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Abstract:

The Transatlantic Trade and Investment Partnership (TTIP) currently under negotiation between the EU and the US continues to divide public opinion on both sides of the Atlantic. As the public became aware of the multiple dimensions of this proposed agreement, one feature proved to be particularly explosive: the inclusion of a mechanism known as Investor-State Dispute Settlement (ISDS) that would give foreign investors the right to legally challenge actions of sovereign states if these actions were seen as violating the rights of the investors. Sensitive to the public mood, and regardless of the fact that this feature has been a standard item in international trade agreements for several decades, both the European Commission and the European Parliament backed away from supporting the inclusion of ISDS. In late 2015, the Commission proposed a new approach to investment protection based on an international investment court system (ICS), which would address the shortcomings of the existing system and assuage the fears of the public. However, this new proposal has not convinced those who are to profit most from it. Nor has it changed hostile public opinion in a number of EU countries.

Introduction

When the EU and the US decided in 2013 to start negotiating what would then have been the biggest trade agreement ever,¹ the thinking on both sides was that it would address three major concerns. First, with sluggish internal demand, trade had become the major engine of economic growth and job creation on both sides of the Atlantic. Second, the share of global trade of both the EU and the US had long been in decline compared to other actors, notably China, potentially threatening their international economic influence. And third, both sides had lost hope in the revival of the World Trade Organisation's Doha Development round as a forum for multilateral trade liberalisation. Bilateral trade agreements were no longer frowned upon in Brussels and Washington for their potential to undermine global trade liberalisation. Joining two blocks that would together account for 30% of global trade would thus have the potential to boost the economies on both sides and also set the pace for further multilateral trade talks.

To sustain their case about TTIP, the Commission produced two feasibility studies² as well as an impact assessment³ aimed at adding evidence to the basic assumption that such an agreement would bring significant economic benefits and an overall positive impact for EU citizens. However,

¹ If ratified, the Trans-Pacific Partnership (TPP) signed in early 2016 between the US and 11 other countries of the Pacific Rim would create an even bigger trading block, accounting for 40% of global trade (TTIP: 30%).

² Ecorys, 'Non-Tariff Measures in EU-U.S. Trade and Investment – An Economic Analysis', Report prepared for the European Commission, 2009. (online) <http://trade.ec.europa.eu/doclib/docs/2009/december/>; CEPR, 'Reducing Transatlantic Barriers to Trade and Investment: An Economic Assessment', Report prepared for the European Commission, http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150737.pdf

³ Impact Assessment Report on the future of EU-US trade relations. 12 March 2013. http://trade.ec.europa.eu/doclib/docs/2013/march/tradoc_150759.pdf

these studies (on which the impact assessment is based) failed to convince the critics of TTIP, since their outcome was generally seen as having been distorted by the choice of basic assumptions that were used as input. Furthermore, the studies showed that TTIP would not yield many benefits unless it were highly ambitious: there would be little to be gained from simply lowering tariffs, which were already very low in transatlantic trade. Thus, a deep and comprehensive trade liberalisation had to address the so called 'behind-the-border issues': laws and regulations on both sides that were had been designed for internal purposes but in effect represented technical barriers to transatlantic trade.

For the EU it was not an easy decision to put its own norms and standards up to review in order to eliminate trade barriers. It was no surprise that public opinion reacted coldly to the prospect of having to put into question the EU's health, environmental and labour standards in order to facilitate the import of goods made in the USA. So why take such a risk? If it had been for (hypothetical) economic benefits alone, the EU would most likely not have done so. There was also a political argument: in a phase of relative decline of both the US and the EU on the global scene and the rise of China and other economies, 'the West' has to team up to remain the global trendsetter, able to define international trade rules that would become by default a global standard with which all other actors would have little choice but to comply.

It is against this background that a mechanism to assure the protection of foreign investment (through the so-called Investor-State Dispute Settlement or ISDS) became part of the Commission's mandate.⁴ ISDS was initially designed as a means to promote direct foreign investment by giving private investors additional rights against discriminatory practices and expropriation in countries with legal standards lower than in their own. Rather than obliging investors to contest expropriation before courts in states feared to be corrupt and inefficient, ISDS would allow them to have their cases heard by an international arbitration panel. This mechanism is far from being a novelty: it features in more than 3,500 international trade agreements (to around half of which EU Member States are signatories). However, since both the US and the EU are generally not considered as countries where the rule of law is particularly weak, and since both have rather well-functioning justice systems, it is legitimate to ask whether the absence of such a mechanism was really holding back private investors.

