Is there a Need for Investor-State Arbitration in the Transatlantic Trade and Investment Partnership (TTIP)?

The European Commission has recently argued that “[t]he reason ISDS [investor-state dispute settlement] is needed in TTIP [the currently negotiated Transatlantic Trade and Investment Partnership between the EU and the US] is that the US system does not allow companies to use international agreements like TTIP as a legal basis in national courts. So European companies – and especially SMEs - will only be able to enforce the agreement through an international arbitration system like ISDS.”¹ This is so far the only substantive argument that the Commission has forwarded for justifying the inclusion of ISDS in the TTIP.

The need for justification arises on a number of points. Not only has there been mounting public opposition to the inclusion of investor protection and especially ISDS in the TTIP negotiation.² There is also academic evidence suggesting that the inclusion of ISDS in the free trade agreement with the US would, on balance, not be advantageous for the EU.³ So far, no traditional capital exporting country has concluded a bilateral investment agreement with any other capital exporting countries (“North-North” BITs).⁴ The traditional purpose of BITs has been used to secure outgoing investments into countries with administrative and judicial systems perceived as less reliable and thus presenting political risk of undue regulatory intervention in private economic activities. In their free-trade agreement of 2004, Australia and the US have abstained from including ISDS in the chapter on investment protection explicitly because of “the fact that both countries have robust, developed legal systems for resolving disputes between foreign investors and government”.⁵ This logic has also inspired the European Parliament in May 2013 to vote unanimously (exempting only the MEPs who reject ISDS altogether) for a clarification that, in general, future EU investment agreements should include ISDS only “[i]n the cases where it is justifiable”.⁶

In the context of the TTIP negotiation (just as the CETA negotiations with Canada), the question is then whether the administrative and judicial systems developed in the EU and the US have to be considered insufficient for protecting legal rights of foreign investors who disagree with regulatory intervention and seek legal remedies. Whereas the Commission does not suggest any short-comings in the EU legal system, it does point at the US legal system as a risk for EU investors: EU investors would not be able to enforce substantive rights granted in the TTIP against US public authorities in US courts. Accordingly, these substantive rights of EU investors could only be enforceable if the TTIP also granted them the right directly to bring actions against the US government in international arbitration. This claim has far reaching consequences: it is also the justification for accepting that, in return, US investors will be able to bring their claims against EU member States and the EU in international arbitration – and thereby avoid having to pursue their remedies in the EU court system like any EU investor would have to. It is therefore worth analysing
whether the Commission’s argument is actually sufficiently well-founded to support such special concessions to foreign investors.

**The evidence forwarded by the Commission**

In its answer to an inquiry by Members of the European Parliament as to the evidence supporting its claim, the European Commission stated:

*In the US there have been occasions where investors found reasons to complain. The Commission can cite two well known examples of denial of justice, which were eventually defeated in investment arbitration for jurisdictional grounds, Loewen v United States (an investor involved in a contractual dispute worth $5m was ordered to pay damages of $500m before he could appeal) and Mondev v United States (an investor could not sue the Boston Redevelopment Authority because of an immunity clause). An example of expropriation without compensation is the Havana Club case: Pernod Ricard, a French investor, has been prevented from using one of its trademarks for over 10 years. The EU has also successfully challenged this in a WTO dispute settlement case; however, the US has yet to bring itself into compliance with the WTO. One of the first WTO cases brought by the EU against the US (the Helms-Burton case) concerned restrictions placed by the US on investors from the EU, on account of investments they had made in Cuba. There are a number of other examples of protectionist actions by US authorities which may impact foreign investors.*

*Loewen and Mondev are certainly examples of unfortunate cases that suggest failures in US local judiciaries. They are, however, no evidence for any broader or systemic problem that would require some remediation through international law rather than internal judicial reform. In fact, a closer look suggests that the two cases, as well as the Pernod Ricard case, actually undermine the strength of the Commission’s argument rather than supporting it.*

