is meant by substantial business activities. It would therefore be left to an investment tribunal to decide whether the activities of an enterprise in a particular country are sufficient to turn the enterprise into an investor of that country.

It should also be noted that the exclusion proposed by the European Commission does not exclude all US companies with foreign parents. In fact, as long as a company is engaged in substantial business activities in the US it would be considered a "US investor" for the purposes of the TTIP investment chapter even if its shareholders are not US citizens.

2. Non-discrimination

Investment protection agreements and chapters usually contain two principles of non-discrimination. The first of these principles, most-favoured-nation (MFN) treatment, obliges the parties of the agreement to treat foreign investors of one country no more favourably than investors of the other party of the agreement. In other words, the EU may not treat US investors less favourably than e.g. Chinese investors. The second non-discrimination principle, national treatment, prohibits more favourable treatment of domestic vis-à-vis foreign investors. Hence, EU investors may not be treated more favourably than US investors.

a) Most-favoured-nation treatment

Experience of existing investment agreements has shown that the standard of most-favoured-nation treatment has been especially problematic. In the past, investment tribunals have allowed investors to base their claims on more favourable clauses in other investment protection agreements arguing that denying this treatment would be less favourable compared to the treatment afforded under the other investment chapter. In general, investment tribunals have embraced this approach and have hence broadened the scope of investment protection beyond the standards agreed upon in the respective agreement ("importation of standards").[24]

The European Commission seems to be aware of this problem and has introduced language which would limit the possibility of importation of standards through the most-favoured-nation (MFN) clause.[25] However, a closer look at the text of the relevant proposal reveals that the EU's limitation

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21 *Hulley Enterprises Limited* (Cyprus) and others v. The Russian Federation, PCA Cases No. AA 226, 227 and 228, Final Award of 18 July 2014, para. 1352.
22 Consultation document (fn. 13), p. 3.
23 Statement of Concern (fn. 18). See also *Hulley Enterprises Limited (Cyprus) and others v. The Russian Federation* (fn.21), para. 1349.
24 UNCTAD, MFN, UNCTAD Series on Issues in International Investment Agreements II, 2010, p. 107.
25 European Commission, Consultation document (Fn.13), p. 4.

only covers procedural provisions of other investment agreements.[26] As a consequence, a foreign investor may not rely on procedural privileges which have been given to foreign investors in other agreements. However, the EU's approach fails to impose the same limitation on substantial provisions. This means that investors may still import standards from other agreements if they are substantial in nature. For example, the EU's approach towards the standards of fair and equitable treatment and indirect expropriation is stricter than in other more traditional investment agreements. These restrictions could be circumvented if the MFN clause does not exclude the importation of substantial standards from other investment agreements. In the EU context, this is especially problematic because the investment protection chapter of the Energy Charter Treaty contains much broader substantial standards and could therefore be used by investors in the TTIP if the MFN clause does not exclude substantial standards as well.

b) National treatment

Another problem posed by the non-discrimination standards concerns national treatment and has to do with de facto discrimination. This refers to laws and other government measures which do not formally treat foreign and domestic companies differently, but which may nevertheless have a discriminating effect on foreign investors. The EU's draft text contains no further definition of the scope of de facto discrimination. In particular, even general laws which have de facto a discriminatory effect could be a violation of the non-discrimination clauses. This is to be criticised in particular since there are examples in other investment protection treaties which define de facto discrimination in a more restricted way.[27]

The national treatment obligation applies to "the establishment, acquisition, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory". In other words, national treatment covers both the pre- and post-establishment phases. However, this does not amount to a right to establishment which depends on the scope of market opening in the relevant sector. In the CETA and potentially also in the TTIP, this will be regulated in a separate chapter on establishment.

c) Exceptions

Most investment agreements do not contain general exception clauses. Consequently, once a measure is considered a violation of a standard such as national treatment or fair and equitable treatment, governments cannot defend the measures as a justifiable exception to these provisions. Contrary to this, international trade agreements usually contain such exceptions which have been used to balance the principles of trade liberalisation with the requirements of national regulatory autonomy.

The EU proposes to include general exception clauses based on the respective provisions of WTO agreements (Art. XX GATT and Art. XIV GATS) in the investment chapters of the CETA and the TTIP applicable to national treatment and most-favoured nation treatment. This would allow states to defend discriminatory measures taken for specific legitimate policy goals provided that the measures are necessary and that their application is not discriminatory and does not constitute a disguised restriction on trade. However, the scope of the exception clauses in the EU's approach is limited to those policy goals mentioned in Art. XX GATT and Art. XIV GATS. Generally, these include public order and public security measures, health and safety measures and environmental measures. Social and labour policy measures are not covered. In other words, if social and labour laws were to have a discriminatory effect on foreign investors, they might

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26 See Art. X.2 (4) of the consultation document: "For greater certainty, the 'treatment' referred to in Paragraph 1: a. does not include investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements, including compensation granted through such procedures (...)"

