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Transatlantic Investment Treaty Protection

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Paper No. 3 in the CEPS-CTR Project on "TTIP in the Balance" and CEPS Special Report No. 102 / March 2015

Abstract

In this chapter we present an informal cost-benefit analysis of the inclusion of investment protection provisions, including investor-state arbitration, in an investment chapter in TTIP. The analysis is conducted from the perspective of the EU and its member states. We argue that there is little evidence to suggest that investor-state arbitration will provide the EU with meaningful benefits, such as increased foreign investment from the US. In contrast, investor-state arbitration may impose non-trivial costs, in the form of litigation expenses and reduced policy space. This is due to the huge volume of US investment that would be covered by the investment chapter, as well as the fact that an investment chapter would almost certainly give foreign investors greater rights than they currently enjoy under EU and member state law. We conclude that, from the perspective of the EU, the case for including investor-state arbitration in TTIP is weak. Although we do not conduct a cost-benefit analysis from the perspective of the US, such an analysis would likely raise similar issues.

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Introduction[1]

This paper presents an informal cost-benefit analysis of including investment protection provisions, including investor-state dispute settlement (ISDS), in the TTIP. Our analysis is conducted from the perspective of the EU, although it covers many of the same issues that would also be relevant in a cost-benefit analysis conducted from the perspective of the US.

Provisions on investment protection, if included, will be important. Almost one-third of all outward FDI stock from 28 member states of the EU will be covered by the agreement and almost 40% of all FDI coming from outside of EU28 (Table 1). These figures dwarf those of the Canada-EU Comprehensive Economic and Trade Agreement (CETA), the first EU-negotiated agreement with significant investment protection provisions and ISDS. For the US, the shares are even greater: 50% of US outward stock will be covered by TTIP and almost 62% of total US inward stock (Hamilton & Quinlan, 2014, Table 7). Assessing the implications of an investment protection chapter is therefore crucial.

Table 1. FDI stock coverage of free trade agreements, 2012 (€ bn unless otherwise specified)

	Transatlantic Trade and Investment Partnership	Comprehensive Economic and Trade Agreement
EU outward FDI stock to…	**2,182**	**340**
% of EU total	32%	5%
EU outward FDI stock from…	**2,026**	**188**
% of EU total	39%	4%

Scarce availability of data makes a rigorous cost-benefit analysis unfeasible, so we rely on our reading of the best and most relevant evidence. Note also, that although an investment chapter could liberalise foreign direct investment (FDI) entry regimes in both the EU and US by requiring pre-establishment national treatment in most sectors, this is not covered in our analysis. The extent to which TTIP would provide liberalisation over and above what the

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[1] The discussion in this chapter closely follows a series of reports that we were commissioned to produce for the United Kingdom's Department of Business, Innovation and Skills (BIS). Our conclusions in those reports, and here, should not be taken as necessarily representing the views of BIS or the UK government. Report on the transatlantic agreement available here: www.gov.uk/government/uploads/system/uploads/attachment_data/file/260380/bis-13-1284-costs-and-benefits-of-an-eu-usa-investment-protection-treaty.pdf (accessed: 10 February 2013). We are grateful to the Department of Business, Innovation & Skills for permission to reproduce parts of the report.

parties would offer is uncertain at this point, and our ability to calculate the net predicted costs and benefits to the EU of marginal changes in openness to FDI across numerous sectors is limited. (On the other hand, it should be noted that the US and the majority of EU member states already provide pre-establishment national treatment in most economic sectors and for most activities as a matter of domestic law). Our analysis thus examines only the inclusion of post-establishment investment protection provisions in the TTIP and takes no account of possible investment liberalisation.

The analysis proceeds on the assumption that these post-establishment investment protections would be enforceable through ISDS. A cost-benefit assessment of a treaty that did not contain ISDS would look very different. Most of the potential benefits – for example, its theoretical ability to promote investment by offering reliable legal protection against certain political risks to investors – stem from investors' ability to enforce their rights under the treaty through ISDS. Similarly, most of the potential economic and political costs associated with the risk of claims stem from investors' ability to enforce their rights under the treaty through ISDS.

ISDS is controversial. In the public hearing organised by the European Commission, more than 145,000 European citizens agreed with non-governmental organisations that investment arbitration should not be included in TTIP (European Commission, 2015a). This meant that 97% of responses were overtly negative and there were only 60 companies that thought the issue was important enough to warrant separate replies apart from submissions from their industrial organisations. Among these 60 firms, two were tobacco companies – including Phillip Morris – and then there were a number of small firms as well, many of which did not express strong support for ISDS. The results made European Trade Commissioner Cecilia Malmström conclude: "*The consultation clearly shows that there is a huge scepticism against the ISDS instrument.*"[2]

Among academics, as well, the merits of ISDS are disputed. It is easy to find respectable academics arguing that it is something close to an unmitigated good, and others, just as respectable, arguing the opposite. For this particular agreement, our conclusions can be simply summarised: ISDS, considered by itself, is unlikely to provide the EU or its member states with significant benefits; moreover, the benefits that ISDS may provide are unlikely to outweigh the associated costs. The inclusion of ISDS in TTIP is, in our view, largely unjustified by the available evidence. Whether the inclusion of ISDS would be a prudent concession on the part of the EU in order to assume some greater benefit in another part of the overall agreement would depend on the scale of the concession offered in return for the inclusion of ISDS, and an assessment of whether there were any less costly ways to secure those additional concessions.

The paper proceeds as follows. After considering the likely investment-protection-related provisions in a TTIP investment chapter, we provide an overview of expected benefits and costs. We focus on both economic and political dimensions of the investment protection chapter and conclude by briefly offering a set of policy recommendations.

1. Treaty provisions: The likely content of the "I" in the TTIP

Since the beginning of its bilateral investment treaty (BIT) programme in the early 1980s, the US has negotiated these treaties on the basis of a detailed model text. Investment chapters in

[2] "Public backlash threatens EU trade deal with the US", *Financial Times,* 13 January 2015.

US FTAs generally follow the same model. Historically, the US has not been willing to deviate considerably from its model treaty (Vandevelde, 2009, p. 108). This means that successful investment treaty negotiations with the US typically resulted in agreements almost exactly mirroring the US template. One notable exception is the investment chapter of the US-Australia FTA, which generally follows the US model BIT except that it does not provide consent to investor-state dispute settlement.

The US has relatively few BITs in place with EU member states and no BITs in place with the EU's most powerful and developed members. The US-EU member state BITs include the following: Bulgaria (1992), Czech Republic (1991), Estonia (1994), Latvia (1995), Lithuania (1998), Poland (1990), Romania (1992), Slovakia (1991) and Croatia (1996). All of these BITs contain comprehensive dispute settlement and pre- and post-establishment national treatment, as well as other provisions common to the US model.