On the other hand, it is obvious that such an instrument might be of high added value if ever the EU or the USA would conclude a trade agreement with a country like China or Russia. Having ISDS in TTIP (and its counterpart, the Trans Pacific Partnership – TPP)⁵ would make ISDS a global standard, which would naturally figure in any other trade agreement. If ISDS were not included in TTIP, it would be very hard for the EU and the USA to convince other major partners to sign up to this mechanism. For a Chinese (or Russian) investor, facing an EU court might be less of a risk and easier to put up with than the other way round.

In this paper, we will analyse the proposals of the European Commission for an Investment Court System (ICS) as a replacement for ISDS in TTIP. We will try to assess whether this proposal has the potential to meet the double objective of the Commission: 1) to have a functional investment protection service in TTIP, thus helping to establish Investment Protection as a global standard; and

⁴ As foreseen in Articles 207 and 218 of the Treaty on the Functioning of the European Union (TFEU), the Commission has been negotiating TTIP on the basis of directives adopted by the Council. The final agreement will require the consent of the European Parliament and will have to be ratified by the Member States.

⁵ The Trans-Pacific Partnership (TPP) concluded in February 2015 between the US and 11 countries of the Pacific Rim (excluding China) includes its own version of an ISDS mechanism.

2) to win the battle for the 'hearts and minds' of the European public by convincing them that this proposal neither undermines the right to regulate and the rule of law, nor poses a threat to the EU's standards in the field of health, environment and social protection.

The role of investment protection in international trade relations

Investors generally see legal provisions that provide for the protection of their direct investments abroad as a necessary guarantee when investing in countries with a weak rule of law. In countries with a high level of corruption, systems of political patronage and weak institutions, local courts are seen as an unreliable means to solve investment-related disputes such as expropriations or discriminatory treatment. In the absence of any legal instruments, diplomatic intervention by the home state of the investors would be the last recourse to challenge such actions by the host government, thus raising such a dispute to the political level. Independently of whether it is appropriate to resolve commercial disputes through diplomatic means, the outcome of such an intervention would fully depend on the political and economic clout enjoyed by the investor's home state in the host country as well as on the quality of diplomatic relations. In such a situation, it is hard to imagine an equitable solution to the conflict.

Beyond this background, a treaty-based mechanism to resolve investment-related disputes outside of the political sphere could be seen as a progress, as cases would be judged only on their substance and with regard to the rules and procedures that were agreed upon by both partners. In principle, both sides profit from such a mechanism: investors are sheltered from political arbitrariness, and host states can create a more favourable investment climate which helps to attract more foreign direct investment and thus generate local jobs and growth.

Although the issue of investment protection has entered public debate in the EU quite recently, investment protection is not a new feature in international commercial relations: the first bilateral investment treaty (BIT) was concluded in 1959 between the Federal Republic of Germany and Pakistan. A marginal phenomena before the 1980s (when the US embraced them), BITs saw their 'hour of glory' after the fall of the iron curtain, when central and eastern European states rapidly rushed to conclude them in an effort to attract foreign investors. Currently, close to 3,500 such bilateral agreements have been recorded, and EU Member States account for about half of them.

Almost all of these BITs also contain a mechanism for investment protection (today more commonly known as ISDS). In essence, these mechanisms give private investors the right to initiate legal proceedings against a host state if investors consider that the host state has violated their rights, through expropriation or other measures that prevent investors benefiting from their investment. These cases would be heard not before a local court, since one basic idea behind ISDS was to assure investors' rights in countries with poorly performing institutions, weak rule of law and high levels of corruption. Nor would these cases be heard before an international jurisdiction (since private investors do not have access to such jurisdictions). They would go before an arbitration panel composed of international business lawyers, chosen by common accord between the conflicting parties, and under rules that were stipulated in the agreement.

From the late 1990s, the number of such cases constantly increased, peaking in 2013 with 60 new cases, bringing the total to about 600.⁶ The full potential of ISDS was illustrated through a couple of high-profile cases which made the wider public aware of the harm that could be caused to states and their citizens by rent-seeking private investors. Although some of these cases are still pending, it is often argued that ISDS provisions tilt the balance of power away from governments and towards global corporations.

Following the Fukushima disaster in Japan in 2011, the German government took the decision to phase out nuclear energy by 2022. Vattenfall, a Swedish company which had made substantial investments in the German nuclear sector, started legal proceedings against Germany, asking – according to media reports - for €4.7bn worth of compensation since they would be unable to capitalise on their investment. The claim is currently being considered by an arbitration panel composed of investment lawyers at the International Centre for the Settlement of Investment Disputes (ICSID – a branch of the World Bank) in Washington.

In 2011, an investment treaty arbitration at the Permanent Court of Arbitration (PCA) in The Hague was initiated by tobacco company Philip Morris against Australia for introducing plain packaging laws on cigarette packets. The company argued that the laws were a form of expropriation. In December 2015 the PCA declared the claim against Australia non-admissible for formal reasons. However, the court did not rule on the substance of the matter. A similar case against Uruguay is currently pending.

