



## **Inclusion of ISDS Arbitration or an Investment Court in the TTIP: Unresolved Concerns**

Brooke Skartvedt Güven  
Legal Researcher, Investment Law and Policy  
Columbia Center on Sustainable Investment  
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brooke.guven@law.columbia.edu

The negotiation of the Investment Chapter of the TTIP presents an important opportunity to thoroughly evaluate the costs and benefits of investor-state dispute settlement. Among other questions of the substantive protections, a critical question is whether the US and the EU will further entrench the controversial ISDS mechanism, or will move forward with a more thoughtful alternative. In addition, based on the EU proposal for an investment court, we should also consider whether this alternative goes far enough to address the problems inherent to ISDS. As I will discuss, an analysis of the ISDS mechanism demonstrates that the costs far outweigh the benefits, and that implementing an investment court to replace ad hoc arbitration will not solve all of these problems.<sup>1</sup>

First, we must ask whether ISDS, particularly between the US and the EU in the TTIP, is effective or necessary to produce its three frequently cited benefits. Namely, that it will increase investment flows by providing investors with security and protection, that it will depoliticize investment disputes, and that it improves the rule of law in the host-states.

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<sup>1</sup> The positions articulated today are further elaborated in Lise Johnson & Lisa Sachs, "The Outsized Costs of Investor-State Dispute Settlement," 16 ABI Insights 1 (2016) at 10, *available at* <http://ccsi.columbia.edu/files/2016/02/AIB-Insights-Vol.-16-Issue-1-The-outsized-costs-of-ISDS-Johnson-Sachs-Feb-2016.pdf>.

First, there is no strong evidence that investment treaties, let alone ISDS, increase investment flows. In other words, inclusion of ISDS in the TTIP will likely have no effect on the investment objectives of this treaty. Second, while proponents of ISDS argue that it is important for “depoliticizing” investment disputes, evidence demonstrates that whether a home state gets involved with an investor’s dispute does not vary based on whether there is a treaty with ISDS in place.<sup>2</sup> Finally, contrary to strengthening the rule of law, ISDS actually weakens domestic rule of law by removing disputes from domestic legal and administrative systems and curtailing regulation in the public interest.<sup>3</sup> And in any event, the US and EU countries already have well-functioning and strong legal systems and legitimate concerns about the rule of law in any of these countries seems dubious. In sum, ISDS is neither effective nor necessary for achieving any of its stated benefits, and all of these objectives can be realized through other means, that I will discuss momentarily.

Second, we must ask whether the purported benefits of ISDS outweigh the costs. The costs of ISDS include negative impacts on domestic law, policy and institutions, and costs of litigation, liability and regulatory space. The reasons that ISDS has these negative impacts on host-states are several, but among other reasons, ISDS allows foreign investors, and only foreign investors, to characterize domestic law claims as treaty claims. For example, a domestic law taking can be re-characterized as a treaty-based expropriation. The investor then avoids the domestic legal system and takes the dispute directly before an unaccountable panel of party-appointed arbitrators with extensive

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<sup>2</sup> Srividya Jandhyala, Geoffrey Gertz, & Lauge N. Skovgaard Poulsen, “Legalization and Diplomacy: Evidence from the Investment Regime,” (2015). Paper presented at 2015 Annual Meeting of the American Political Science Association.

<sup>3</sup> Tom Ginsburg, “International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance,” *International Review of Law and Economics*, 25(1): 107-123 (2005); Mavluda Sattorova, “The Impact of Investment treaty Law on Host State Behavior: Some Doctrinal, Empirical, and Interdisciplinary Insights,” in S. Lalani & R. P. Lazo (Eds), *The Role of the State in Investor-State Arbitration* (Leiden: Nijhoff/Brill, 2014).

abilities to determine liability in a context where an appellate mechanism is not available. While both the US and the EU have insisted that “no greater rights” will be afforded to foreign investors than to domestic investors,<sup>4</sup> this is simply not the case.<sup>5</sup> The protections afforded to foreign investors include greater substantive rights than domestic investors have under the domestic legal systems in both the EU and the US, including greater procedural rights that *result* in greater substantive rights. In addition to granting greater rights to foreign investors, ISDS is problematic in that from the rule of law perspective, it upsets the separation and balance of powers that are constitutionally calibrated under domestic legal systems. It undermines the role of domestic courts in their core functions of developing, interpreting or applying the law. Finally, the monetary and regulatory costs of ISDS are extensive. Even if states avoid a judgment, which are usually in the millions or billions of dollars, states must spend time and millions of dollars defending disputes. While the costs that result from a loss of regulatory space are more difficult to