27 UNCTAD, National Treatment, Series on Issues in International Investment Agreements, 1999, p. 40-41.

not be justifiable under the general exemption clauses. The same holds true for general measures aimed at the protection of essential public services.

Finally, as is the case with the relevant WTO provisions, the proposed exception clauses contain an introductory clause (the "chapeau") which subjects the application of any measure to a proportionality test. As this test would be applied and administered by an investment tribunal, it is safe to claim that the ultimate act of balancing the investment restriction and how the measure contributes to certain policy goals would be left to these adjudicatory bodies.

3. Fair and equitable treatment (FET)

The requirement of "fair and equitable treatment" is a traditional investment protection standard and can be found in virtually all investment agreements. Extensive interpretations of this standard in past investment arbitration awards turned this standard into a weapon against domestic laws and other regulatory measures. The most important element of this standard concerns the legitimate expectations of the investor[28] which can be based on the legal framework in general[29] or on the behaviour of officials.[30] Another important element of FET is the maintenance of a stable legal and business environment.[31] These interpretations include a presumption against changes and reform and are therefore especially problematic from a social and labour regulation perspective.

The European Commission acknowledges the problems associated with the broad interpretation of FET and rightly aims at a limited scope of this standard. In particular, the EU's approach is based on a closed list of specific situations such as denial of justice, fundamental breach of due process, manifest arbitrariness, targeted discrimination on manifestly wrongful grounds or abusive treatment of investors. In addition, the EU's approach would allow the parties of the agreement (i.e. the US and the EU in the case of the TTIP) to adopt a decision to include "further elements of the fair and equitable treatment obligation". The proposed list would clearly reduce the scope of this clause and lessen its potential to curtail regulatory policies. Yet, it should be noted that the list still contains a number of open terms such as "manifest arbitrariness" or "fundamental breach of transparency". In the past, a number of investment tribunals have based their decisions more on previous case law than on variations of treaty language. Hence, it cannot be predicted whether and to what extent the list proposed by the EU to define FET would reduce the impact of this standard on domestic regulatory autonomy.

Furthermore, the EU's approach towards FET would also include a clause stating that, "the tribunal may take into account whether a party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated". This provision reintroduces the notion of the frustration of legitimate expectation into the definition of FET. It is difficult to see how this could be reconciled with the closed list proposal for defining FET. A systematic and logical interpretation would suggest that the FET standard only applies if a state made specific representations not to deny justice or to fundamentally breach due process. Such an interpretation does not seem practical and it is hence likely that tribunals will predominantly or even only rely on specific representations and legitimate expectations. This would be problematic as states usually make a number of representations to induce investment and they are not always made by the competent officials. A federal invest-

28 The investor's legitimate expectations are the "dominant element" of the fair and equitable treatment according to standard according to the tribunal in *Saluka Investments B.V. v. Czech Republic,* UNCITRAL Arbitration, Partial Award of 17 March 2006, para 304.

29 *CMS Gas Transmission Company v. Argentine Republic,* ICSID Case No. ARB/01/8, Award of 12 May 2005, para 277.

30 *Metalclad Corporation v. United Mexican States,* ICSID Case No. ARB(AF)/97/1, Award of 30 August 2000, paras 85 et seq.

31 *CMS Gas* (fn. 29), para 274.

ment promotion authority, for example, could indicate to the investor that obtaining local licenses will be possible or that exemptions from certain labour and social regulations might be granted without first consulting the competent authorities. It is possible that an investment tribunal might ask the question of whether this created legitimate expectations which were later frustrated. It would have been better if the EU's draft had specified that only representations by competent authorities could create legitimate expectations. This is also a general principle of administrative law.

In the context of the FET standard, the standard of "full protection and security" is also relevant. It has sometimes been interpreted together with the FET standard as one single standard or as a standard with a similar broad meaning.[32] The EU's approach usefully limits this standard to the protection of the physical security of investors and covered investments. As a consequence, non-violent demonstrations, peaceful blockades of factories or strikes can under no circumstances be considered a violation of the standard of full protection and security even if they have an effect on a factory's daily business.

4. Expropriation

Protection against uncompensated expropriation is the historic root and raison d'être of international investment protection. In fact, legal remedies against expropriation – understood as the outright taking of property by the state – have been the main focus of international investment law throughout the 20th century.[33] Usually investment agreements cover direct and indirect expropriation. While the former is usually not considered to be problematic from a regulatory perspective, the notion of indirect expropriation has been used to challenge measures of a general and regulatory nature. However, the exact contours of indirect expropriation remain unclear and have been contested.[34] Regulatory expropriation denotes regulatory measures which generally aim (or are said to aim) at public interests but which deprive the investor of the commercial value of the investment. This notion makes the potential for conflict between investors' rights and regulatory autonomy clearly visible.