The US released its most recent model BIT in 2012, which is the intended basis for all current and future US BIT negotiations (Vandevelde, 2009, p. 108).[3] Given the US negotiating position in the past, it is very likely that Washington will insist that its 2012 model text provides the starting point for negotiations in the TTIP. In Europe, however, it is not entirely clear which direction the EU is going to take at this point given what Maupin accurately refers to as "the confusing range of objectives set forth by the Council, the Parliament, and the Commission." (Maupin, 2013, p. 196; see also Reinisch, 2013). For the purpose of this paper, we assume that the EU could accept the 2012 US model, or something close to it, as a starting point for negotiations. This assessment is based on our understanding that the proposed investment chapter in the CETA reflects a US-style (or NAFTA) approach to investment protection. We therefore assume for the purposes of this chapter that the text of TTIP investment provisions would follow the CETA/2012 US model BIT approach.[4]

The US model BIT is considerably more detailed and more comprehensive than the existing BITs typical of EU member states. Unlike EU member state BITs, US BITs mandate national treatment (NT) and most-favoured nation (MFN) treatment at both the pre-establishment and post-establishment phases. With the exception of Canadian and Japanese BITs, the BITs of most other countries do not address pre-establishment rights. The US model can thus be seen as requiring the liberalisation of inward FDI policy in addition to investment protection. The US model BIT also includes typical post-establishment provisions, such as guarantees of the international "minimum standard of treatment" (Art. 5), full compensation for expropriation (Art. 6), and the right to free transfer of capital (Art. 7). Finally, the US model contains comprehensive investor-state dispute settlement (ISDS) (Sec. B), which unlike the simple ISDS provisions in many European BITs, specifies required ISDS procedures in significant detail, including mandatory "transparency" of arbitral proceedings (Art. 29).

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[3] The 2012 US model BIT can be found at www.state.gov/documents/organization/188371.pdf.

[4] It is likely that the TTIP investment chapter will include a most-favoured nation MFN clause. Unlike the MFN clauses of other investment treaties, the MFN clause of the US 2012 model BIT does not apply to dispute settlement. Also, US BIT practice contains some examples of treaty-based limitations on the applicability of MFN clauses. For example, some US BITs include sectoral or subject matter exceptions to MFN treatment in an annex. The US has also sometimes excluded from its MFN clause treaty provisions in *earlier* BITs ensuring that the MFN clause only applies to more favourable treatment provided in *later* BITs. Our analysis is based on the assumption that the MFN provision of the TTIP would be drafted to exclude the application of MFN to early treaties.

The comprehensive nature of the US model is evident in other provisions that go beyond the traditional core of favourable standards of treatment backed up by access to ISDS. For example, the US model bans many types of 'performance requirements', beyond what is already prohibited under the WTO TRIMs agreement (Art. 8). It also encourages the implementation a US-style 'notice and comment' system for the development and promulgation of investment-related administrative regulations (Art. 11). And it contains provisions concerning the host state's right to implement treaty-consistent measures to protect the environment (Art. 12) and the desirability of not weakening domestic labour laws in order to attract investment (Art. 13). These latter two articles are largely hortatory, however. The US model is also notable for its inclusion of various explanatory footnotes and annexes that attempt to clarify the meaning of otherwise vague or ambiguous treaty text. For example, the "minimum standard of treatment" is defined as equivalent to the "customary international law minimum standard of treatment of aliens" (Annex A).

Finally, the US model contains a number of exceptions designed to enhance the host state's policy space. For example, Article 18 provides a self-judging 'essential security' exception that allows the host state to apply otherwise treaty-inconsistent measures "that it considers necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace and security, or the protection of its own essential security interests." The self-judging nature of the essential security exception ("that it considers necessary") means that the host state's invocation and application of the exception will be difficult or perhaps impossible for an investor to challenge in arbitration.[5] Article 20 of the US model provides another exception, for prudential measures designed to ensure the "integrity and stability of the financial system". Crucially, the investor's right to challenge state decisions taken under this exception is subject to numerous important limitations drafted into the article's text. Moreover, the US model limits the ability of investors to challenge 'taxation measures' as treaty-inconsistent (Art. 21).

A key question for the cost-benefit assessment, of course, is whether the chapter will be backed up by comprehensive ISDS. While the US did agree to remove ISDS from the investment chapter of its 2004 PTIA with Australia – at Australia's request – several stakeholders in the EU and the US desire comprehensive ISDS.[6] For our purposes, we assume that if negotiations are concluded, the investment protection chapter will indeed include comprehensive ISDS. Our assessment is conducted on this basis.

2. Potential benefits of ISDS

2.1 Promotion of US investment in the EU

The main potential economic benefit of an EU-US investment chapter lies in its theoretical ability to promote additional inbound investment to the EU by providing US investors with valuable international legal protections that they currently do not enjoy. In other words, is an EU-US investment chapter likely to increase the volume of US FDI in the EU? In our view, there is little convincing empirical evidence that investment treaties containing ISDS actually promote FDI in any significant way.

[5] For an overview of these so-called 'non-precluded measures', see Burke-White & von Staden, 2008.

[6] The US-Australia FTA, in addition to *not* including ISDS, also *does* include the various exceptions discussed above: essential security (Art. 22.2), taxation (Art. 22.3) and prudential regulation of financial services (Art. 13.10).

First of the all, the types of risks an investment protection chapter would cover are not generally considered present in most EU member states. This is clear from the US government's official "Investment Climate Statements", summarised below in Table 2. Even in what would typically be considered the most 'risky' investment destinations in Eastern Europe, the US government considers foreign investments there generally safe from expropriation and post-establishment discrimination, and advertises it as such to potential American investors.

Table 2. Summary of US Investment Climate Statements 2014 for 28 EU member states

	Post-establishment discrimination	Expropriation	Courts
Austria	No concerns	No concerns	No concerns
Belgium	No concerns	No concerns	No concerns
Bulgaria	Concerns about frequent changes in regulatory framework, but no significant concerns about discrimination	No concerns, except for intellectual property rights	Some concerns about corruption and nepotism and serious concerns about efficiency But while slow and bureaucratic, courts do resolve investment disputes and Bulgaria is seen as having effective means of enforcing property and contractual rights
Croatia	Some concerns about transparency and efficiency, but no specific concerns about discrimination	None except for a potential concern that Ministry of Justice oversees expropriation complaints over real property	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Cyprus	No concerns	No concerns	Some concerns about speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Czech Republic	A few concerns about corruption in procurement practices	No concerns	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Denmark	No concerns	No concerns	No concerns
Estonia	No concerns	No concerns	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Finland	No concerns	No concerns	No concerns
France	A few concerns about publicly held firms	No concerns	No concerns
Germany	No concerns	No concerns	No concerns
Greece	No concerns	No concerns, except for intellectual property rights	Some concerns about efficiency and speed of court proceedings and some foreign firms complain about bias Overall, however, no concerns about independence of courts or the enforcement of property and contractual rights

Hungary	Some concerns about transparency and efficiency, but no specific concerns about discrimination	Concerns over IPRs and some about compensation expressed by a few non-US firms, which were later settled in court	Some concerns about independence of courts, but no concerns about the enforcement of property and contractual rights
Ireland	No concerns apart from transparency of government tenders	No concerns	No concerns
Italy	A few concerns about advantages to parastatal firms in procurement decisions	No concerns, except for IPRs	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Latvia	No concerns	No concerns	Some concerns about speed of lower court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Lithuania	No concerns	No concerns	No concerns
Luxembourg	Not available	Not available	Not available
Malta	No concerns	No concerns	Some concerns about speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Netherlands	No concerns	No concerns	No concerns
Poland	No concerns	No concerns	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Portugal	No concerns	No concerns	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Romania	Significant concerns about transparency and predictability in regulatory framework, but no significant concerns about discrimination	No concerns, except for IPRs and some outstanding disputes from Communist era	Serious concerns about efficiency and speed of court proceedings, but no concerns about independence of courts
Slovakia	No concerns	Some expropriation cases but no significant concerns about state's commitment to provide full compensation	Some concerns about efficiency and speed of court proceedings, but no concerns about independence of courts
Slovenia	No concerns	No concerns	Some concerns about efficiency and speed of proceedings about private property expropriated by Socialist Yugoslav government, but no concerns about independence of courts

