



# Investor-state dispute settlement (ISDS) and the Transatlantic Trade and Investment Partnership (TTIP)

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Investor-state dispute settlement (ISDS) is a provision often found in the text of trade and investment agreements. It allows investors to bring legal proceedings against foreign governments that are party to the agreement, typically if they believe they have been subject to expropriation or discriminatory treatment in that country. The proposed Transatlantic Trade and Investment Partnership (TTIP) is envisaged to contain “an effective and state-of-the-art investor-to-state dispute settlement mechanism.” This has raised concerns that the TTIP will undermine the power of national governments to act in the interest of their citizens.

This note answers some common questions about investor-state dispute settlement provisions (ISDS) and discusses some ISDS cases in the context of the proposed EU-US Transatlantic Trade and Investment Partnership.

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# 1 Background questions

## ***What is investor-state dispute settlement (ISDS)?***

ISDS is a provision often found in trade and investment agreements that allows investors to bring legal proceedings against a foreign government that is party to the agreement. Importantly, these proceedings are brought under international law, thereby providing more certainty that the investor will have their claim adjudicated in an impartial manner. If the government is found to be in breach of its obligations under the agreement, the harmed investor can receive monetary compensation or other forms of redress. This may occur, for example, if the government has expropriated the investor's assets, or treated it in a discriminatory way, assuming such actions are prohibited by the agreement.

## ***Where are ISDS provisions found?***

Most ISDS are contained not in trade agreements, but in the spaghetti bowl of bilateral investment treaties (BITs), of which there are at least 2,500 currently in force. A recent OECD survey found that 93% of BITs contained ISDS provisions.<sup>1</sup> However, 'trade' agreements that also contain investment promotion measures can also be expected to include ISDS: for instance, the North American Free Trade Agreement (NAFTA) contains ISDS provisions in [Chapter 11 Section B](#), while the proposed EU-US Transatlantic Trade and Investment Partnership (TTIP) is envisaged to contain "an effective and state-of-the-art investor-to-state dispute settlement mechanism".<sup>2</sup>

## ***How did ISDS emerge?***

The ISDS system emerged simultaneously with the development of BITs as a means of promoting and protecting investment: the UK's earliest BIT, with Egypt in 1975, contained ISDS provisions, as does Germany's 1962 BIT with Turkey.<sup>3</sup> Prior to the emergence of the ISDS system, investor state disputes that could not be resolved by direct investor-state dialogue or proceedings in domestic courts were either not settled, or were handled by diplomatic action and, *in extremis*, the threat or use of military force.

## ***Why did ISDS emerge?***

In principle, the availability of remedies through ISDS enhances the credibility of investment treaties, since states have a stronger incentive to honour their treaty commitments. Thus, ISDS is both an enforcement mechanism that promotes compliance and a means of compensating victims of harm caused by breaches of investment treaty provisions. This may be particularly important where domestic dispute resolution procedures may be biased (e.g. as a result of institutional weakness and corruption).

Proponents of ISDS often point out their mutual benefits for both state and investor in this respect, since as well as providing a guarantee for investors that claims will be adjudicated impartially, it enables countries to attract foreign investment that may otherwise be discouraged by poor governance. Others point out that ISDS can create an unjust situation whereby foreigners have access to a form of redress denied to domestic firms and individuals who also suffer from the same problems. There are a number of other concerns with ISDS relating to transparency, legitimacy, decision-making, independence and cost, which are examined in more detail below, and in the briefings at the footnote.<sup>4</sup>

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<sup>1</sup> OECD (2012) [Investor-state dispute settlement: a scoping paper for the investment policy community](#)

<sup>2</sup> [European Council TTIP negotiating directive](#), 17 Jun 2013

<sup>3</sup> Treaty between the Federal Republic of Germany and the Republic of Turkey, [Article 11](#)

<sup>4</sup> UNCTAD IIA Issues Note No.2 [Reform of investor-state dispute settlement: in search of a roadmap](#) (June 2013) and Issues Note No.1 [Recent developments in investor-state dispute settlement](#) (May 2013)

## What are the concerns with ISDS arrangements?

### Legitimacy

Foreign investors can use ISDS claims to challenge measures that may have been adopted by governments in the public interest. For instance, a change to the way health services are delivered to favour provision by a state monopoly may lead foreign investors to claim that they have been treated in a discriminatory way, or that their assets have been indirectly expropriated.<sup>5</sup> Some have questioned the democratic legitimacy of arrangements whereby such conflicts between public and foreign commercial interests are resolved by three individuals, appointed on an *ad hoc* basis (see 'decision making' section below). It has also been argued that the threat of arbitration proceedings can create disincentives for governments to pursue regulation in the public interest.