The European Commission rightfully addresses this problem. The proposed text covers direct and indirect expropriation, but in order to achieve greater legal clarity these terms are further defined in an Annex on Expropriation. This technique follows the approach of North American investment agreements[35] and can also be found in the 2004 Canadian Model BIT.[36] In fact, the definition of indirect investment in the EU's approach is largely identical to the Canadian Model BIT.

According to the definition in the annex, indirect expropriation is a measure or a series of measures with an effect "equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure."[37] This is a standard and broad definition of indirect expropriation based on previous case law and legal doctrine. The definition is further specified by a list of factors which should be taken into account when determining indirect expropriation. These include the economic impact, the duration and the character of the measure as well as the extent to which the measure interferes

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32 *Cordero Moss,* Full Protection and security, in: *Reinisch* (ed), Standards of Investment Protection, 2008, pp. 144-145

33 *Reinisch,* Expropriation, in: *Muchlinski/Schreuer/Ortino* (eds), The Oxford Handbook on International Investment Law, 2009, p. 408.

34 *Técnicas Medioambientales Tecmed S.A, v. The United Mexican States,* ICSID Case No. ARB (AF)/00/2, Award of 29 May 2003, para. 114; Dolzer, The Impact of International Investment Treaties on Domestic Administrative Law, NYU Journal on International Law and Politics 2005, p. 959.

35 UNCTAD, Expropriation, UNCTAD Series on Issues in International Investment Agreements II, 2012, S. 60.

36 Annex B.13(1) Canada 2004 Model BIT.

37 Consultation document (fn. 13), p. 24-25.

with reasonable investment-backed expectations. The text also clarifies that the sole fact that a measure has an adverse effect on the economic value of an investment is not sufficient to establish an indirect expropriation. Finally, the annex adds a further clarification which states that measures designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations except in rare circumstances. These circumstances are characterised by a severe impact of the measure which appears "manifestly excessive".

Whilst it is positive that the Commission's proposal clearly rejects the so-called "sole effects"-doctrine which would only assess the effects of a measure to determine whether it amounts to indirect expropriation, the definition uses a number of unclear and broad aspects which may provide investment tribunals with the possibility of assessing many general regulatory measures on the basis of protection against indirect expropriation. For example, when assessing the "character" of a measure the tribunal shall be looking at its object, context and intent. This could be (mis)understood by a tribunal to evaluate the measure from a general policy perspective and determine whether the object and intent were legitimate. In addition, the notion of "manifestly excessive" could invite tribunals to assess the measure from the perspective of the proportionality principle.[38] This would give an investment tribunal an overly broad authority to review domestic laws and regulations based on the tribunal's own assessment of the measure's necessity and its relation to the goal that the measure pursues.

Finally, the definition – again – makes a reference to the legitimate expectations of the investor. However, in the context of expropriation, these expectations must be investment-based. In other words, expectations which are solely based on presumptions and discussions with national authorities before the investment was made would not amount to indirect expropriation. In short, it might even be possible that the new definition of indirect expropriation could be broader than the definition of FET and therefore establish a new "boom" of indirect expropriation.

5. Right to Regulate

As indicated at the outset and throughout this study, the impact of investment agreements on domestic regulations is the most contentious substantial issue concerning investment protection in TTIP and CETA. Its impact depends on a number of factors and elements of the agreement. These concern the scope of the investment protection chapter and the definition of the substantial standards such as non-discrimination, FET and expropriation.

Furthermore, the scope of general exception clauses is relevant. As already mentioned, the general exclusion clauses of the EU's approach only apply to non-discrimination clauses (national treatment and MFN), but not to other provisions or to the chapter in general. In addition, they only cover a limited set of policy goals. In particular, there is no clause which would exempt public interest objectives such as fundamental labour rights, protection of public, health, security, rights of employees, social legislation, human rights, financial market regulation, industrial, policy and tax policy and environmental protection from the standards of investment protection.

In the context of the right to regulate, the European Commission also refers to the usual exclusion of audiovisual services from the chapter on investment and services and the so-called prudential carve-out which serves to protect measures taken for prudential reasons in financial services. Both clauses have been used in trade agreements for many years and have not contributed significantly to the protection of the right to regulate.

38 Statement of concern (fn. 18).

However, it should be noted that the EU approach does not contain a so-called umbrella clause which incorporates all other legal claims, including contractual ones, of the investor into the realm of the investment agreement.[39] Due to the potentially broad scope of the umbrella clause and its impact on regulatory autonomy, the omission of this clause in the EU's approach is important and to be welcomed.