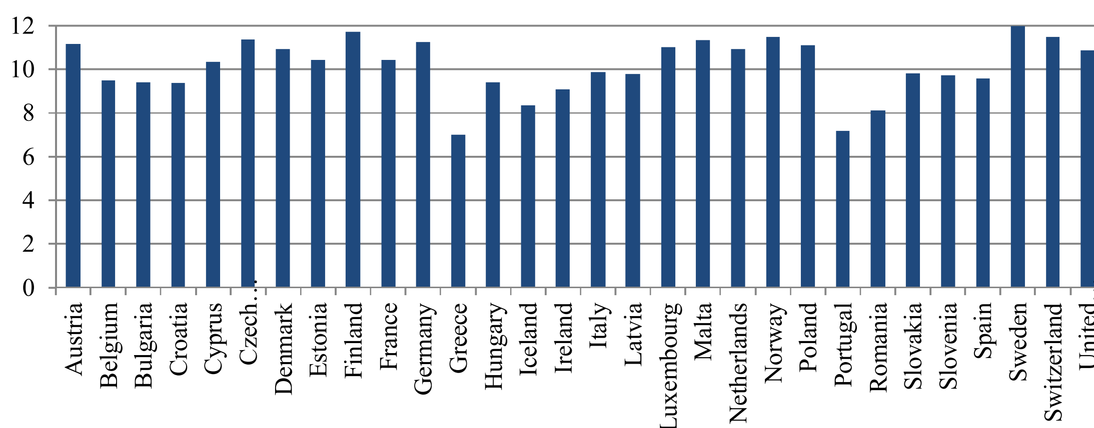
Spain	Some concerns about advantages to SOEs	No concerns	Some concerns about speed of court proceedings, but no concerns about independence of courts or the enforcement of property and contractual rights
Sweden	No concerns	No concerns	No concerns
UK	No concerns	No concerns	No concerns

Source: US investment climate statements (available at: www.state.gov/e/eb/rls/othr/ics/2014/index.htm).

A recent survey of Chinese investors in the EU by the European Union Chamber of Commerce in China supports the conclusions that we draw from the US Investment Climate Statements. That survey reports that Chinese investors view the EU as a "safe and stable place to invest, with a transparent and predictable legal environment…. Chinese companies are confident about the long-term prospects of their investments there, which were contrasted with regions such as Africa and Southeast Asia."[7] While the report includes some complaints by Chinese investors about certain difficulties encountered in operating in the EU, those complaints seemed to concern issues that are not typically dealt with in investment treaties, such as inflexibility of labour laws, difficulties in obtaining visas and work permits, and high costs and taxes.[8]

Our sense that many EU member states are already viewed as attractive places for US investors, despite, in many cases, the lack of a US BIT, is further confirmed by quantitative indicators of the investment climate. For example, the Investment Profile index published by the PRS Group in its International Country Risk Guide (ICRG) rates countries on a 12-point scale as to the favourability of their investment climates. Indexes such as this suffer from a number of methodological problems (Yackee, 2014), but it is nonetheless interesting to note that EU Member States tend to rate very well. The average ICRG Investment Profile index score for EU member states in 2011 (the last year for which we have data) was 10.14 (where a higher rating means a more favourable investment climate), only Portugal and Greece fall below a rating of 8.0 (see Figure 1, below). In contrast, the world average ICRG Investment Profile rating for 2011 was 7.56.

Figure 1. 2011 ICRG Investment Profile Index, EU member states



[7] European Union Chamber of Commerce in China (2013).

[8] Ibid., p. 33.

There are a few exceptions to the generally high quality of EU domestic legal systems, such as Bulgaria and Romania, where US Investment Climate Statements indicate that serious concerns persist about procurement practices, intellectual property rights protection and inefficient courts. In the case of Bulgaria, the courts are also seen as subject to political influence – a relevant factor to consider for investment disputes against the government.[9] However, the US already has BITs with Romania and Bulgaria. Thus, including investment protection provisions in TTIP would not result in a significant change to the status quo for US investors considering investing in Bulgaria and Romania.

Moreover, even in Bulgaria and Romania, existing US BITs do not appear to have helped promote investment. A 2012 study found that past US treaties with investment protection clauses rarely had a tangible impact on US outward investment – even in far more risky jurisdictions than European economies (Table 3).[10] For those treaties that have had a measurable impact, it has been only marginal. Crucially, not a single investment treaty with a developed country – including Canada, Australia, Israel and Singapore – has had an impact on US investment outflows. Nor is there evidence that BITs with Eastern European members of the EU were effective in promoting American investment.

*Table 3. Estimation of investment effects of US BITs and PTIAs**

	Sustained positive effect on US FDI (annual increase in net US inflows)	**No sustained effect on US FDI**	**Insufficient data**
BITs	Bangladesh ($28 million) Honduras ($83 million) Trinidad & Tobago ($254 million) Turkey ($155 million)	Albania, Argentina, Azerbaijan, Bahrain, Bolivia, **Bulgaria**, Cameroon, Rep. of Congo, DR Congo, **Croatia**, Ecuador, Egypt, **Estonia**, Georgia, Grenada, Jamaica, **Latvia**, Mongolia, Morocco, Mozambique, Panama, **Poland**, **Romania**, Senegal, Sri Lanka, Tunisia and Uruguay	Armenia, **Czech Republic**, Jordan, Kazakhstan, Kyrgyz Republic, **Lithuania**, Moldova, Serbia, **Slovakia** and Ukraine
PTIAs	Morocco ($72 million)	Australia, Bahrain, Canada, Chile, El Salvador, Guatemala, Honduras, Israel, Mexico, Morocco, Nicaragua and Singapore	Jordan

* Preferential trade and investment agreements.

Notes: Analyses regressed each country's net FDI inflows from the US on a one-year lag of net FDI inflows, a one-period pulse for the first full year after the agreement entered into effect and a dummy variable taking the value of one in each year the agreement has been in effect. Further details explained in the source. EU member states in bold.

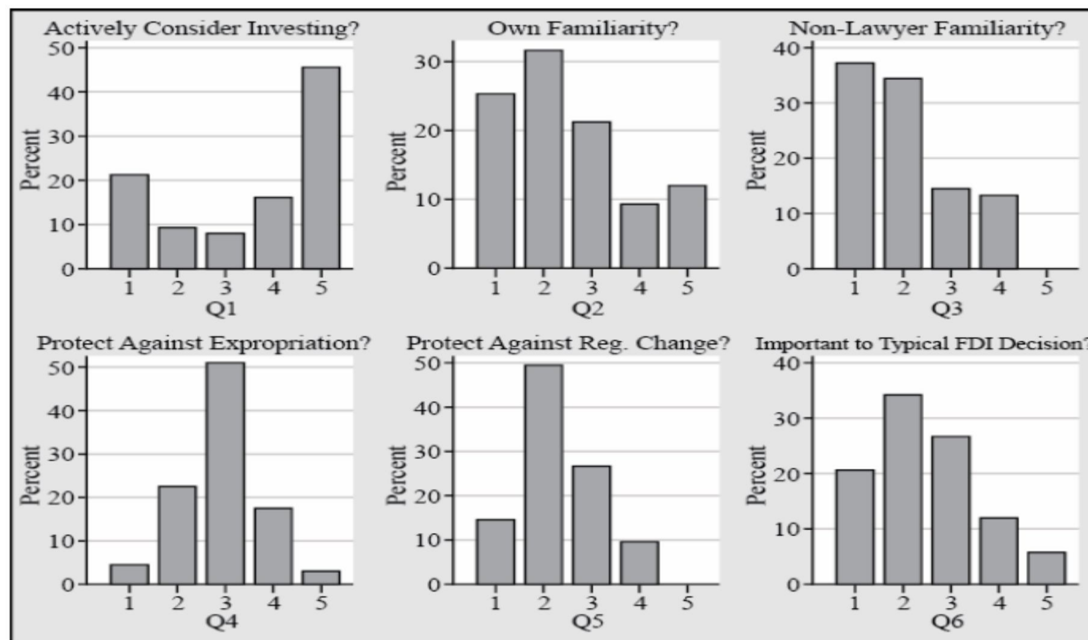
Source: Adapted from Peinhardt & Allee (2012).