It is a hallmark of democracy that a country's legislators and regulators should adopt laws and define rules that protect its citizens and express collective preferences regarding public health, environmental protection, labour laws and rules protecting consumers. Such measures sometimes have impacts on international investment: legislation that intends to curb smoking or to phase out nuclear energy will make it harder or even impossible for investors in these sectors to benefit from their investments.

If foreign investors have the right to challenge government decisions that they see as harmful to their commercial interests, the question arises as to whether this undermines the the 'right to regulate' of the competent authorities, at national or European level. In addition, if regulators face a high probability that their decisions may be challenged through legal means and could entail high compensation payments from the public purse to private foreign investors, they may factor this into their decisions and refrain from adopting rules that affect the interests of investors. This 'regulatory chill' or self-censorship by regulators and lawmakers could significantly reduce a government's 'policy space' and prevent it from acting in what it considers the best interest of its citizens.

It is not surprising that this prospect has caused huge commotion in a number of EU countries, as this can look like allowing corporate interests to override democratic processes. Especially in Germany, France and Austria, ISDS became water on the mills of the anti-TTIP campaign.

Although the arguments of those opposing ISDS have to be taken seriously, one needs to ask whether the cases used in the debate are representative. Out of the more than 600 cases known

⁶ Although not all cases are known, since there was generally no obligation for the parties to go public with their dispute.

today, only a handful raised public concern, as they fully seem to confirm the cliché of big profit-hungry multinationals trampling over the environmental and health concerns of citizens and democratically elected governments. But this image is distorted. First, the vast majority of ISDS claims so far have challenged administrative decisions affecting individual investors rather than legislative or regulatory acts per se.⁷ Second, claims that directly challenged government regulations, and thus the government's policy space, have so far never succeeded.⁸ Thirdly, ISDS is not, as is often claimed, an instrument that serves the interest of US companies represented by trigger-happy tort lawyers. Rather, it is EU companies that have been the biggest users of ISDS so far, with more than half of all known cases initiated by EU Member States.⁹ Also, there seems to be a widespread assumption that ISDS mostly serves big multinationals in sectors harmful to the environment and public health. However in reality these sectors do not represent a majority of cases. The main sectors include, for, example, renewable energy. In 2013, nearly a quarter of all arbitrations involved challenges to regulatory actions in two countries (Spain and the Czech Republic) that negatively affected investments in this sector.¹⁰

So why has the public debate around investment protection only begun with the start of the TTIP negotiations in 2013, if investment protection mechanisms have been widely used around the globe – and particularly by EU Member States - for more than 15 years? These agreements were traditionally concluded between developed countries wanting to protect their investors and developing or emerging countries wanting to attract foreign investment. They were generally drafted by the countries representing the investors in order to protect the interests of the latter. The host countries generally had to sign up to the conditions posed by the industrialised nations, and disputes used to be a one-way street: investors in rich countries challenging government decisions in poor states. This generally has not raised many concerns in the EU. However, while in former agreements with mostly developing states, the European partners were in a more powerful negotiating position and could, to a great extent, determine the terms of the agreement, this would be unthinkable with an agreement with the US.

The Lisbon Treaty: a competence shift

⁷ Tiedje, Christian: Investment protection and investor-state dispute settlement in TTIP in: the TTIP negotiations between the US and the USA: caught between myth and reality? Cidob 2015.

⁸ The claim put forward by Phillip Morris challenging the Australian government decision to impose illustrations of smoking-related diseases on cigarette packages was dismissed on formal grounds by the Permanent court of arbitration in December 2015.

⁹ In particular, the countries where ISDS is most controversial (Germany, France and Austria) have been using the system extensively, but hardly had to respond to any claims themselves. Also, none of these countries has so far ever lost an ISDS claim. Whereas German enterprises have initiated 51 proceedings, the country was defendant in only 3 cases (two of them having been settled). For France, the relation is 38 to 1 (settled) and for Austria 14 to 1 (settled) (source: UNCTAD investment policy hub, <http://investmentpolicyhub.unctad.org/ISDS/FilterByCountry>)

¹⁰ With respect to the Czech Republic, investors are challenging the 2011 amendments that placed a levy on electricity generated from solar power plants. They argue that these amendments undercut the viability of the investments and modified the incentive regime that had been originally put in place to stimulate the use of renewable energy in the country. The claims against Spain arise out of a seven per cent tax on the revenues of power generators and a reduction of subsidies for renewable energy producers. http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf

For international investment protection, the Lisbon Treaty which came into force in 2009 was a major game changer. In addition to giving the EU legal personality which would enable it to sign international agreements, Member States transferred their competence to conclude investment agreements to the EU, thus putting an end to the half-century old practice of Member States' concluding such agreements between each other and with third countries. Moreover, the Treaty gave the European Parliament a formal veto right ('consent') over any future trade or trade-related agreement.¹¹

Thus several factors came together. First, the conclusion of investment agreements ceased to be a national affair, but became a matter for the EU as a whole. Second, the veto right of the EP meant that this issue became subject to reinforced public scrutiny at the European level. Thirdly, the fact that the TTIP is being negotiated between two equal partners (as opposed to previous trade agreements where the EU was the uncontested norm-setter) meant that the EU would have to face the challenge of being exposed to ISDS on the receiving end if US companies filed complaints against EU Member States¹².