In order to balance the right to regulate with investment protection, the European Commission seems to place a great deal of emphasis on the preamble of the agreement. This preamble contains a reference to the parties' right to take regulatory measures. However, the preamble of an international agreement contains usually only non-binding language and is hence often of limited practical value. In fact, the explicit reference to the right to regulate in the GATS Preamble has not been applied in WTO disputes concerning the impact of the GATS on domestic regulations.

Interestingly, the preamble of the EU approach also mentions the OECD guidelines for multinational enterprises.[40] However, this reference is extremely weak. It only states the desire of the parties to encourage enterprises to respect these standards. This is even weaker than the text of the OECD Guidelines itself which "recommend" the observation of the guidelines.[41] Generally, it would be possible to link the adherence of an investor to international standards to its protection through an investment agreement. For example, an investment agreement could state that only investors who adhere to the OECD guidelines or other standards would have access to investor-state-arbitration. Such an approach could be realised in the same manner as the "clean hands"-doctrine.[42]

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39 *Van Haersolte-Van Hof/Hoffmann,* Relationship between International Arbitral Tribunals and Domestic Courts, in: *Muchlinski/Ortino/Schreuer* (eds), The Oxford Handbook of International Investment Law, 2009, p. 974 et seq.

40 Consultation document (fn. 13), p. 26.

41 OECD Declaration on International Investment and Multinational Enterprises, 25 May 2011, http://www.oecd.org/daf/inv/investment-policy/oecddeclarationoninternationalinvestmentandmultinationalenterprises.htm

42 See above III. 1. a)

V. Procedural aspects of investment protection: ISDS

While the substantial provisions of an investment protection agreement or an investment chapter in a free trade agreement define whether or not a national measure violates international investment law, the dispute settlement provisions determine whether such a violation can actually lead to a binding legal decision. Until the late 1980s, dispute settlement in international investment agreement was based on interstate proceedings, i.e. disputes between the host and the home states. As states are generally reluctant to sue each other, hardly any cases were decided in that way. The introduction of investor-state dispute settlement in the 1990s, notably through NAFTA and some modern BITs, allowed foreign companies to lodge claims directly against the host state before an ad hoc arbitration tribunal. Investor-state dispute settlement is now also at the heart of the public opposition against investment protection in CETA and TTIP. The EU's approach reacts to most of the recent arguments against ISDS and proposes a number of new elements while retaining the essence of ISDS.

1. Transparency in ISDS

ISDS in investment agreements is often criticised because of its lack of transparency. Tribunals do not meet in public. The publication of awards is not mandatory. Other documents – such as the complaint – are usually not published. Depending on the applicable arbitration rules, it may not even be known publicly that the hearing took place at all.

In order to introduce more transparency, the European Commission proposed to include the 2013 UNCITRAL Rules on Transparency in Treaty-based Investor-State-Arbitration[43] as mandatory rules in any ISDS under CETA or TTIP. The 2013 UNCITRAL Transparency Rules are the result of three years of negotiations in the UNCITRAL Working Group on Investment Arbitration. The new rules which came into effect in April 2014 require the most significant documents of the case to be published such as briefs and statements of the parties including annexes and all decisions of the tribunal. The EU's approach would include even more documents such as the intent to challenge an arbitrator or the agreement to mediate. Furthermore the investment arbitration tribunals have the right to receive submissions from a third person, i.e. a person that is neither a disputing party nor a party of the TTIP or CETA. In practice, these third persons could be NGOs with an interest in the outcome of the proceedings and who wish to submit so-called "amicus curiae briefs". Finally, all hearings would be public. There are a number of exceptions to these transparency requirements, in particular so as to protect confidential business information. It is left within the discretion of the tribunal to determine whether these exceptions are applicable.

Incorporating the UNCITRAL Transparency Rules into CETA and TTIP and making them binding for all ISDS cases arising from these agreements would be a major improvement compared to previous EU Member States' investment treaties and might significantly change the current investment dispute settlement regime. It is to be welcomed that the EU's approach embraces the most far-reaching transparency rules for investment arbitration that exist today. In fairness, it should be said, however, that many of the standards that have been incorporated

43 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (effective date: 1 April 2014), http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency.html.

into the UNCITRAL Rules already exist in the context of some North American investment agreements.

There are a few open questions concerning the 2013 UNCITRAL Transparency Rules and their modest modification in the EU's approach. In particular, the language could have been more specific in places. For example, Article 6 (3) gives the tribunal the right to hold all hearings in private if this becomes necessary for logistical reasons. It is unclear how an investment tribunal would interpret the term "necessary for logistical reasons". Similarly, Article 4 (3) requires the investment tribunal to assess whether a third party would have a significant interest in the arbitral proceedings. The meaning of these terms could be specified further in the investment protection chapter or the investment agreement itself and not left for an investment tribunal to decide.