[9] See also European Commission (2015b), Figure 47.

[10] Econometric analyses of the impact of investment treaties often suffer from an absence of high-quality investment data and the problem of reverse causality: Do investment treaties cause investment flows, or is it the other way around? Investigating American agreements only allows the authors to use more complete investment data than panel-type studies, as American FDI flows are more readily available. Also, to account for the endogeneity of the relationship between FDI and investment treaties, the authors analyse the impact of each investment treaty in isolation with one or more lagged dependent variables. This further prevents questionable assumptions of homogeneity of effects across different countries, as is otherwise standard in panel data studies.

These 'negative' findings are supported by feedback from American investors themselves. In 2010, a survey of in-house legal counsel in the 100 largest American multinationals showed that not only did many find BITs less effective to protect against expropriation and adverse regulatory change than commonly assumed, hardly any saw the treaties to be critical to their companies' investment decisions (Figure 2). This survey concerned the US BIT programme, which consists almost exclusively of treaties with developing and transition economies. In our view, this is a strong indication that US investors are highly unlikely to factor the availability of ISDS with EU countries into their investment decisions.

Figure 2. Response from general counsel within American multinational corporations about awareness and importance of BITs



Notes: Histogram reports responses from in-house legal counsel in major American multinationals to: i) To your knowledge, how regularly does your company actively consider investing in foreign (non-US) operations, businesses, joint ventures, or other projects? ii) How familiar are lawyers in your office with the basic provisions of BITs? iii) How familiar are non-lawyer senior executives in your corporation with the basic provisions of BITs? iv) In your view, how effective are international treaties like BITs at protecting foreign investments from expropriation by a foreign government? v) In your view, how effective are international treaties like BITs at protecting foreign investments from adverse regulatory change in the foreign country? vi) How important is the presence or absence of a BIT to your company's typical decision to invest in a foreign country? For the first question, 1 indicates 'Never or Rarely' and 5 indicates 'Frequently'. For the next two questions, 1 indicates 'Not at all familiar' and 5 indicates 'Very familiar.' For questions four and five, 1 indicates 'Not at all Effective' and 5 indicates 'Very Effective'. For the last question, 1 indicates 'Not at all important' and 5 indicates 'Very Important'.

Source: Yackee (2010).

This is important, as investment protection treaties have arguably been more likely to be considered by US firms compared to European firms (Poulsen, 2010). Apart from their legally binding liberalisation provisions, the inclusive and open debates in Washington on investment protection treaties following the very public investment claims under NAFTA (see below) has led to a greater awareness of the treaties among US multinationals. This contrasts with Europe, where BITs have hardly ever been politicised until recently. Yet, irrespective of the greater

awareness of investment treaties in the US, they do not appear to have played a considerable role in promoting American investment abroad.

Finally, it is worth highlighting that most public political risk insurance agencies in Europe do not find investment treaties important for pricing of availability of insurance even in otherwise risky jurisdictions (Poulsen, 2010). The same is the case for the Overseas Private Investment Corporation (OPIC). So even if ISDS in the TTIP could hypothetically have an impact on the transaction costs of foreign investment via the provision and pricing of insurance, this does not seem likely either.

In sum, we find it unlikely that investment protection provisions in the TTIP would have a tangible impact on the amount of US investment flowing to the EU.

2.2 Protecting EU investment in the US

A couple of very large European companies like Repsol and Total have told the European Commission that they are in favour of strong ISDS protections in TTIP and so have a number of European industrial organisations.[11] This, of course, is not surprising. A comprehensive investment protection chapter would add yet another layer of protection to European investors operating or seeking to operate in the US – without the investors having to pay for such protections themselves (as they would when taking up political risk insurance for instance). But the proper question is not whether some firms or industrial groups would like TTIP to include strong investment protections but rather whether the treaty would mitigate significant concerns actually experienced by European investors in the US. We find this unlikely as well.

To our knowledge, there are very few aspects of the US investment climate that concern EU investors. EU investors in the US have no restrictions on repatriation of profits, dividends, interest or royalties. And with respect to discrimination, it is true that 'buy American' provisions in the 2009 American Recovery and Reinvestment Act raised concerns about discrimination against foreign investors. However, despite these provisions foreign firms commonly receive national treatment in the US with respect to local, state and federal government fiscal or financial incentives.[12] More generally, there are hardly any discriminatory measures against foreign investors after establishment. Exceptions from national treatment are clearly set out in the OECD's National Treatment Instrument and both local, state, and federal level deviations from treatment proscribed by investment treaties are set out in the non-conforming measures annexes of recent US BITs and FTAs.[13]

With respect to discrimination when it comes to M&As or takeovers, the administration, via the Committee on Foreign Investment in the United States (CFIUS), has become increasingly politicised in recent years when reviewing security implications of such transactions. CFIUS decisions are unlikely to be challengeable in investment arbitration, however, given the likely national security exception in an EU-US investment chapter. This means that even if EU

[11] European Commission, "Online public consultation on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement", Brussels, 13.1.2015, SWD(2015) 3. After reading an initial draft of this chapter, a representative from Repsol (a Spanish firm) responded that strong investment protections in TTIP were necessary to protect against political risks in southern Europe, yet it is our understanding that there are no plans to have the chapter protect intra-European investment flows.

[12] See e.g. the United States report on its investment regime to APEC (APEC, 2011).

[13] Available at: www.ustr.gov.

investors are concerned about the politicisation of CFIUS – which we do not have evidence to sustain – an EU-US investment treaty is unlikely to provide them with any other recourse than is currently available. It is also important to note that while acquisitions by EU investors account for the largest share of notices to CFIUS (60% in 2011), few of these result in legally binding mitigation measures. Rather, actual restrictions have primarily been targeted at sovereign-owned or -controlled investments, particularly from China (see e.g. Fagan, 2010).

With respect to expropriation, property rights are protected under the US Constitution, constitutions of individual states, as well as federal, state, and local laws. As in BITs, US 'takings' jurisprudence addresses both direct and indirect forms of expropriation and provides for compensation at fair market value at the time of the 'taking'. Enforcement of contracts is not a problem either. Due to the efficiency of the US judicial system in enforcing contracts, the US ranked 6th in the World Bank's *Doing Business 2013* report on this indicator.