### Transparency

For the most part, investor-state arbitration rules were originally crafted to apply to commercial disputes between private parties.<sup>6</sup> Thus, depending on the arbitration forum and rules, ISDS proceedings may be subject to a very high degree of confidentiality, with proceedings, outcomes and awards unpublished. In many cases, the very existence of a dispute may be unknown.<sup>7</sup>

### Forums and rules

Typically, the ISDS provision in an investment treaty or trade agreement will set the terms under which a claim can be submitted to international arbitration (e.g. some will require attempts at an amicable settlement to be made first). Where a claim is brought, it may also prescribe the set of **rules** by which the dispute is to be adjudicated and the international **forum** in which the case is to be heard.

Many treaties offer a choice of forums and rules. The most notable of these is the International Centre for the Settlement of Investment Disputes (ICSID), which offers both a forum (i.e. a centre that administers arbitration cases), and a set of rules for arbitration that have been developed specifically for investor-state disputes. The Court of Arbitration of the International Chamber of Commerce also offers both a forum and a set of rules, although this is primarily geared towards commercial arbitration. Alternatively, the parties may have the choice of appointing their own *ad hoc* arbitration panel, operating under its own rules, or under some set of existing rules, such as the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).

The choice of forum and rules will generally influence the level of transparency of proceedings, and may even have a bearing on the final outcome. According to the OECD, the 'overwhelming majority' of ISDS provisions allow the investor the ultimate choice over the forum. Rules, if they are 'ad hoc', generally have to be mutually agreed.

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<sup>5</sup> The European Commission has asserted that investor-state dispute settlement arrangements in its trade and investment agreements, such as that included in the Canada-EU Comprehensive Economic and Trade Agreement, do not interfere with states' rights to 'regulate to pursue legitimate public policy objectives such as the protection of health, safety, or the environment' (see, for instance [Investment provisions in CETA](#))

<sup>6</sup> The exception is the ICSID rules.

<sup>7</sup> The ICSID arbitration rules were amended in 2006, partly with the aim of improving transparency and allowing non-parties the opportunity to influence tribunal decisions. The UNCITRAL rules were amended in January 2013 to improve transparency, including a public registry of disputes, open oral hearings, and publication of key documents; but these rules only apply to *future* BITs and other investment agreements. For further details, see, for instance, Johnson et al (2013) [New UNCITRAL rules on transparency: application, content and next steps](#)

### *Decision-making*

According to the UN Conference on Trade and Development, the arbitral decisions that have been made publicly available have “exposed recurrent episodes of inconsistent findings... [including] divergent legal interpretations of identical or similar treaty provisions as well as differences in the assessment of the merits of cases involving the same facts”.<sup>8</sup> As well as issues of justice and fairness, the inconsistency of findings raises concerns about the predictability of international investment law, and questions about whether ISDS are fit for their intended purpose.

### *Independence and impartiality*

Members of ISDS tribunals are generally legal professionals with other career activities: the same individual could be arbitrator, counsel or expert in different ISDS cases. In most cases, the panel consists of three arbitrators, two of whom are selected by each party, with the third chosen by mutual agreement. Some believe this can lead to biased judgements. According to the OECD, “parties generally try to identify candidates who will be sympathetic to their case and who have the right character, reputation and persuasiveness to convince the other two arbitrators (and in particular the likely presiding arbitrator) of the validity of their case”. It also notes that 95% of dissenting opinions are written by the arbitrator nominated by the losing party.<sup>9</sup> Others argue that both state and investor prefer having the ability to choose an arbitrator, as it gives them more control over the process.<sup>10</sup>

### *Time and cost*

The average cost of an arbitration case is \$4m per party, approximately 82% of which is legal fees. Most take several years to conclude. This is partly due to the fact that many legal issues remain unsettled, meaning extensive resources must be used to develop a legal position by closely studying previous arbitral awards. Under the ICSID rules, each member of the arbitral panel can claim a daily fee of \$3,000 plus expenses,<sup>11</sup> while billing rates for arbitration lawyers run to \$1,000 per hour.<sup>12</sup> Generally, tribunals have not required the investor to pay the state’s costs, irrespective of the outcome.