In Mondev, the arbitral tribunal faced the question whether statutory immunity against tort claims granted by statute and enforced by the courts of Massachusetts would infringe the Canadian investor’s rights under NAFTA Chapter 11. The arbitrators made very clear that neither the decisions of the US courts applying the immunity provisions (the US Supreme Court considered that it was not necessary to accept appeal against them) nor the immunity provisions themselves violated the investor’s right. \(^8\) Not only did the arbitral tribunal confirm that there was no judicial impropriety involved; but the case also showed that investment arbitration could not help the investor against the immunity rules that the host state established. It is thus not clear how ISDS in the TTIP could achieve a different result, let alone because the TTIP investment chapter will likely not provide for higher standards of investment protection than NAFTA Chapter 11.

In Loewen, \(^9\) a Canadian investor in funeral services was struck with extraordinary punitive damages (£400 million) by a jury verdict in a Mississippi state court based apparently on discriminatory and xenophobic considerations; the incapacity to post 125% of the
judgment’s sum as security, as required then by Mississippi law, caused his appeal to be struck out and ultimately his company’s insolvency. But what this case really highlights is that ISDS could not compensate for local weaknesses in the US judicial system. While the Loewen case led to a significant reform of the local judicial system in Mississippi in 2004, the NAFTA arbitration did not grant Loewen any remedy – and is actually itself cause for concern. One of the tribunal members publicly conceded having met with officials of the US Department of Justice prior to accepting his appointment, who told him: “You know, judge, if we lose this case we could lose NAFTA”; to which he replied: “Well, if you want to put pressure on me, then that does it.” This raises significant issues of propriety in this investment arbitration, which remained without remedy. As it happens, the US is not known to have so far lost in any investment arbitration.

As for the WTO case relating to the Havana Club trademark, it is worth mentioning that the trademark itself could only be acquired by Pernod Ricard as a consequence of the uncompensated expropriation of the previous Cuban owners, the Arechabala family by the Castro regime in 1960 – a circumstance that sheds a somewhat different light on the Commission’s claim of expropriation and protectionism. What is correct is that the WTO Appellate Body indeed found that the US legislation in question was incompatible with the TRIPS Agreement in 2002. Nevertheless, the US Government has still not taken the steps necessary for complying with the WTO ruling. This case rather shows that the existence of an international dispute settlement mechanism did not effectively help any foreign investors in the US up to date.

In summary, the evidence put forward by the European Commission cannot be considered sufficient for showing the necessity of including ISDS in the TTIP. On the contrary, the cases relied upon, if anything, cast more doubts on the efficiency and propriety of investor state arbitration with the United States than on the efficiency and propriety of US courts in general.

Other possible arguments for the need for ISDS

The Commission’s original claim that the protection of EU investors in the US would require ISDS seemed to suggest much less a lack of judicial propriety in the US but rather some technical barrier to the enforcement of treaty-based investor rights in US courts. The US has a long tradition of entering into trade agreements that explicitly confer rights of actions to foreign individuals. The Treaties of Friendship, Commerce and Navigation (FCN) of the 19th and 20th Century, which preceded the US BITs, did not contain ISDS provision but guaranteed foreign investors full access to the local courts of the host state. An example for this can be found in the FCN with Italy of 1948, which is still in force:

*The nationals, corporations and associations of either High Contracting Party shall enjoy freedom of access to the courts of justice and to administrative tribunals and agencies in the territories of the other High Contracting Party, in all degrees of jurisdiction established...*
by law, both in pursuit and in defense of their rights ...; and shall be permitted to exercise all these rights and privileges, in conformity with the applicable laws and regulations, upon terms no less favorable than the terms which are or may hereafter be accorded to the nationals, corporations and associations of the other High Contracting Party...

And, indeed, there have been numerous cases brought against U.S. public entities on the basis of these FCN. It is only lately that an issue with the application of so-called self-executing treaty provision in US courts has arisen. The US Supreme Court in the Medellín decision initiated a tendency to restrict the possibilities of foreigners directly to invoke rights conferred on them in international treaties: “Even when treaties are self-executing in the sense that they create federal law, the background presumption is that international agreements, even those directly benefiting private persons, generally do not create private rights or provide for a private cause of action in domestic courts.” In Medellín, the Supreme Court reasoned that certain treaty provisions, even if they clearly granted specific rights to individuals, were not self-executing and thus not enforceable unless implemented into law by Congress. This was a move away from the previous strong presumption that “if a treaty dealt with right of private parties, it was generally treated as self-executing and the source of a private right of action.”