Finally, US courts are characterised by both high quality and a high level of independence. In its arguments in favour of including ISDS in TTIP, the European Commission, in a statement dated 27 January 2014, suggested that there is nonetheless evidence that US courts are biased against foreign investors. The Commission presented a small number of examples, which we quote at length:

> 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.[14]

In our view, these examples of questionable conduct by the US government are not persuasive evidence of the need for ISDS to protect EU investors in the US. Both the Havana Club and the Helms-Burton cases involve the unique circumstances of US restrictions on business with Cuba. Moreover, the Havana Club case can be read as illustrating the strong US commitment to protecting property rights, and not the opposite, as the Commission statement suggests. Pernod Ricard acquired the trademarks from the Cuban government, which had taken (expropriated) the marks from the previous Cuban owners, the Arachabala family. From Washington's viewpoint, US law served to discourage expropriation by preventing the expropriating government (Cuba) from seizing and then selling intellectual property. Understood in this way, the case is hardly a useful indicator of US disregard for property rights.

Nor are the *Loewen* or *Mondev* cases particularly relevant. It is true that *Loewen* is widely regarded by international investment law experts as being very poorly reasoned, and perhaps objectively 'incorrect'. The case involved a state-court trial of a contract dispute between a

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[14] Answer by Karel de Gucht on behalf of the Commission to Parliamentary Question NO/E-013215/13, 27 January 2014.

large Canadian funeral home operator and a much smaller Mississippi funeral home operator. A Mississippi jury awarded the Mississippi plaintiff $500 million, most of which entailed punitive damages for allegedly unsavoury business practices. Many observers of the case may view the facts as illustrating something approaching a 'denial of justice'. On the other hand, the Commission mischaracterises the case in describing it as involving a "court order to pay damages of $500 million before [the defendant] could appeal". In fact, the court order was to post a performance bond of 125% of the jury award (which, as indicated, included punitive damages for allegedly egregious behaviour on Loewen's part) in order to pursue an appeal, as was the law in Mississippi. Loewen refused to post the bond, declined to appeal to the United States Supreme Court, and settled the case for a fraction of the jury award. The NAFTA Tribunal declined to reach the merits of the case, and the United States was never found to have committed a denial of justice.

There are aspects of the underlying trial in *Loewen* that are admittedly disturbing, especially to European eyes unused to the sight of trial by jury, or of outsized punitive damage awards. On the other hand, it is remarkable that there are thousands of foreign investment projects in the United States and there have been hundreds of cases in US courts involving foreign investors, and yet *Loewen* – a case which the foreign investor *lost* in ISDS – is only one of two concrete examples of 'bias' in the US court system that the Commission can identify. Think what one may of *Loewen*, but it is a stretch to view the case as illustrating widespread anti-investor bias in the US justice system. Indeed, given the tremendous amount of FDI in the US, the lack of other examples would seem to illustrate the very high quality of the US justice system, and not the opposite.

Mondev is an equally problematic example. There, a Canadian real estate company sought to overturn a Massachusetts State Supreme Court decision in its contract dispute with a local government entity over a failed commercial redevelopment project. The Tribunal found that the state court's decisions were perfectly acceptable as a matter of international investment law. The Canadian plaintiff also challenged a state law that limited immunity in tort—not contract—to the local government actors. The Tribunal firmly rejected this challenge as well, upholding the grant of immunity as consistent with international investment law. Neither Massachusetts law nor Massachusetts courts violated plaintiff's international law rights.

In short, both *Loewen* and *Mondev* are exceptional cases; furthermore, they are cases in which the investor *lost* in ISDS, Loewen due to a lack of jurisdiction and Mondev on the merits. They are not evidence of systematic, serious flaws in the US judicial system's treatment of foreign investment.

While the high quality of the US judicial system (and US laws) concerning foreign investors is beyond debate, we have heard concerns from some European parties that without ISDS, EU investors will not be able to enforce their TTIP rights in US courts. This argument is not particularly convincing. It makes sense only insofar as there is an underlying justification for including enforceable investment protection provisions in TTIP. Our analysis in this paper suggests that such a justification is lacking.

Even assuming, for the purposes of argument, that there were a coherent policy rationale for ensuring that TTIP provides EU investors in the US with a set of enforceable investment protections that go beyond what they would otherwise be entitled to under US law, the inclusion of ISDS in TTIP would be unnecessary. It is true that, under the US Supreme Court's *Medellin* case law (which raises a number of subtleties regarding so-called 'non-self-executing treaties' that we do not delve into here), some US treaties may indeed be difficult or impossible for private parties to enforce in US court. However, access to US courts can be assured either

by clearly indicating in TTIP that the US considers the treaty to be 'self-executing', or by having the US pass appropriate implementing legislation. In other words, if one believed that was a problem of domestic-court enforceability of TTIP rights in the US, the appropriate response by the EU would be to insist in its negotiations that the US pass implementing legislation securing a right to access US courts for certain TTIP violations, not to include ISDS in TTIP.

2.3 The possibility of investment diversion and treaty-shopping

Related to our discussion of the potential of a TTIP investment chapter to promote FDI into the EU is the possibility that the investment chapter may in many cases simply divert US investment from one EU member state to another. For example, an investment chapter might, in theory, make western European states that currently lack a BIT with the US more attractive as destinations for US foreign investment by increasing the level of investor protection above the status quo. So, for example, we might imagine that an EU-US investment chapter would make the UK (or France or Germany) marginally more attractive to US investors because the chapter would give US investors considering investing in those countries international legal rights that they currently do not enjoy. On the other hand, an investment chapter would probably not change the status quo vis-à-vis those EU member states that already have a BIT with the US. For those states, an investment chapter would be largely redundant with the protection that US investors in those states already enjoy. Conceivably, the differential impact of an investment chapter on, say, Bulgaria (as an EU member state that has a BIT with the US) and the UK (which does not have a US BIT) may even divert some investment away from the former to the latter, as the EU-US investment chapter would eliminate any international investment law 'advantage' that Bulgaria currently enjoys over the UK.

However, in assessing the likelihood of diversion effects, it is important to note our analysis above, which suggests that the presence or absence of an investment treaty is unlikely to play a significant role in the location decisions of US investors, especially as to those EU member states that enjoy strong rule-of-law traditions and institutions. This observation implies that, even if an EU-US investment treaty alters the relative strength of investment protections available to US investors in various states within the EU, this legal change is unlikely to induce significant diversion effects.

Our conclusion here is also influenced by the possibility that US investors may currently be able to structure their EU investments in ways that provide BIT protections even where the ultimate EU destination for the investment does not have a BIT with the EU—a phenomenon called 'treaty shopping'. For example, if US investors in, say, Germany (which does not have a BIT with the US) route their investment via an intermediary incorporated in a third state that *does* have a BIT with Germany, the investment may be entitled to the protection of the Germany-third state investment treaty. Germany, like the UK, France, and many other EU member states, has an extensive network of BITs, most of which contain ISDS. If US investors in EU member states like Germany currently structure their investments in such a way as to gain BIT coverage, then an EU-US investment chapter is likely to have little impact on the amount or location on inbound investments to the EU. This is because, again, an EU-US investment chapter will likely be redundant with international legal protections that the US investor already enjoys, or that the US investor can enjoy through appropriate corporate structuring.