### *Proliferation of cases*

According to the UN Conference on Trade and Development,<sup>13</sup> ISDS cases proliferated during the 2000s and the number of *known* new cases reached a record number of 58 in 2012, bringing the cumulative total to 514 by the end of that year.<sup>14</sup> However, since most arbitration forums do not maintain a public registry of claims, the total number of cases is likely to be higher. Of the 244 known cases that have been concluded, 31% were resolved in favour of the investor, 42% in favour of the state, and the specific terms of the remaining 27% remained confidential.

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<sup>8</sup> UNCTAD IIA Issues Note No.2 [Reform of investor-state dispute settlement: in search of a roadmap](#) (June 2013)

<sup>9</sup> OECD (2012) [Investor-state dispute settlement: a scoping paper for the investment policy community](#)

<sup>10</sup> See, for instance, [comments](#) submitted to OECD public consultation on investor-state dispute settlement

<sup>11</sup> ISCID [Schedule of fees \(effective January 1<sup>st</sup> 2013\)](#)

<sup>12</sup> OECD (2012) [Investor-state dispute settlement: a scoping paper for the investment policy community](#)

<sup>13</sup> UNCTAD IIA Issues Note No.1 [Recent developments in investor-state dispute settlement](#) (May 2013)

<sup>14</sup> The UK has been the source of thirty known claims (i.e. investors from the UK have brought thirty claims against foreign countries), the third-highest in the world behind the Netherlands (50) and the US (123).

### ***Where does ISDS sit in the international legal framework?***

ISDS sits among a diverse array of international bodies, procedures and mechanisms that promote compliance with international law, help to settle disputes, and provide redress for victims of harm caused by violations international law.<sup>15</sup> However, an OECD working paper notes three features which distinguish it from other international legal institutions:-<sup>16</sup>

Firstly, while many the other international dispute settlement mechanisms are anchored in well-defined treaty frameworks, the legal basis of ISDS is complex and varied, resting as it does on the dispute resolution provisions contained in thousands of BITs, in other conventions like ICSID, and in arbitration rules.

Secondly, ISDS allows private parties to bring claims against states that may result in large monetary awards: the largest to date has been a \$1.77bn award against Ecuador, while the largest claim (sought by three claimants) has been \$114bn against Russia. Few other mechanisms enable private parties to compel states to participate in dispute resolution procedures involving monetary compensation of this magnitude.

Finally, the institutional set-up of ISDS draws heavily on that of commercial arbitration (e.g. ad hoc, party appointed arbitration panels, emphasis on speed and finality of findings).

### ***Do the treaties on which the EU is founded contain ISDS provisions?***

The arrangements in the EU are slightly different from typical ISDS mechanisms because there is no provision in EU law for claims by companies against governments to be brought to *international* arbitration; instead, companies can bring claims to the Court of Justice of the European Union (CJEU). The CJEU consists of one judge per Member State; its status is enshrined in the EU treaties agreed by all Member States; and its hearings are in public. Its transparency and claims to legitimacy are thus arguably stronger than the arbitral panels used to settle ISDS cases.

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<sup>15</sup> See in particular the chart produced by The Project on International Courts and Tribunals: [The international judiciary in context](#)

<sup>16</sup> OECD (2012) [Investor-state dispute settlement: a scoping paper for the investment policy community](#)

## 2 The Transatlantic Trade and Investment Partnership (TTIP) and ISDS cases

The proposed TTIP is envisaged to contain “an effective and state-of-the-art investor-to-state dispute settlement mechanism”. An idea of what is meant by this can be gleaned from the European Commission’s draft text for ISDS provisions, which it is envisaged will form the basis of ISDS in future trade agreements negotiated by the EU.<sup>17</sup> According to some analyses,<sup>18</sup> the text contains considerably more detail on transparency, enforcement of awards, and the constitution of tribunals than is typically found in ISDS other arrangements.

Nonetheless, the inclusion of ISDS in TTIP has raised concerns that the agreement will undermine the power of national governments to act in the interest of their citizens.<sup>19</sup> In particular, some commentators have claimed that, as a result of ISDS proposals for the TTIP, measures to open up the NHS to competition could be made irreversible if the provisions required US companies to be compensated in the event of a change of policy.<sup>20</sup>

The UK has more than 90 BITs, all of which have ISDS arrangements. To date, only two publicly known claims have been brought against the UK under ISDS, and neither was in connection with a change in public policy.<sup>21</sup> There are, however, international examples of policy change motivating legal action by foreign investors, including in the health sector. A few selected cases are discussed in more detail below.