2. Selection and qualification of arbitrators

The selection and role of arbitrators has been at the centre of the public critique of ISDS alongside the lack of transparency. Investment tribunals are usually composed of three arbitrators.[44] Each disputing party (i.e. the investor and the responding state) usually selects one arbitrator and the two then select a third member who will serve as a "neutral" chairperson. Members of an investment tribunal are therefore not permanent judges with a fixed salary and personal independence, but are practicing lawyers and sometimes retired judges, diplomats or academics. Due to the specificities of the legal field, the number of individuals who have gained significant experience and know-how to manage these claims is limited. One study convincingly showed that about half of all known investment cases were decided by a group of 15 lawyers.[45] Many arbitrators are recruited from a small number of specialised international law firms.

As many arbitrators also serve as counsel for investors or governments in other cases, it has been argued that this leads to conflicts of interests and an institutional bias of ISDS towards the interests of the investors.[46] Since ISDS can only be initiated by private companies, arbitrators have an interest in generally serving corporate interests if they want to keep the system alive. If tribunals decide too often in favour of governments, investors will eventually lose interest in filing ISDS claims.

The EU approach attempts to address this problem by drawing up a special roster for arbitrators. This roster shall be established by the TTIP Committee on Services and Investment. However, arbitrators are only selected from the roster if the tribunal has not been constituted within 90 days after the claim has been filed. The roster would therefore be voluntary and not mandatory. In practice, the roster would only be relevant if the two parties (i.e. the investor and the state) could not agree on the chair of the tribunal, because only the chair needs to be appointed by agreement. The other two arbitrators are appointed by the parties. As it is unlikely that a party will not be able to select its own arbitrator, appointments from the roster will usually only concern the chair and only if there is no agreement regarding that person. It is hence very likely that the roster will not play an important role in practice.

The EU's approach would also contain the requirement that an arbitrator has experience in public international law, in particular investment law. Expertise in trade law is also desirable. Other fields of international law such as labour or human rights law are not mentioned. In addition, the arbitrators need not be experts on the domestic law of the

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44 Investment agreements and chapters also foresee the possibility of a sole arbitrator, but in practice most tribunals consist of three arbitrators.

45 Corporate Europe Observatory (CEO), Profiting from injustice – How law firms, arbitrators and financiers are fuelling an investment arbitration boom, 2012, p. 38 et seq..

46 *Van Harten* (fn. 9), p. 167 et seq.

responding state even if the case involves highly complicated issues of tax, environmental, social or labour law.

In order to avoid a conflict of interests, arbitrators shall comply with the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration and a Code of Conduct for arbitrators adopted by Committee on Services and Investment. However, it should be noted that the IBA Guidelines only relate to an individual conflict of interests, and not to systemic interest in upholding investment arbitration for the benefit of investors. Furthermore, the proposed code of conduct can only be adopted once the agreement has entered into force. The mandate for the drafting of such a code is quite broad. The EU's approach does not foresee further guidance through the contracting parties as to what behaviour should be regulated by the code and how it should be done.

3. Relationship of ISDS and domestic courts

Traditionally, international law requires local legal remedies to have been exhausted before an international court or tribunal can be presented with the matter.[47] This is still the general rule in proceedings before human rights courts such as the European Court of Human Rights, but also before the International Court of Justice. The underlying rationale behind this principle is to allow the state to rectify an international wrongdoing through its own legal system first before turning to an international judicial or arbitral body.

The principle of exhaustion of local remedies is not a principle of international investment law.[48] Most investment treaties or investment protection chapters do not require the investor to seek local remedies first. Instead, the very idea of ISDS is to provide the investor with a remedy that is not dependent on the use of national courts. This feature of ISDS has been heavily criticised as it allows foreign – not domestic – companies to circumvent the domestic legal system. Nevertheless, as this is the standard approach in almost all investment treaties, it should come as no surprise that the EU approach does not require the exhaustion of local remedies before relying on ISDS either.

Surprisingly though, the European Commission claims in its consultation document that it "favours domestic courts".[49] However, it is unclear how this favour translates into the EU approach. In fact, there are no incentives for the use of domestic legal remedies in the text.[50]

The EU's approach employs what is known as a "Fork-in-the-Road"-clause which excludes in principle parallel proceedings before an investment tribunal and a domestic court. The investor must either declare that any claims before domestic courts have been terminated or that the claims have been settled through a final judgement. As a consequence, the investor cannot bring a claim to ISDS if there is a pending domestic case unless it is withdrawn. If there is no domestic case yet, the investor must also waive the right to bring a claim before domestic courts. However, if there has been a final judgement by a domestic court, the investor can bring the claim without any restriction.