We are not aware of any evidence that US investors in the major EU member states actually do (frequently or otherwise) structure their investments via third states for the purpose of accessing the protection of existing investment treaties. This is not surprising because, as we

explained above, evidence suggests that neither US investors in the EU nor EU investors in the US have expressed significant concerns about the sort of risks against which an investment treaty might protect, nor do they seem to particularly value the protections that ISDS may offer. Nevertheless, in cases where investors have specific concerns about future government measures, it is conceivable that they could structure the investment with investment treaty implications in mind. For example, in the dispute between *Philip Morris Asia v Australia*, the Australian government has argued that the Philip Morris group structured its investment in Australia so as to bring its trademarks within the coverage of the Hong Kong-Australia BIT.[15] Insofar as there is a possibility to structure investment between the US and EU member states so as to bring it under the protection of existing investment treaties, this would have implications for our estimation of both the costs and the benefits of a US-EU investment protection chapter, as ISDS in TTIP would be redundant with what US investors can already obtain via restructuring.

Just as US investors might use corporate structuring to take advantage of existing third-state BITs when investing in the EU, so too might EU investors seeking to invest in the US also attempt to gain BIT coverage by routing their investments through any of the 40-some states which currently have a BIT with the US. However, EU investors would face two challenges. The first is that the US has included 'denial of benefits' provisions in a number of its investment treaties and FTA investment chapters. According to a commentary on the 2012 US model BIT, the main purpose of denial of benefits provisions is to provide "safeguards against the problem of treaty shopping through the creation of 'sham' enterprises." (Caplan & Sharpe, 2013, p. 812). For example, NAFTA Article 1113(2) allows the United States (and the other Parties to NAFTA) to:

> deny the benefits [of NAFTA's investment chapter] to an investor of another Party that is an enterprise of such Party and to investments of such investors if investors of a non-Party own or control the enterprise and the enterprise has no substantial business activities in the territory of the Party under whose law it is constituted or organized.

The term "substantial business activities" is not further defined. Equivalent denial of benefits provisions are included in the 2012 and 2004 US model BITs (Art. 17 in both cases), and in other non-NAFTA free trade agreements, including the United States-Central America-Dominican Republic FTA (CAFTA, Art. 10.12).[16]

A second difficulty is that the US lacks investment treaties with states such as the Netherlands, Cayman Island and the Virgin Islands, which are likely to be attractive for tax reasons. This is an important consideration as tax planning plays a far greater role in corporate structuring than concerns related to investment treaties.

In sum, US investors in the EU may currently be able to obtain investment treaty coverage of their investments even in the absence of an investment treaty between the US and the EU host state. If this is the case, ISDS in TTIP will prove largely redundant with the coverage US investors can already enjoy, if they wish. On the other hand, US investment treaty practice makes it more difficult for EU investors in the US to engage in such 'treaty shopping' under

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[15] *Philip Morris Asia v Australia*, Australia's Response to the Notice of Arbitration, 21 December 2011 [4]-[6].

[16] CAFTA's denial of benefits provision was, in fact, recently successfully invoked by El Salvador to defeat jurisdiction in a claim filed by a US-based holding company that, in the Tribunal's view, was only a "passive actor" in the US. *Pac Rim Cayman LLC v Republic of El Salvador* (ICSID Case No. ARB/09/12) (Decision on Jurisdiction).

existing arrangements. If, contrary to our analysis in this section, the availability of investment treaty protection were a decisive factor for EU investors considering investing in the US, then the difficulties associated with 'treaty shopping' under existing US treaties would mean that ISDS in TTIP would prove a greater benefit to such EU investors.

2.4 De-politicisation of transatlantic investment disputes

One potential benefit of investment arbitration is if it 'de-politicises' investment disputes. One version of this claim is that investment arbitration reduces the role of the home state in the resolution of specific conflicts between foreign investors and their host states (Shihata, 1986). This has also been used as a core argument against relying on inter-state dispute resolution in the investment protection chapter. Yet, in our view, concerns about politicisation of transatlantic investment disputes are often exaggerated.

First of all, it is rarely clear what exactly is meant by de-politicization of investment disputes (Paparinskis, 2012). While the involvement of home states in a dispute is one *type* of politicization, it is not the only one. Few would argue that the Phillip Morris claim against Australia is not politicised, for instance, and the same could be said of Vattenfall's claims against Germany. More broadly, the controversial nature of investment arbitration to resolve public law disputes has brought about considerable political controversy in Europe – potentially at the expense of broader foreign policy agendas, such as a swift negotiation of TTIP.

Secondly, while the de-politicisation thesis is widely shared amongst lawyers, it has never been subject to any rigorous empirical testing. Moreover, we are aware of no evidence to suggest that investment disputes across the Atlantic have spilled over into broader diplomatic conflicts. In the case of the Netherlands, interviews with diplomatic officials indicate that this has never happened – despite the large bilateral investment flows between the two countries (Tietje & Baetens, 2014, pp. 69-72).

Third, an investment chapter in TTIP is unlikely to provide meaningful access to ISDS for the kinds of investment disputes that are most likely to raise political sensitivities. As mentioned above, an EU-US investment chapter is almost certain to include a self-judging national security exception similar to Article 17 of the 2012 model US BIT. In that case, decisions by the US government to block acquisitions by European investors on national security grounds may be essentially unreviewable in arbitration, leaving diplomatic protection as the investor's only option to challenge the denial of permission to invest.

Finally, and with respect to US pressure on European states, the US Department of State formally maintains a restrictive policy toward diplomatic espousal of investment claims, requiring, for instance, full exhaustion of local remedies.[17] And while the US executive has historically been drawn into investment disputes in numerous developing countries,[18] the high quality of the US-EU political relationship combined with Europe's favourable investment climate makes us expect that incidences of strong US pressure on European states on behalf of US investors are rare. Diplomatic representations are bound to take place, but the type of politicisation of investment disputes seen in the mid-20th century between Western and developing states is highly unlikely. Transatlantic investment flows have flourished for decades without significant politicisation of the dispute settlement process.

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[17] www.state.gov/s/l/c7344.htm.

[18] Maurer (2013).

2.5 Impact on future negotiations with third parties

A final potential benefit of including ISDS in the TTIP is if it increases the bargaining power of both the US and the EU in future negotiations with countries such as China. Although difficult to assess *ex ante*, we urge caution about the plausibility of this scenario.

First of all, with respect to China, Beijing has adopted investment treaties for decades and the Chinese leadership has developed a somewhat distinct investment treaty practice tailored to its perception of China's national interest (Gallagher & Shan, 2009). China has indicated considerable interest in an investment treaty with the EU – also before knowing the outcome of the TTIP negotiations – and has not expressed concerns about extending ISDS to post-establishment provisions. China also recently signed an investment treaty with Australia that included ISDS. This was despite the fact that Australia had previously refrained from enshrining ISDS provisions into its preferential trade and investment agreement (PTIA) with the United States. As noted by Berger & Poulsen (2015, p. 2), "Beijing was thereby not deterred from including investment arbitration in an agreement with a developed country, which had previously refused to include similar provisions in a treaty with the US. This seems to be the final nail in the coffin for the already implausible argument that China's support of ISDS depends on the nature of investment protection agreements among developed countries."