Sensitive to public opinion and keen to be seen as defenders of the interests of citizens, the EP did not hesitate in using its new powers. In 2012 the Parliament had already rejected the Anti-Counterfeiting Trade Agreement (ACTA), thus invalidating years of negotiation between the EU and its partners. This memory was still fresh when the EU started negotiating TTIP in 2013. When the Member States gave a mandate to the Commission to negotiate, they included a strong condition: although ISDS was part of the mandate, the negotiating directives also provided that the final decision as to whether to include it or not at the end stage of the negotiations would depend on '*whether a satisfactory solution meeting the EU interests*' was achieved.¹³

It was therefore no surprise that TTIP in general and ISDS in particular found their way also on to the agenda of the European Parliament. There was increasing opposition from civil society, and the fact that TTIP and ISDS were mostly defended by business representatives did not help to make it more acceptable for the wider public. In the battle for 'hearts and minds', the movement opposed to TTIP and ISDS proved to be more successful than their proponents, and succeeded in occupying the moral high ground.

Policy changes in trade policy often coincided with changes of leadership within the European Commission. Just as Trade Commissioner Mandelson abandoned the WTO-centred approach of his predecessor Pascal Lamy after 2004, Cecilia Malmström, who followed Karel De Gucht as Trade Commissioner in 2014, soon introduced a different approach to ISDS. Whereas De Gucht stated, while on his way out in 2014, that 'there will be no TTIP without ISDS',¹⁴ Malmström announced during a speech before the EP in March 2015 that ISDS was 'not fit for purpose in the 21st century' and that she wanted 'the rule of law, not the rule of lawyers'.¹⁵ For some, this seemed as if ISDS as a concept had fallen from grace. Opponents also stressed that the idea of ISDS was to protect the rights of investors in states with weak institutions and an insufficient level legal protection –but few

¹¹ Arts. 207 and 218, Treaty on the Functioning of the European Union.

¹² Most of the Member States that joined the EU in 2004 and 2007 had already concluded bilateral investment treaties with the US in the early 1990s, which would be superseded by investment protection measures in TTIP. The fact that there is little resistance to the inclusion of investment protection into TTIP in these states can be explained by the fact that terms under TTIP are likely to be more favourable for these countries.

¹³ Directives for the negotiation on the TTIP between the EU and the US, as adopted by the Foreign Affairs Council (Trade) on 14 June 2013, point 22.

¹⁴ <http://www.ibtimes.co.uk/eu-trade-commissioner-karel-de-gucht-warns-no-ttip-without-isds-1470373>

¹⁵ http://europa.eu/rapid/press-release_SPEECH-15-4624_en.htm.

people would claim that this was an issue in the USA. So what would be the point of having ISDS in TTIP in the first place?

Is investment protection relevant for EU-US trade?

It is reasonable to ask whether it is appropriate to have an investment protection mechanism in an EU-US Free Trade agreement. On both sides of the Atlantic, there are robust institutions and functioning courts that deliver justice.

It is true that some aspects of the US justice system, such as trial by jury in commercial disputes, are not in line with EU practices and do not necessarily inspire confidence in US investors. Similarly, the European Commission's justice scoreboard – a comparative analysis of the justice systems of the 28 Member States – shows that there are big differences in the national justice systems of the 28 Member States, especially when it comes to access of foreign investors to justice and timeframes for delivering and implementing justice.¹⁶ This is not only a worry for US investors, but also for the EU itself. There is a link in the EU between the efficiency and effectiveness of justice and high levels of socio-economic development:¹⁷ investors generally have a preference for these countries, depriving poorer Member States of much-needed investment and thus contributing to an increase in socio-economic discrepancies.

Yet in spite of these arguments, one has to realise that transatlantic investment is robust with an annual investment volume of over € 3 trillion, and there are no signs that investors are shying away from investing because of lacking legal mechanisms to prevail themselves of their rights. The real reasons for both the USA and the EU to have a functioning investment protection mechanism in TTIP lie elsewhere. This is where the geopolitical dimension comes in.