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<sup>4</sup> USTR, Fact Sheet: “Investor-State Dispute Settlement (ISDS),” (March 2015), available at <https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2015/march/investor-state-dispute-settlement-isds> (“These investment rules mirror rights and protections in the United States and are designed to provide no greater substantive rights to foreign investors than are afforded under the Constitution and U.S. law”); European Parliament resolution of 8 July 2015 containing the European Parliament’s recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP) (2014/2228(INI)) (8 July 2015), at (2)(c)(xv) “to ensure that foreign investors are treated in a non-discriminatory fashion, while benefiting from no greater rights than domestic investors...” available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0252+0+DOC+XML+V0//EN>.

<sup>5</sup> See Lise Johnson, Lise Sachs & Jeffrey Sachs, “Investor-State Dispute Settlement, Public Interest, and U.S. Domestic Law,” (May 2015), available at <http://ccsi.columbia.edu/files/2015/05/Investor-State-Dispute-Settlement-Public-Interest-and-U.S.-Domestic-Law-FINAL-May-19-8.pdf>; see also Jan Kleinheisterkamp, “Who is Afraid of Investor-State Arbitration? Unpacking the Riddle of ‘No Greater Rights’ in the TTIP,” 4 *Investment Treaty News* 5, p. 9 (2014) available at [https://www.iisd.org/sites/default/files/publications/iisd\\_itn\\_november\\_2014\\_en.pdf](https://www.iisd.org/sites/default/files/publications/iisd_itn_november_2014_en.pdf); see also Lise Johnson & Oleksandr Volkov, “Investor-State Contracts, Host-State ‘Commitments,’ and the Myth of Stability in International Law,” 24(3) *American Review of International Arbitration* 361 (2013).

capture, they are potentially even more damaging as ISDS may discourage economically efficient government regulation that is in the public interest.<sup>6</sup>

An investment court will not solve these problems. While a court would be able to address important concerns surrounding arbitrator bias and conflicts of interest, and an appellate mechanism would be available to correct panel mistakes in fact and law, a court alone would not address the other issues that I have discussed today. Namely, that a parallel system, particularly one that does not require domestic exhaustion nor defers to domestic law, has a negative impact on the effective functioning of the domestic legal and regulatory system. A court will not address the fact that foreign investors will be afforded greater substantive rights than domestic investors, and a court will also not protect legal and policy regulatory space. In fact, without resolving the underlying substantive issues, a court runs the risk of legitimizing and further entrenching the risks and impacts of ISDS.

Given that ISDS is not effective or necessary to achieve its objectives and that the costs are substantial and that an investment court will not remedy these concerns, what then, are alternatives? First, particularly in the context of the TTIP between the US and the EU, the first place for recourse for foreign investors should remain the domestic legal system of the host country, where all other domestic investors and stakeholders resolve their disputes. The original rationale for ISDS, that investors must be protected from weak host-state legal systems, is simply not applicable in the US-EU context. Second, investors can

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<sup>6</sup> For example, investors have challenged new and stronger environmental regulations and regulations protecting the rights of indigenous peoples (*Glamis Gold, Ltd. v. The United States of America*, more information available at <http://www.italaw.com/cases/487>), the phase-out of nuclear power in the wake of the Fukushima Daiichi nuclear disaster (*Vattenfall AB and others v. Federal Republic of Germany*, more information available at <http://www.italaw.com/cases/documents/1655>), and public health measures, such as plain packaging regulations on cigarettes (*Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, more information available at <http://www.italaw.com/cases/460>, and *Philip Morris Asia Limited v. The Commonwealth of Australia*, more information available at <http://www.italaw.com/cases/851>).

purchase additional protections through political risk insurance, which is designed to price political risk on the market, sending a signal to both the investors and the host states about the security of investments in host jurisdictions.<sup>7</sup> Third, existing human rights mechanisms such as the European Court of Human Rights and the Inter-American Commission on Human Rights are available to investors aggrieved by government expropriations, discrimination or denial of justice.<sup>8</sup> To the extent that investors consider these mechanisms inadequate, the TTIP parties should work to strengthen these human rights mechanisms and their enforcement provisions for all stakeholders. Finally, state-to-state mechanisms can be used to address egregious treatment of foreign investors, while giving appropriate latitude to the regulatory concerns and sovereignty of the host jurisdictions.