Secondly, both European countries and the United States have refrained from signing BITs with developed countries for decades, yet that didn't prevent them from expanding their already widespread BIT-networks with developing countries. Similarly, although OECD countries failed to agree to the Multilateral Agreement on Investment in the 1990s among themselves, this didn't prevent OECD countries from continuing to sign BITs with developing countries. The reason is simple: the main purpose of ISDS is to act as a substitute for poor judicial systems, so it is not clear why it should be seen as illegitimate to exclude ISDS in agreements where there are for the most part developed legal systems on both sides. This was the argument used by Australia and the US for not including ISDS in their 2005 agreement and the logic behind the European Parliament's 2013 vote to clarify that future EU investment agreements should include ISDS "[i]n the cases where it is justifiable".[19] Similarly, Commissioner De Gucht implied that the EU would not necessarily push for ISDS if parties had well-developed legal systems, like the United States: "[o]bviously you need [ISDS] when it is an agreement with a third country that does not have a properly-functioning judicial system, where one can have doubts about the rule of law."[20] The United States is not such a country and nor are any of the EU member states that do not currently have BITs with the United States, so we find it unlikely that investment protection provisions in the TTIP would have a tangible impact on the extent to which third parties will agree to ISDS with the US and/or the EU.

[19] See Committee Report tabled for Plenary, 1st Reading/Single Reading, 26 March 2013 (www.europarl.europa.eu/oeil/popups/summary.do?id=1255871&t=d&l=en).

[20] See Remarks of Commissioner De Gucht, EUR. PARL. DEB. (339), 22 May 2013) (www.europarl.europa.eu/sides/getDoc.do?type=CRE&reference=20130522&secondRef=ITEM-019&language=EN&ring=A7-2013-0124).

3. Potential costs

3.1 Risk of claims and adverse awards

The primary cost to the EU of ISDS-backed investment protection is the increased risk of successful investment treaty claims against the EU or its member states. In estimating the scale of this cost, the first step is to assess the size of US investment stocks in the EU, as the likelihood of claims against the EU can be expected to increase roughly in proportion with the size of the investment stock in the EU covered by the treaty. As mentioned initially, the EU possesses a very large stock of US-origin investment.

This is important. An often-heard argument in European debates about TTIP is that since (western) EU member states have been subject to only a few claims after having signed hundreds of BITs for decades, there is no reason to expect that the number of claims should rise significantly after TTIP. But this argument is based on a comparison between BITs signed with (mostly) insignificant sources of FDI and a potential future treaty signed with a very significant source of inward investment. Take the case of Germany, for instance, which has signed more than 150 BITs – the vast majority with developing countries. In 2011, 3% of FDI stock in Germany came from developing countries, 9% came from the United States.[21] Similar patterns emerge when looking at other western EU member states. In France, 4% of its 2011 FDI stock came from developing countries and 10% from the United States. In Sweden, 2% came from developing countries, 7% from the United States. And in the United Kingdom, 28% of inward FDI stock came from the United States, 8% from developing countries.

Two further issues relate to the type of US investments in the EU: their size and sectoral composition. These issues are relevant because investment treaty claims involving investors in certain sectors and of certain sizes have been more common. Given the tremendous quantity of US investment in the EU, there are undoubtedly a great number of investment projects that are of sufficient size to make the economics of an investment treaty claim (i.e. ratio of legal costs to potential award) viable in theory. With respect to the distribution of sector-specific investment, US companies have made significant investments across virtually all sectors of the EU economy.[22]

A different consideration concerns the culture and practice of dispute resolution among US investors in the EU. For example, American investors appear to be especially litigious. Accordingly, the British government warns UK investors operating in the US:

> Americans are, in general, inclined to start litigation or to threaten it – probably more so than the British. It is not just American lawyers that exhibit this tendency, but also American business people. Americans often sue or threaten suit as a strategic device to obtain some sort of amicable settlement (e.g., a money payment, a new contract, an agreement by the other side to abandon its claim). The great majority of commercial litigation started is never decided by the court or an arbitration panel. It is settled by the parties after the legal proceeding has begun; sometimes, the threat of legal action is sufficient to bring about a settlement. (UKTI, 2013, p. 32).

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[21] The following calculations are based on UNCTAD's FDI statistics (http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx). Note that bilateral FDI statistics are subject to considerable measurement error.

[22] See US Bureau of Economic Analysis data (www.bea.gov/scb/pdf/2013/07%20July/0713_direct_investment_positions.pdf).

This also seems relevant in the context of investment treaty arbitration. A 2007 empirical analysis of the 83 investment treaty disputes that were known at the time to have resulted in awards found that 32 of those cases—over 38%—involved an investor from the United States (Franck, 2007, p. 28). The second-most-frequent nationalities were Canada and Italy, with just six cases each. In the absence of a theoretical model for predicting baseline expectations for investor participation in investment treaty arbitration, it is difficult to draw any definitive conclusions from these figures. For example, the US is a major source of outward FDI, and for that reason it may not be entirely unexpected that many investment treaty claims would involve US investors. On the other hand, the high proportion of claims by US investors may be seen as striking, given the relatively low number of US investment treaties in force (approximately 40, plus investment chapters in US FTAs, such as NAFTA). Unfortunately, Franck's data do not control for such things as the amount of FDI from the home country, so it is impossible to say whether the level of US investor claims is objectively "high". Franck's data also show that investors won damages in 38.5% of claims that were finally resolved in an award (Franck, 2007, p. 49 & p. 58). Franck's data do not break out these statistics by the home state of the investor, so we are not able to say whether US investors win more often, or win more, than other investors.

Canada's experience under NAFTA Chapter 11 is relevant here, as Canada is a developed country with a strong rule-of-law tradition – just like most EU member states. As of February 2015, Canada had been the target of 35 NAFTA investment-chapter claims, all but one brought by US investors.[23] If anything we would expect that EU member states would be more prone to US claims than Canada, as Canada hosts less than 8% of US outward FDI stock, whereas the EU hosts more than 50% (UNCTAD, 2014, Table II.7). Table 4 shows all known Chapter 11 notices of intent filed by US investors against Canada. The table lists the claimant's name, the minimum amount of damages sought (as indicated in the notice of intent), the year the notice of intent was filed, a short description of the dispute and the dispute's outcome.

Table 4 illustrates the breadth of Canadian government actions that US investors have challenged: electricity regulation, changes in tax laws, the revocation or denial of various licenses, export bans on hazardous materials, health care regulations, patent decisions and more. The table also shows that a significant proportion of notices of intent are eventually withdrawn or become inactive (14/35). Unfortunately, the Canadian government does not indicate the reason for withdrawal or inactivity. We think it likely that many withdrawn or inactive notices of intent are withdrawn or become inactive because the investor realises that the claim has little chance of success, or that proceeding with arbitration will be too costly. However, we have no hard evidence to support this hypothesis. Eleven notices of intent have proceeded to arbitration and led to an award or a formal settlement. Of those eleven, only five have resulted in payments to the investor. In total, it appears that Canada has paid investors approximately CDN 156 million, with the bulk of that total consisting of a CDN 130 million settlement in *AbitibiBowater*. (Damages are still pending in the recent award in *Mobil Investments*). Eight disputes are on-going. US investors appear to have become more active in filing Chapter 11 notices of intent in recent years, with nine notices filed since 2010. Those nine notices together claim a minimum of over USD 3 billion in damages, including a claim for USD 1.5 billion in the *Detroit International Bridge Co.* case. However, it is probably safe to say that

[23] See www.naftaclaims.com/disputes_canada.htm. By "claims" we mean that a notice of intent to file a Chapter 11 claim was filed by the investor.

those damage claims are exaggerated and intended by the investors to increase pressure on Canada to settle in the investors' favour.