The US case law based on Medellín could, at first glance, give rise to worries also regarding the investor protection provisions in the TTIP: if not backed up by the procedural right of investors to seek their enforcement in international arbitration, they could be meaningless if US courts refused to understand them as self-executing and thus to apply them. A second look, however, reveals that such a conclusion misses a decisive point. US courts are clearly obliged to apply international treaty provisions if they have been implemented through legislation by Congress. The situation is thus not relevantly different from that in Germany or France or any country following the dualist conception of international law, which requires the transformation of international law into national law by the legislature. As pointed out by HATHAWAY ET AL, numerous treaties are currently enforced in the US through implementing legislation that includes private rights of action, such the UN Convention Against Torture, the Hague Convention on International Child Abduction and the Chemical Weapons Convention, all implemented through acts of Congress to give effect to the US obligations under international law. Moreover, in relation to investment treaties, the Senate’s Committee on International Relations explicitly stated when considering the US-Rwanda BIT:

Following the Supreme Court’s decision in Medellín v. Texas, 552 U.S. 491 (2008), the committee has taken special care to reflect in its record of consideration of treaties its understanding of how each treaty will be implemented, including whether the treaty is self-executing. As noted in Executive Report 110-25, the committee believes it is of great importance that the United States complies with the treaty obligations it undertakes. In
accordance with the Constitution, all treaties—whether self-executing or not—are the supreme law of the land, and the President shall take care that they be faithfully executed. In general, the committee does not recommend that the Senate give advice and consent to treaties unless it is satisfied that the United States will be able to implement them, either through implementing legislation, the exercise of relevant constitutional authorities, or through the direct application of the treaty itself in U.S. law.\textsuperscript{22}

And even though the Committee in that case had recommended the Senate to condition the BIT’s ratification by a clarification that “\textit{[n]one of the provisions in this Treaty confers a private right of action},”\textsuperscript{23} the Senate ultimately omitted this sentence and merely declared that “\textit{Articles 3 through 10 and other provisions that qualify or create exceptions to these Articles [i.e. the substantive investor protection provisions] are self-executing}.”\textsuperscript{24}

\textbf{Conclusion}

The analysis allows drawing two conclusions:

1. There is no evidence for any broader problem with the US judicial system. Whereas some few cases may have been unfortunate, they do not reveal any systemic deficiency capable of proper remediation. On the contrary, those cases cited by the Commission, if anything, rather suggest weaknesses of investor-state arbitration as well as a lack of efficiency of ISDS mechanisms to overcome the foreign investors’ problem.

2. International commitments by the US to European investors can very well be made applicable in US courts and even confer right of action to individuals. The exact form of such implementation for the US to comply with international law is ultimately an internal problem of the US institutions.

It is uncontroversial that the implementation of the TTIP obligations relating to investment in the US will be politically difficult.\textsuperscript{25} But this circumstance cannot, in itself, provide a justification for a rather fundamental policy choice, i.e. to accept the creation of a new jurisdiction that would allow US investors in the EU to take regulatory disputes out of European courts – with the reverse discrimination that this entails for EU investors in the EU.\textsuperscript{26} The question to be asked is ultimately whether there is something fundamentally wrong with the judicial systems on both sides of the Atlantic. And even if that were the case, the real question would be whether any structural deficiencies in the U.S. or EU judiciaries should be reformed by the creation of a parallel new jurisdiction, for which there is less than a good arguable case. Whereas there might be good justifications for inserting ISDS in future EU agreements,\textsuperscript{27} those presented by the Commission in relation to the United States so far are not really convincing.