Including ISDS or an investment court in the TTIP is not necessary to achieve any of the stated objectives of promoting investment between the US and the EU, and involves many costs to domestic legal systems and regulatory space that should not be further entrenched. The impact, accessibility, and contours of any dispute settlement mechanism included in the TTIP deserves very careful analysis and discussion to ensure it is meeting its objectives without undermining the rule of law.

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<sup>7</sup> Political risk insurance can be purchased from government and private entities. Government providers include entities established by individual home states (e.g. the U.S.'s Overseas Private Investment Corporation) and entities established by multilateral institutions (e.g. the World Bank's Multilateral Investment Guarantee Agency). Private political risk insurance providers include Chartis, Lloyd's, Sovereign, and Zurich. *See, e.g. Daniel Wagner, Managing Country Risk: A Practitioner's Guide to Effective Cross-Border Risk Analysis*, New York: CRC Press (2012).

<sup>8</sup> For an overview of these systems, *see, e.g.* <http://www.ijrcenter.org/courts-monitoring-bodies/>.

### **Additional Resources:**

Lise Johnson & Lisa Sachs, "The Outsized Costs of Investor-State Dispute Settlement," 16 *ABI Insights* 1 (2016) at 10, available at <http://ccsi.columbia.edu/files/2016/02/AIB-Insights-Vol.-16-Issue-1-The-outsized-costs-of-ISDS-Johnson-Sachs-Feb-2016.pdf>.

Lise Johnson, Lise Sachs & Jeffrey Sachs, "Investor-State Dispute Settlement, Public Interest, and U.S. Domestic Law," (May 2015), available at <http://ccsi.columbia.edu/files/2015/05/Investor-State-Dispute-Settlement-Public-Interest-and-U.S.-Domestic-Law-FINAL-May-19-8.pdf>

Lise Johnson & Lise Sachs, "The TPP's Investment Chapter: Entrenching, rather than reforming, a flawed system," (Nov. 2015), available at <http://ccsi.columbia.edu/files/2015/11/TPP-entrenching-flaws-21-Nov-FINAL.pdf>.

Lise Johnson & Oleksandr Volkov, "Investor-State Contracts, Host-State 'Commitments,' and the Myth of Stability in International Law," 24(3) *American Review of International Arbitration* 361 (2013), available at [http://ccsi.columbia.edu/files/2013/10/Investor-state\\_contracts\\_host-state\\_commitments\\_-\\_ARIA\\_V24\\_No3\\_L\\_Johnson\\_O\\_Volkov.pdf](http://ccsi.columbia.edu/files/2013/10/Investor-state_contracts_host-state_commitments_-_ARIA_V24_No3_L_Johnson_O_Volkov.pdf).

Lise Johnson, "How Investments Under International Investment Law Expand Investors' Rights and States' Potential Liabilities as Compared to US Law," presented at TTIP Stakeholder Briefing, May 21, 2014, available at [http://ccsi.columbia.edu/files/2014/07/TTIP-Stakeholder-Briefing\\_FINAL.pdf](http://ccsi.columbia.edu/files/2014/07/TTIP-Stakeholder-Briefing_FINAL.pdf) and accompanying PowerPoint available at <http://ccsi.columbia.edu/files/2014/07/TTIP-presentation-.pdf>.

Lise Johnson, "Ripe for Refinement: The State's Role in Interpretation of FET, MFN and Shareholder Rights," GEG Working Paper 2015/101 (April 2015), available at <http://ccsi.columbia.edu/2015/05/21/ripe-for-refinement-the-states-role-in-interpretation-of-fet-mfn-and-shareholder-rights/>

Lise Johnson and Oleksandr Volkov, "State Liability for Regulatory Change: How International Investment Rules are Overriding Domestic Law," 5(1) *Investment Treaty News*, IISD (January 6, 2014), available at <https://www.iisd.org/itn/2014/01/06/state-liability-for-regulatory-change-how-international-investment-rules-are-overriding-domestic-law/>.