The other argument for ISDS

In trade policy, size matters. Whereas the WTO is the international forum that sets universal rules for trade, it is the industrialised countries represented in the Organisation for Economic Cooperation and Development (OECD) that have been the driving force and global trendsetters in international trade for more than half of a century. The economic powerhouses assembled in this 'country club of the UN' accounted for most of global trade and were therefore in a privileged position to define global norms and standards, which became de facto universal.

However, over the last decade, the share of the OECD in the global economy and in global trade has contracted continuously. Whereas a decade ago, the USA and the EU accounted for 17 per cent of world trade each, their share had shrunk by 2014 to 13.3 per cent and 14.8 per cent respectively. In the same period, the EU's share of global GDP fell from 34 per cent to 21 per cent.¹⁸ This relative decline of the USA and the EU contrasts with the rapid rise of the so-called BRICS (Brazil, Russia, India, China, South Africa), in particular China. This country managed to expand its share of global trade from 5 per cent to over 15 per cent in this period, thus becoming the second biggest trading bloc in the world, and likely to become the biggest trading bloc soon.

¹⁶ For example, the time needed to resolve litigious civil and commercial cases:

http://ec.europa.eu/justice/effective-justice/files/justice_scoreboard_2016_en.pdf

¹⁷ Edam, Kenneth, the Judiciary and Economic Development. *John M. Olin Law & Economics Working Paper* No. 287.

¹⁸ Eurostat, DG Trade 2015.

A higher share of global trade also brings stronger influence in shaping international rules, norms and standards. It is therefore no wonder that both the EU and the USA are nervous about the prospect of China's defining international standards in areas affected by trade rules, such as health, environment or the protection of workers. Although the USA and the EU often have quite different views on norms and standards,¹⁹ there is still more common ground on these issues across the Atlantic than there is common ground with China (and its potential allies).

The decreasing role of the WTO as a forum for shaping international trade rules has made states (and trade blocs such as the EU) increasingly reliant on bilateral and regional agreements to define rules, norms and standards. If they come into effect, TTIP and the Trans-Pacific Partnership (TPP) would together cover two-thirds of global trade. Therefore, the provisions that are in these treaties would de facto become global standards by virtue of the sheer size of the blocs that have accepted them. Since discrepancies in norms, rules and standards are presently the most important obstacle to free trade, this would push third countries towards adopting these standards since otherwise they will limit their ability to trade with their partners.

Although for EU and US investors the inclusion or not of an investment protection mechanism in TTIP may not be the most urgent issue, both are keen to have such a mechanism at their disposal when it comes to protecting their investments in China. ISDS already exists in the TPP. Should investment protection also be included in TTIP, it will cover most of global trade relations, making it a de facto standard that can reasonably be expected to figure in any future trade agreement, also with China. However, should it be absent from TTIP, why should China ever agree to such a feature? Suggesting that it was not necessary to include it with the US (since their justice system could be relied upon) but that it was seen as a necessity with China (in the absence of an equitable justice system) would be unlikely to impress China, which would most certainly consider such a suggestion as discriminatory and patronising. Having an unpopular ISDS included in TTIP should therefore be seen as an attempt to maintain the position of both partners as 'norm makers' in a global perspective, rather than facing the possibility of being reduced, over time, to the role of 'norm takers'.

Neither of these arguments was convincing to an increasingly hostile public opinion. As previously mentioned, several factors coincided: the new powers of the EP to veto trade agreements imposed a higher degree of transparency, thus stimulating public debate. A number of prominent cases, such as *Philip Morris* and *Vattenfall*, seemed to be grotesque zero-sum-games between the corporate interest of big business and the state's efforts to protect public health, greatly helping to cast ISDS in an unfavourable light.

Is ISDS the problem, or ISDS with the US?

The EU has already signed trade agreements incorporating ISDS mechanisms with Singapore and Canada. In particular the latter, called the Comprehensive Economic and Trade Agreement (CETA) was seen as a possible template for TTIP: its provisions on investment protection were seen by experts as 'state of the art', containing all possible safeguards against an abuse of the system by profit-seeking corporations at the expense of citizens and government.

In particular, CETA contained:

¹⁹ Whereas EU regulators apply the 'precautionary approach' meaning that a product must be proven beyond doubt to cause no harm before putting it on the market, the US use the 'scientific approach' which allows the certification of a product if there is no compelling scientific evidence of harmful consequences – thus making it easier to license new products.

- detailed general exceptions confirming the explicit right of the state to regulate on the grounds of public health, the environment, public order and morality;
- clear definitions of key concepts such as 'indirect expropriation' or 'fair and equal treatment';
- an extensive preamble making it clear that the aim of the agreements is not exclusively the protection of the rights of the investors, but also the promotion of sustainable development, the enhancement of levels and labour and environmental protection, and recognising the importance of democracy (including the right to regulate) and human rights.