It seems that this rule could exclude behaviour such as that of the Swedish energy company Vattenfall which is challenging the German abolition of nuclear energy before an investment tribunal[51] and in the German Federal Constitutional Court through a constitutional complaint of its German daughter company[52] at the same time. However, the EU's approach only addresses situations in

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47 *Crawford/Grant,* (fn.8).
48 *Van Haersolte-Van Hof/Hoffmann* (fn. 39), p. 1000.
49 Consultation document (fn. 13), p. 12.
50 Statement of concern (fn. 18).
51 *Vattenfall AB and others v. Federal Republic of Germany,* ICSID Case No. ARB/12/12.
52 *Kernkraftwerk Krümmel GmbH & Co oHG und Vattenfall Europe Nuclear Energy,* 1 BvR 1456/12.

which the investor is essentially seeking the same remedy – compensation or damages.[53] In other words, the Vattenfall strategy would not be excluded as the constitutional complaint is seeking withdrawal of the measure while the investment claim seeks compensation.

Investment agreements between countries which operate functioning and mature systems of legal remedies should avoid any possibility of parallel legal proceedings or circumvention of the domestic system. In fact, there is no convincing argument as to why an investment agreement between the US and the EU or Canada and the EU, if it contains ISDS at all, should not require the exhaustion of local remedies as a general principle. Even in investment agreements with less developed legal systems, this principle should be included as it could provide an incentive for reforms and improvements of domestic judicial systems.

4. Further elements of ISDS

a) Rejecting frivolous and unfounded cases

The EU's approach also includes a mechanism for quickly rejecting claims which are manifestly without legal merit or which are unfounded as a matter of law. It is unclear whether and to what extent frivolous or unfounded cases are a significant problem for the impact of ISDS on regulatory autonomy. Undoubtedly, there could be a number of claims which would in fact be clearly without merit and therefore misuse the system. However, it should be noted that ICSID Arbitration Rule 41 (6) already provides for such a possibility. The EU approach would extend this option to cover proceedings under other arbitration rules which do not contain an explicit reference to such a possibility. Nevertheless, the practical value of this instrument appears limited.

The EU approach also contains a provision which would require the tribunal to order the unsuccessful party to pay for the costs of the proceedings unless exceptional circumstances call for another solution to be found. In the past, investment tribunals often ordered each party to bear its own costs regardless of the outcome of the case.[54] In other words, even if the investor lost a case, the responding state would still be required to bear its own costs. The consequence of the rule of the EU's approach would be that if the investor loses the case, the responding state could claim back the costs from the investor. However, if the investor wins, the state will be required to bear the costs of the investor as well. It is unclear which rule would have a greater impact on a state's ability to regulate. It is equally unclear if the new rule would really deter an investor from raising a claim which bears a high risk of being lost.

b) Guidance by the parties through binding interpretations

The state parties of an international investment agreement usually cannot intervene jointly in ISDS proceedings or decide to set aside wards of investment tribunals. They are typically left without any remedy for correcting interpretations of "their" agreement which do not reflect their historic or current intention. In order to provide the state parties with a possibility to influence the interpretation of the agreement, the EU approach foresees the potential for the parties to the agreement to issue binding definitions on specific legal points. In addition, the non-disputing party of an ISDS – usually the home state of the investor – may have the right to participate in the proceedings in order to contribute to the interpretation of the agreement.

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53 Consultation document (fn. 13), p. 31-32.

54 *Gotanda,* Consistently Inconsistent: The Need for Predictability in Awarding Costs and Fees in Investment Treaty Arbitrations, ICSID Review 2013, p. 420.

While mechanisms to guide investment tribunals are generally a useful tool, it is doubtful whether interpretative declarations can meet this objective. In this context it should be remembered that the NAFTA Free Trade Commission issued an interpretative statement on the FET standards in NAFTA in 2001 which was the source of some irritation for investment tribunals.[55] In any event, the NAFTA Free Trade Commission has not used this instrument since which seems to suggest that it may not be the most effective tool for influencing the decisions of investment tribunals.

c) Appellate Mechanism

Unlike the WTO dispute system, ISDS only consists of one level. Debates about the possibility and necessity of an appeals mechanism such as the WTO Appellate Body were especially prominent in the mid-2000s when some investment tribunals issued diametrically opposed interpretations of the same or very similar investment agreements.[56] These and other inconsistencies of investment tribunals could be addressed and rectified by an investment appeals mechanism. Some model BITs such as the US Model BIT contain a clause that would allow an appeals procedure in the event of such a mechanism being introduced at global level. However, there seems to be no international consensus on establishing such a mechanism for all investment agreements.

The EU approach contains the possibility of establishing an appellate body which would apply only to the respective agreement, i.e. the CETA or the TTIP. It is hence questionable whether the decisions of this appellate body would significantly contribute to the general and systemic coherence of ISDS decisions in general. In fact, an appellate body that only reviews awards issued on the basis of one agreement may also contribute to incoherencies. In any event, the proposed text is very short and lacks any details concerning the appellate body. It is hence impossible to assess fully this element of the EU's approach.