London, 14 February 2014
(updated 17 March 2014)
Notes:

1 Statement by the EU Trade Spokesman John Clancey, ‘Investment Protection does not give multinationalss unlimited rights to challenge any legislation’, Memorandum 20 December 2013, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1008. See also already the Commission in its ‘Fact sheet: Investment Protection and Investor-to-State Dispute Settlement in EU agreements’, 26 November 2013, http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf, p.5: ‘The main reason for having an ISDS mechanism is because in many countries investment agreements are not directly enforceable in domestic courts. Therefore, an investor who finds him- or herself discriminated against or whose investment is expropriated cannot invoke investment protection rules before the domestic court to get redress.’ This argument has also been echoed by the Chairman of the European Parliament’s Commission on International Trade (INTA), Vital Moreira (S&D): ‘INTA Chair Demands Same Access To TTIP Documents As EU Member States’, Inside U.S. Trade, 4 December 2013: ‘For instance, Moreira noted that in the EU, once an international investment agreement is approved, it becomes the “law of the land.” This means a foreign investor could bring legal action in a member state court or the European Court of Justice arguing a breach of the treaty. But the same is not true under US law, where, without ISDS, the only recourse for a foreign investor is to argue that a government violated US or state law with respect to the way its investment was treated.’


Whereas arbitral tribunals have held that the Energy Charter Treaty, which was signed in 1994 not only by the EU but also its member states at the time, is applicable in relation to the Central and Eastern European countries which joined the EU in 2004 (Electrabel v Hungary, ICSID Case No. ARB/07/19, Decision on Jurisdiction 30 November 2012), it is still disputed – and indeed questionable – whether the ECT can have been intended to side-line the EU Internal Market rules in relations between old member states in a series of ongoing claims brought against Spain for its termination of favourable feed-in tariffs for photovoltaic electricity.


7 Mondev International Ltd v United States, ICSID Case No. ARB(AF)/99/2, ¶151-156


9 In reaction to the underlying O’Keefe v Loewen Group case, the Mississippi Supreme Court changed its Rules of Appellate Procedure in 2001, MRAP 8, so as to allow exceptions to appeal bonds where they threaten to cause insolvency; http://courts.ms.gov/rules/msrulesofcourt/rules_of_appellate_procedure.pdf. This was followed by the Mississippi Tort Reform Act 2004, which, inter alia, in Section 4 put caps on punitive damages that juries can impose; http://billstatus.ls.state.ms.us/documents/20041E/html/HB/0004-0095/HB0004-095H/B0004-095H/B0004-095H.B000135G.htm.


11 For summaries of all cases brought against the US see http://www.state.gov/s/jl/c3741.htm.

12 For an overview, see http://www.wto.org/english/tratop_e/dispu_e/cases_e/ds176_e.htm.


Ibid. at 514, 516.


See, e.g., Article 53 of the French Constitution: ‘Les traités de paix, les traités de commerce, les traités ou accords relatifs à l’organisation internationale, ceux qui engagent les finances de l’État, ceux qui modifient des dispositions de nature législative, ceux qui sont relatifs à l’état des personnes, ceux qui comportent cession, échange ou adjonction de territoire, ne peuvent être ratifiés ou approuvés qu’en vertu d’une loi. Ils ne prennent effet qu’après avoir été ratifiés ou approuvés.’ For Germany see Article 59(2) Grundgesetz, which also requires a legislative act of parliament for allowing the executive power to ratify an international treaty with legislative effects and which also performs the transformation of the resulting obligations into national law; see also Bundesverfassungsgericht, 2 BvR 1481/04, Görgülü, 111 BVerfGE 307 ¶ 31.

Hathaway et al (n 19) at 77-78.


Also the US legislation excludes the US-Australia FTA excludes such rights of action, see H.R. 4759, Public Law 108-286, 108 Stat. 919 (2004), 19 USC 3805 notes, Section 102(c): Effect of Agreement With Respect to Private Remedies. –No person other than the United States—

(1) shall have any cause of action or defense under the Agreement or by virtue of congressional approval thereof; or

(2) may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State, on the ground that such action or inaction is inconsistent with the Agreement.