These points are much more than legal details. The analysis of previous ISDS cases has shown that it was the absence of such provisions that opened the door for corporate lawyers to attack actions of host states. Earlier generations of investment agreements often mentioned in their preamble as the only objective the protection of investors' rights.²⁰ Thus, any arbitrator interpreting such an agreement in case of dispute would look at the case in the sole light of whether the rights of an investor had been harmed, without taking into account any considerations about the legitimacy of such an action. If the interest of the investor is the only criterion, a restriction to market cigarettes or an obligation to close a nuclear power plant is indeed a violation of the rights of the investors, as they forgo opportunities to gain a return on their investment. But if the protection of human health or the environment were mentioned in the preamble, any arbitrator would have to weigh both arguments against each other, thus drastically reducing the possibility of the investor to claim compensation.

Thus, the existence of clearly defined exception clauses, under which the investors cannot avail themselves of legal remedies against the state, also drastically diminishes the probability of investors' going successfully before an arbitration tribunal. Clear definitions of what could be considered as indirect expropriation or discrimination also work as a shield against unreasonable claims.

So far, even with bilateral investment treaties that did not contain the sophisticated safeguards and protective clauses of CETA, there is not much evidence that ISDS was able to reduce the policy space of states. Basically all cases where investors have successfully brought states before a tribunal have targeted concrete actions of the state vis-à-vis a defined investor, but not the right of a state to regulate as such. Also in cases where states seemed to have neglected to include provisions to protect their right to regulate (such as Australia in the BIT with Hong Kong that gave rise to the Phillip Morris claim), the arbitrators have frequently rejected the claims of the investors for compensation.

Even if one could imagine the effect of 'regulatory chill' on some regulators, it could be argued that one of the effects of ISDS could be a 'protectionist chill', making regulators think twice about introducing new barriers to trade that would be justified not by public interest but as protectionist barriers.

However CETA did not address – or did so only partially²¹ – one of the reproaches made to ISDS by its opponents: namely that ISDS was bypassing established courts by giving private business lawyers the power to force states to pay important compensations to investors with the money of their taxpayers.

²⁰ The preamble of the 1959 Germany-Pakistan BIT mentions as sole objective the desire to intensify economic cooperation and to create favorable conditions for investors.

²¹ CETA provides for the appointment of arbitrators from a pre-selected and vetted roster and for the limitation of fees of the arbitrators.

Even if it could be argued that the states in fact had agreed to this principle in order to depoliticise commercial disputes, it is true that, in particular in view of an alleged 'claim culture' in the USA, this feature is unlikely to reassure a wider public in the EU (and also in the USA) that their legitimate interests as citizens are appropriately protected.

In this respect, it should be noted that it was not CETA which raised public concerns about ISDS. CETA became drawn into the controversy only after public opinion had been mobilised by the TTIP debate. This could be explained by the fact that before TTIP, the wider public was largely unaware of the existence and the scope of this mechanism. But the essential question seems to be a lack of trust: whereas public opinion in some EU countries associates the USA with aggressive tort lawyers and multinational enterprises that are disrespectful of consumer rights, public health or the environment, Canadians are often perceived as culturally closer to Europeans and as sharing more of Europeans' norms and values than their southern neighbours. It also did not help that the start of the TTIP negotiations coincided, in Germany, with the start of the so-called NSA scandal, where the US National Security Agency had to admit to the tapping of mobile phones of top EU leaders.

The European Commission: making a U-turn in the face of public opinion?

The growing inability of the Commission to defend ISDS vis-à-vis an increasingly hostile public opinion prompted Trade Commissioner Cecilia Malmström, a few months into her mandate in March 2015, to express before the European Parliament her dissatisfaction with the existing system and to condemn what she then qualified as 'the rule of lawyers'. This was preceded by an internal row about ISDS within the Commission, as a consequence of which President Juncker - highly sceptical about ISDS - shifted the final responsibility for ISDS from the Trade Commissioner to Vice-President Timmermans.²² In May 2015 Malmström then published, as a test balloon, an entry on her personal blog entitled 'Investment in TTIP and beyond – towards an international investment court' in which she laid out a proposal to set up an international public investment court system. Rather than existing in parallel with national court systems, this system would be complementary to national courts. It would also grant the right of appeal to any party to the conflict and enshrine the right to regulate of states.

The publication of this blogpost was a clear sign that the Commission had disavowed their previous approach to ISDS. ISDS therefore became indefensible also for the European Parliament, which was under strong pressure to give in to public demands to put a stop to ISDS. It was therefore no surprise that the European Parliament, in July 2015, adopted a resolution rejecting ISDS in TTIP. However, the EP resolution stopped short of demanding to scrap investment protection entirely. Instead, it asked to replace the ISDS system with a new system for resolving disputes between investors and states which is subject to democratic principles and scrutiny, "where potential cases are treated in a transparent manner by publicly appointed, independent professional judges in public hearings and which includes an appellate mechanism, where consistency of judicial decisions is ensured, the jurisdiction of courts of the EU and of the Member States is respected, and where private interests cannot undermine public policy objectives".²³

²² <http://blogs.ft.com/brusselsblog/2014/10/23/leaked-letter-14-ministers-take-on-juncker-over-trade/>

²³ 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)).