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55 *Kaufmann-Kohler,* Interpretive Powers of the Free Trade Commission and the Rule of Law, in: Gaillard (ed), Fifteen Years of NAFTA Chapter 11 Arbitration, 2011, p. 183.

56 *Qureshi,* An Appellate System in International Investment Arbitration, in: *Muchlinski/Ortino/Schreuer* (eds), The Oxford Handbook of International Investment Law, 2009, p. 1155 et seq.

VI. Missing elements

The EU's approach to investment protection and ISDS in the CETA and the TTIP seems to contain certain elements which have not yet been used extensively in investment protection agreements of the EU Member States and which can therefore be considered "new" from a European perspective. However, there are also a number of elements which could have or should have been included especially in order to protect labour and social interests.

First, it should be noted that the EU approach contains no provisions on investors' obligations. The EU therefore follows the traditional approach of investment agreements that only set out the rights, but not the obligations, of enterprises. It is often argued that investor obligations, for example in the field of social and labour rights, are set out in domestic laws which the investor must adhere to. However, this argument is flawed in the context of international investment law: investment agreements contain investors' rights which often also exist at the national level such as the protection of the right to property, transparency, rule of law, proportionality, access to justice and the right to legal review. If it seems appropriate to safeguard these rights through international agreements there is no compelling reason to reject the idea that investor obligations which also exist at the national level should be reinforced or reiterated at the international level. For example, the Model Agreement on Investment for Sustainable Development of the International Institute of Sustainable Development (IISD) includes a provision that obliges investors to "uphold rights in the workplace and in the state and community in which they are located."[57]

Second, the EU approach has nothing whatsoever to say on the relationship between investment protection on the one hand and the promotion of human or labour rights as well as social and environmental standards on the other hand. This is disappointing not only in the light of the lively academic and public debate on these issues[58], but also because investment agreement practice of other states addresses these issues. For example, the US Model BITs contains a specific provision on labour and investment.[59] In this provision, the parties to the agreement reaffirm their obligations as members of the International Labour Organisation (ILO) and their commitments under the ILO Declaration on Fundamental Principles and Rights at Work. Furthermore, they are obliged not to waive or derogate from the labour laws in order to attract investment. EU trade agreements usually contain similar obligations in separate chapters, however, without a specific reference to the investment chapter. Yet, such a reference might be useful in indicating the importance of labour protection to investment tribunals.

Furthermore, there is no requirement in the EU's approach for the investment or the investor to fulfil criteria such as corporate social responsibility standards[60] or to meet the requirements of non-binding guidelines for multinational enterprises. For example, an investment agreement could exclude from its scope activities which cause or contribute to serious violation of international

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57 *Mann,* International Investment Agreements, Business and Human Rights: Key Issues and Opportunities, IISD 2008, p. 14.

58 *See Dupuy/Petersmann/Francioni* (eds), Human Rights in International Investment Law and Arbitration, 2008.

59 See Article 13 of the 2012 US Model BIT available at http://www.state.gov/documents/organization/188371.pdf

60 See also *Griebel,* Die TTIP-Verhandlungsposition der EU-Kommission – ein überzeugender Reformansatz mit leichten Schwächen im Detail, 16.4.2014,http://www.verfassungsblog.de/de/die-ttip-verhandlungsposition-der-eu-kommission-ein-ueberzeugender-reformansatz-mit-leichten-schwaechen-im-detail/

human rights, in particular core labour standards such as collective bargaining, equal pay and abolition of child and forced labour.

The EU's approach also contains no general exception clause applicable to all standards of the agreement. As mentioned above, the general exception clauses only apply to non-discrimination and not to the agreement as such. In other words, a measure amounting to an indirect expropriation or a measure violating the fair and equitable treatment standard could not be justified on the basis of the exception clauses. In order to allow for a more balanced approach, the EU's proposed investment chapters should include a general exception clause which would cover all obligations. In this regard, an example would be Article 10 of the Canadian Model Bilateral Investment Protection Agreement.[61] Furthermore, the exception clause contains no reference to social and labour policy measures within the existing exception clause. As a consequence, it might be easier to defend measures aimed at the protection of the environment or at the protection of human or animal health than measures aimed at safeguarding labour rights or social security.

61 Article 10 (1) Canada 2004 Model BIT: "Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: (a) to protect human, animal or plant life or health; (b) to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or (c) for the conservation of living or non-living exhaustible natural resources.", available at http://italaw.com/documents/Canadian2004-FIPA-model-en.pdf.

VII. Conclusion and summary of main findings

The EU approach towards investment protection and ISDS as described and explained in the consultation documents contains a number of improvements when compared with traditional BITs, including BITs of some of the EU Member States. If one considers the system of investment protection generally to be useful and assumes that this system can be improved through reforms, the EU approach should be perceived as a step in the right direction as it contains a number of useful improvements.