### *Cases against the Slovak Republic*

The Slovak Republic extensively liberalised its health insurance market in 2004, leading to inward investment from a number of foreign companies in that sector. In late 2006, a new government sought to reverse this liberalisation; the effect of the reversal was to restrict the extent to which insurance companies could repatriate or retain their profits. A number of separate claims were brought by the insurers or parent companies and different outcomes have resulted. For instance, in *HICEE v Slovak Republic*, the arbitration tribunal found that the applicable bilateral investment treaty between the Netherlands and Slovakia did not extend HICEE’s protections to investments held through a locally incorporated intermediary company. In *Achmea v Slovak Republic*, however, a tribunal awarded \$22m damages plus \$3m legal costs. In order to enforce the judgement, Achmea has succeeded in getting the Luxembourg courts to order local banks to freeze the €29.5m-worth of assets of the Slovak Republic.<sup>22</sup>

In most (if not all) cases, the Slovak Republic has argued that, as a result of its accession to the European Union, EU law superseded the BITs, and so the arbitration panel had no jurisdiction to decide the disputes. This argument has, on the whole, been rejected by tribunals, though more generally, the status of bilateral investment agreements between EU Member States has resulted in complex legal issues and conflicting decisions of investment arbitral tribunals.

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<sup>17</sup> The draft text was not published, but a summary of the Commission’s approach can be found in the November 2013 fact sheet [Investment protection and ISDS in EU agreements](#)

<sup>18</sup> See, for instance, Investment Treaty News [Analysis of the European Commission’s draft text on ISDS for EU agreements](#)

<sup>19</sup> See, for instance, George Monbiot [This Transatlantic trade deal is a full-frontal assault on democracy](#), Guardian, 4 Nov 2013

<sup>20</sup> See, for instance, Davies, P. (2013) [Trade secrets: will an EU-US treaty enable big business to gain a foothold?](#) BMJ 2013;346:f3574

<sup>21</sup> [UNCTAD database of treaty-based ISDS cases](#). The specific cases are *Eurotunnel Group v. France and United Kingdom 2003* (awarded in favour of investor) and *Sancheti v. United Kingdom 2006* (unknown outcome).

<sup>22</sup> [Achmea press release](#), 23 May 2013

### ***Philip Morris v Uruguay***

This case, brought under the Switzerland-Uruguay BIT, concerns measures relating to cigarette packaging and branding imposed by the Uruguayan Government. Specifically, Philip Morris is complaining about three measures that it asserts 'deprive the company of its ability to use its legally-protected trademarks and brands':-

- a requirement for companies to sell only one variation of cigarettes per brand (thereby ruling out, say, the marketing of Marlboro Lights and distinct from Marlboro Red).
- an increase in the size of health warnings on cigarette packets from 50% to 80% of total pack size
- the design of the six messages/images that fill the 80% space, which Philip Morris says are not designed to warn of the actual health effects of smoking, but to 'invoke emotions of repulsion and disgust, even horror'

The case is pending. Because the claim is being heard under the ICSID rules, more information is available than for other types of case (see footnote).<sup>23</sup>

### ***NAFTA cases***

As well as changes in public policy, a common theme in ISDS cases relates to the violation of treaty provisions that guarantee that foreign investors will not be treated less favourably than domestic companies. This was (at least part of) the substance of cases brought by Apotex, a Canadian pharmaceutical company, against the US Government; and of Centurion Health Corporation against Canada. Both of these, however, were dismissed: the first as a result of the failure of the claimants to pay a share of a \$100,000 deposit towards costs, the second on the grounds that the tribunal had no jurisdiction.

The US pharmaceutical firm Eli Lilly has brought a claim for 500m Canadian dollars under NAFTA after Canadian courts invalidated their monopoly patent rights for two of their drugs, Strattera and Zyprexa.<sup>24</sup> Eli Lilly claims that, in invalidating the patent, the courts were applying new and additional requirements to demonstrate the drug's utility to those existing at the time the patent was granted. On this basis, they contend that Canada is breaching its investment obligations under NAFTA Articles 1110 (relating to expropriation and compensation) and 1105 (which requires foreign investments to be treated in accordance with international law).<sup>25</sup>

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<sup>23</sup> A full set of documents can be found [here](#).

<sup>24</sup> Eli Lilly and Company (June 2013) [Notice of arbitration](#)

<sup>25</sup> The original notice of intent also referred to NATFA Article 1102 (which requires foreign investors to be treated no less favourably than domestic ones).