The EP thus endorsed the approach proposed by the Commissioner in her personal blog a couple of months earlier. As a result, taking into account the veto power of the EP on this issue, it was logical that the Commission should have formally adopted Malmström's proposal in September 2015 and presented it as the EU's proposal to the US negotiators.

The Commission proposal on an Investment Court System

Malmström's proposal on replacing ISDS by an Investment Court System contains a number of new provisions, in particular:

- establishment of a public court system with publicly appointed judges (as opposed to panels of private lawyers) composed of a first instance Tribunal and an Appeal Tribunal'
- clarifications as to relations between national courts and the ICS (clear definition of cases where an investor can go to court);
- enshrining the right to regulate of the states.

The proposal to replace ISDS with an ICS was not meant to be limited to TTIP, but would apply also to CETA²⁴ as well as to all future EU trade agreements with an investment component.²⁵

These features were introduced in order to address one of the main complaints against the secret nature of ISDS, since cases in the past were public only with the agreement of both sides.

Whether or not the Commission's main motivation was a deep conviction that the previous ISDS practice went against democratic and legal standards, winning the 'hearts and minds' of both the wider public and of the European Parliament with its veto right became an absolute necessity, at least after the EP resolution of July 2015 disavowing ISDS. The question is whether 1) the new proposals managed to convince a critical public and the EP; and 2) whether these proposal satisfy the main stakeholders who were meant to profit from ISDS in the first place. In this regard, the results have been rather disappointing.

Shortly after the Commission proposals were published, some of the main stakeholders came out with public statements putting the merits of the system into question. BusinessEurope, the main organisation representing the interests of EU enterprises, produced a rather critical opinion of the proposal.²⁶ The US Trade Representative voiced similar concerns.²⁷ An even stronger rejection of the ICS came in February 2016 from the German association of judges.²⁸ The main doubts of the stakeholders regarding the ICS can be summarised as follows:

- The mention of the state's 'right to regulate' does not give any additional clarity as to the limits that a state has when regulating. In the worst case, this could be seen as a carte blanche for the state to undertake any measure regardless of whether this would be

²⁴ Although CETA negotiations – including its ISDS provisions – had already been concluded in 2014, the text had been amended afterwards in order to replace ISDS with ICS. In order to not to reopen the negotiations, these modifications have been declared as “legal scrubbing”, a process of in-house revision of the document by lawyers-linguists in order to ensure its internal coherence and consistency

²⁵ The ICS was already mentioned in the 2016 draft EU-Vietnam FTA.

²⁶ https://www.businesseurope.eu/sites/buseur/files/media/position_papers/rex/2015-10-23_assessment_of_commission_proposal_on_a_new_investment_court_system.pdf

²⁷ <http://www.reuters.com/article/us-trade-ttip-idUSKCN0SN2LH20151029>

²⁸ https://www.foeeurope.org/sites/default/files/eu-us_trade_deal/2016/english_version_deutsche_richterbund_opinion_ics_feb2016.pdf

justified or not. Existing ISDS provisions (as in CETA) already provide clear language about the conditions under which a state can restrict the rights of investor in order to protect public interest. Rather than being of added value, the proposal is likely to create greater confusion among those who will have to interpret its provisions.

- The pool of judges that would qualify for such a position through possessing a very good knowledge of international investment law is very small. As previous experiences with the WTO appellate body and other international courts have shown, states are often unwilling to provide sufficient financial resources.²⁹ Rather than attracting the most qualified experts, positions are more likely to be filled by political appointees. On the other hand, former arbitrators are more likely to reinvent themselves as legal counsel of the investors, where they will challenge the state-appointed judges.
- The appointment of judges by the states and the impossibility for the conflicting partners to agree on the arbitrators are not likely to increase the impartiality of the court. If the concern was that private business lawyers serving as arbitrators have a natural bias towards the enterprise, could government-appointed judges not also be suspected of having a natural bias towards the state, in particular their own?
- The right for both parties to lodge an appeal is likely to drive up both costs and lengths of any procedure, thus undermining the main advantage of ISDS, which is the delivery of rapid decisions. Under pressure from either their citizens or their shareholders, both sides are likely to appeal judgements that are not in their favour. Moreover, judgements in appeal would set de facto precedence, thus establishing a new international legal order – which neither the EU nor the USA would welcome.
- A clear distinction between international law and domestic law might not be in the interest of the EU. Whereas international arbitration, including ISDS, is subject to domestic court review and supervision,³⁰ this might not be the case in an International Court System, where judgements would be de facto directly enforceable. In the case of the WTO dispute settlement body, the EU has so far refused to recognise such a direct effect.³¹

Conclusion

The European Commission's proposal for an Investment Court System to replace the controversial Investor State Dispute Settlement (ISDS) has so far failed to win the hearts and minds of a European public which has been widely hostile or skeptical towards the ISDS. More, it has failed to convince those stakeholders that were meant to profit most from such a system - European producers, SMEs and business associations.