These improvements concern *inter alia*
- a clarification that pure letter-box companies will not benefit from investment protection;
- the exclusion of procedural matters from the application of the MFN clause;
- the clarification and limitation of the scope of the concepts of fair and equitable treatment and indirect expropriation; and
- mandatory transparency requirements for ISDS based on the UNICTRAL Transparency Rules.

However, even from a perspective of considering an improved investment protection system including a reformed ISDS to be more desirable than no investment protection, the EU approach is somewhat unsatisfying because it fails to incorporate reform proposals which have been advanced in recent debates and treaty practice.

In this respect, the EU's approach is insufficient because it fails to
- exclude portfolio investments from the scope of investment protection;
- clarify that MFN does not apply to substantial standards of other investment treaties;
- clearly state that investors' expectations are only relevant if they are based on formal statements issued by competent authorities and do not prejudge the legislative process;
- apply general exceptions to all substantive investment standards instead of just to non-discrimination;
- avoid investors seeking remedies from ISDS before relying on domestic courts first if remedies in a functioning judicial system are available through a local remedies exhaustion rule;
- oblige the parties to adopt binding rules on arbitrator ethics and specify the contents of these rules; and
- foresee the possibility of an appeals mechanism which would apply to all investment treaties and not just the TTIP.

Including these elements would improve the EU's approach from a reformist perspective. Regarding the requirement of the exhaustion of local remedies, unless these are not available or effective, one option could be to require the investor to prove that he or she cannot expect effective remedies from the domestic legal system, because these remedies are not available to him or her and effective remedies may not be on offer. In this respect, guidance can be found in the case law of the European Court on Human Rights. In addition, the EU's approach could be improved by requiring investors to adhere to international standards and guidelines for multinational enterprises (such as the OECD Guidelines or the ILO Declaration) before turning to ISDS.

Despite the improvements and regardless of potential further improvements from a reformist perspective, investment protection including ISDS in an EU-US agreement remains in principle problematic for the following reasons:

First, ISDS establishes a system of judicial protection which is only available for foreign investors. By definition, this additional system awards bene-

fits to foreign companies which are not given to domestic companies. This discriminates against domestic companies.

Second, ISDS has the potential to destabilise the domestic judicial system, because public measures (such as laws, regulations, decisions, etc.) can be subject to two diverging legal assessments. This leads to legal uncertainty in particular if the questions before domestic courts and investment tribunals are essentially the same (i.e. whether the measure violates individual economic rights such as the right to property).

Third and finally, ISDS can influence domestic legislative and administrative decision-making. Even if the substantive standards are defined in a restrictive way and even if ISDS proceedings are transparent, investors may nevertheless file their claims. The likelihood of the investor winning could be reduced through the EU's reform proposals, but the potential threat of an ISDS claim remains as long as agreements such as TTIP or CETA contain a chapter on investment protection.

Improvements to the international investment protection system would require a new start, instead of relying on reforms of the current system. Such a new start should be based on the following principles and rationales: international investment law should generally protect domestic and foreign investors engaged in sustainable investment activities against arbitrary state actions, promote the rule of law and the protection of property rights in order to foster sustainable development and growth in all countries, be compatible with domestic regulations aimed at legitimate public interests even if they have negative impacts on private business activities and be integrated into domestic legal systems and support the development and maintenance of an impartial and functioning judicial system which is compatible with international human rights standards.

Measured against these requirements, current international investment agreements including the EU's approach as laid down in the draft investment chapter of CETA are not the appropriate path. Therefore, it does not seem possible to bring about improvements in the current system without making a fundamental change.

An alternative investment protection system could be founded on a number of ideas. One option would be a reliance on state-to-state dispute settlement. This approach which has worked effectively in the WTO has never been tested in the context of investment protection even though it exists in virtually all investment agreements and chapters. Under such an approach, the investor's home state would sue the host state after the investor had exhausted local remedies. Another option would be to establish a permanent international investment court which would hear claims on the basis of investment treaties instead of arbitration tribunals. This option would keep the right of investors to raise claims on their own behalf but the legitimacy, transparency and neutrality of international court would be higher than that of investment tribunals.

Apart from these alternatives to investment arbitration, a completely new approach would be to negotiate and agree on measures which would improve the judicial systems in countries which are still developing an independent and efficient judiciary. To further advance this cause, investment agreements could include chapters on judicial reform and the rule of law and international trade and investment agreements should offer cooperation and support for countries which are struggling with these issues. For example, it might be worth exploring this avenue in the EU's current and future negotiations on trade and investment agreements with Thailand, Vietnam or other countries. However, a trade agreement with the US or with Canada does not require such a chapter, because the US and the Canadian legal systems offer sufficient protection for economic actors including foreign investors.

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