It is true that the Commission did not have many options. With a growing divide between public opinion and what is generally referred to as 'Brussels', the Commission could not just do 'business

²⁹ Tiedje, 2015

³⁰ The *lex arbitri* principle. An exception to this rule are cases settled under the International Centre for State Investor Disputes (ICSID) of the World Bank, which are directly enforceable. The EU not being a state cannot be a member of ICSID; therefore this exception would not apply to the EU anyway.

³¹ Tiedje, CIDOB.

as usual' and ignore public opinion by pointing out the numerous potential advantages of this agreement. Technically, the Commission could hide behind the European Parliament, since the EP had made it clear in its resolution of July 2015 that it would not accept any agreement containing ISDS and asked to replace it with something different. However, this would not be very convincing, since it was Commissioner Malmström herself who publicly disavowed ISDS before the EP adopted its resolution.

Hence, the question is not that something had to change, but whether the current proposed changes are meeting their objective. Stating that 'ISDS is out' may be a nice catch-phrase for public consumption, but what remains when we look not at the form (or the wording), but at the content? First of all, ISDS has never been monolithic. Rather, it is a series of principles that can be adapted according to the needs of the parties involved. There is a huge difference between the first generation of BITs containing ISDS, which were indeed grossly unbalanced in favor of international investors and more recent agreements: the ISDS provisions in CETA were seen as state-of-the-art ISDS, containing plenty of safeguards and other provisions to guarantee the right to regulate of the state and to protect public health and the environment. Although no drafts of ISDS/ICS provisions under TTIP have been made public, it can be reasonably assumed that TTIP would not go below the level of protection offered under CETA (and it would be hard to imagine that a lesser level of protection would be ratified by all the Member States plus the European Parliament).

So is the proposed Investment Court System better than ISDS? Few stakeholders are actually making this claim. There is in reality not much evidence to sustain the claim that government-appointed tenured judges would be more competent, objective and impartial than business lawyers appointed by the conflicting parties. The possibility to appeal against judgements is likely to lead to an increase in the cost and length of cases. Lip service to the right to regulate is above all symbolic, because it is not the principle itself which is contested: the difficulty lies in determining whether the right to regulate has been affected or not. Therefore, the regulatory space of a government depends on the exact content of an agreement, not on the label put onto it. And, by making it necessary to clarify the relationship with national and EU law, the EU risks shooting itself in the foot, as it could end up having to formally endorse the supremacy of international trade law over EU law (which the EU has so far refused to acknowledge).

Including rules on investment protection or not in TTIP is a policy choice that has to be taken by policy makers (and endorsed by the people of Europe through their elected Parliaments) based on sound analysis and weighting the risks and opportunities (and there are plenty of both...). However, debating whether an ICS is better than ISDS may be a moot point, since they are meant to reach the same objective, albeit by different means: ensuring non-discrimination against foreign investors. This may indeed narrow down the policy space of governments. The extent of this voluntary self-limitation of regulatory space depends on the political will of the European legislators, but it has little to do with the acronym that is used. Bigger potential benefits almost invariably come with bigger risks.

Even if we see the current ICS proposal as a nod to public opinion with little practical effect, it may be counterproductive in the long run if it were to result in increasing – rather than decreasing – the number of those who are either opposed to investment protection, or simply see no point in it. Since most stakeholders, including the greater part of the business and legal communities as well as the US government, are skeptical about the proposal, there is a risk that this increasingly controversial item will simply be dropped from the TTIP agenda in order to minimize risks and to save TTIP as a whole. This may not be dramatic in the short term, since an absence of investment protection measures is unlikely to deter transatlantic investment. However, abandoning investment protection

in TTIP and CETA – or dropping TTIP and CETA altogether, as an increasing number of politicians and citizens in Europe are advocating – would certainly reduce the ability of the ‘West’ (meaning basically the industrialised members of the OECD) to define global trade rules over the next decades. Some may cheer at the perspective of ending centuries of Western hegemony in international trade. Yet, while it is legitimate to ask about the democratic accountability of global trade rules that have been shaped by ‘the West’, it is also worth asking whether the possible alternative of global rules being written by the emerging nations (China India, Russia...) would be more in line with the interests of Europeans when it comes to protecting public health, the environment, consumer and labour rights or other items that we highly value.