Table 4. Claims against Canada by US investors pursuant to NAFTA chapter 11

	Claimant(s)	Minimum damages sought	Year notice intent	Dispute description	Outcome
1	Signa S.A. de C.V.	CDN 50 million	1996	Drug patent decision	Withdrawn
2	Ethyl Corp.	USD 201 million	1997	Import ban on gasoline additive	Settled; investor paid approx. CDN 20 million
3	Pope & Talbot Inc.	USD 30 million	1998	Softwood lumber	Partial award for investor, USD 408 thousand
4	S.D. Meyers Inc.	USD 10 million	1998	Export ban for PCB waste	Award for investor, CDN 6 million
5	Sun Belt Water, Inc.	NA	1998	Denial of license for water export	Inactive
6	Ketcham Investments, Inc. and Tysa Investments	CDN 30 million	2000	Softwood lumber	Withdrawn
7	United Postal Service of America, Inc.	USD 100 million	2000	Anti-competitive practices of Canadian postal service	Investor claims rejected on merits
8	Chemtura Corp.	$100 million	2001	Regulation of crop pesticide	Investor claim rejected on merits
9	Trammel Crow Co.	USD 32 million	2001	Abuse of postal service procurement process	Withdrawn
10	Albert Connolly	NA	2004	Forfeiture of mining claim site	Inactive
11	Contractual Obligation Prod. LLC et al.	USD 20 million	2005	Denial of television programming subsidy	Inactive
12	Peter Nikola Pesic	NA	2005	NA	Withdrawn
13	GL Farms LLC and Carl Adams	$78 million	2006	Milk export programme	Inactive
14	Merrill & Ring Forestry LP	$25 million	2006	Export controls on logs	Investor claims rejected on merits
15	V.G. Gallo	$355 million	2006	Expropriation of landfill	Investor claims dismissed for lack of jurisdiction
16	Gottlieb Investors Group	USD 6.5 million	2007	Change in tax laws	Inactive
17	Mobil Investments Inc. & Murphy Oil Corp.	$50 million	2007	Imposition of performance requirements	Award in investor's favour; compensation TBD

18	Centurion Health Corp.	USD 155 million	2008	Restrictions on private health care	Investor claim terminated by tribunal
19	Clayton Bilcon	USD 188 million	2008	Environmental assessment of quarry project	Pending
20	David Bishop	USD 1 million	2008	Revocation of license for wilderness outfitter	Inactive
21	Dow AgroSciences LLC	$2 million	2008	Ban on lawn pesticides	Settled with no compensation paid
22	Georgia Basin L.P.	USD 5 million	2008	Export controls on logs	Inactive
23	Janet Marie Broussard Shiell et al.	USD 21 million	2008	Fraudulent bankruptcy proceedings	Inactive
24	William Jay Greiner and Malbaie River Outfitters Inc.	USD 5 million	2008	Revocation of license for wilderness outfitter	Withdrawn
25	AbitibiBowater Inc.	CDN 300 million	2009	Termination of water and timber rights	Settled; investor paid CDN 130 million
26	Christopher and Nancy Lacich	USD 1.2 thousand	2009	Change in tax laws	Withdrawn
27	Detroit International Bridge Co.	USD 1.5 billion	2010	Regulation of toll bridge	Pending
28	John R. Andre	CDN 4 million	2010	Emergency caribou hunting restrictions	Inactive
29	Mesa Power Group LLC	CDN 775 million	2011	Renewable energy regulation	Pending
30	St. Mary's VCNA, LLC	USD 275 million	2011	Denial of license for quarry	Settled with no compensation paid
31	Eli Lilly & Co.	CDN 100 million	2012	Invalidation of pharmaceutical patent	Pending
32	Lone Pine Resources Inc.	CDN 250 million	2012	Revocation of mine permit	Pending
33	Mercer International Inc.	CDN 250 million	2012	Electricity generation	Pending
34	Windstream Energy LLC	CDN 475 million	2012	Renewable energy regulation	Pending
35	J.M. Longyear	$12 million	2014	Forestry taxes	Pending

Notes: "Minimum damages sought" are taken from Notices of Intent and do not include pro forma requests for costs, interest and the like; actual amounts claimed in arbitration may be higher. Where "US" or "CDN" is not listed, the Notice of Intent is ambiguous as to whether the investor is requesting monetary relief expressed in US or Canadian dollars. Last updated 4 February 2015.

Sources: Website of Department of Foreign Affairs and International Trade (www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/NAFTA.aspx) and NAFTAClaims.com.

We think that it is fair to say that Canada has managed to compile a relatively impressive record of success in defending itself against investor-state claims, at least in the sense of avoiding frequent and/or large adverse awards.[24] This contrasts with the experiences of certain developing countries, such as Argentina and Ecuador, which have seen very large adverse awards as a result of investor-state arbitration initiated by US investors (Gallagher & Shrestha, 2011, Table 1).

If an EU-US investment chapter provided US investors with more generous rights than they would otherwise have under the laws of European states, the risk of investor lawsuits and adverse arbitral awards would rise, perhaps considerably. It is beyond the scope of this paper to offer a general survey of the legal regimes of all EU member states. Instead, we provide an illustrative case study, using the UK as an example. It is probably fair to say that the UK has a legal regime that, both in terms of substantive content and implementation by local courts, is among the best in the EU at protecting the property rights of both domestic and foreign investors. We nonetheless find some meaningful risk of adverse awards for the UK; *that risk will necessarily be higher for member states that do not have as high-quality legal regimes as does the UK*. In other words, we expect that an analysis of all EU member states would indicate that, on average, the risk of adverse awards is *higher* than we estimate that risk to be for the UK considered alone.

3.2 The UK as an example of the risk of adverse awards

In general, our view is that an EU-US investment chapter is unlikely to grant US investors in the UK *significantly* greater rights than they would otherwise have under UK law. As we explain below, however, an EU-US investment treaty may provide opportunities or incentives for investors to bring claims that they would not bring under UK domestic law. The content of international investment law remains contested and uncertain, and it is possible that an ISDS tribunal formed under an EU-US investment chapter would grant a US investor significant damages for conduct that would not normally be actionable under UK domestic law.

We say that an EU-US investment chapter would not grant US investors in the UK *significantly* greater rights than they currently enjoy because most successful investment treaty claims concern circumstances that would clearly be inconsistent with UK law, such as the unilateral abrogation of contracts by government authorities, or serious procedural failures in administrative or judicial processes. While in some cases investment tribunals have interpreted investment treaty text in ways that go beyond the protections contained in UK law – for example, on the question of 'legitimate expectations' or the granting of regulatory permits and licenses (Poulsen, Bonnitcha & Yackee, 2013) – we believe that an EU-US investment chapter is likely to contain relatively restrictive formulations of the minimum standard of treatment, regulatory expropriation and other standards that have, when drafted without qualification, been interpreted more expansively. Since the well-known *Methanex* NAFTA Chapter 11 arbitration, in which a Canadian investor unsuccessfully challenged a California environmental regulation, the US has appeared to be particularly concerned with protecting its right to change the legal or regulatory regime in non-discriminatory ways (Caplan & Sharpe, 2013, p. 756). We see that sensitivity in the various explanatory footnotes and annexed text in the 2012 US model BIT that, for example, limit the fair and equitable treatment standard

[24] While Canada, as indicated, has lost a small number of investor-state arbitrations, the US has never lost an investment treaty arbitration.

to the customary international law standard for the treatment of aliens,[25] or that reaffirm that "except in rare circumstances, non-discriminatory regulations that are designed and applied to protect legitimate public welfare objectives…do not constitute indirect expropriation",[26] or that clarify that whether a regulatory grant of permission to engage in an activity is not a covered "investment" if the grant of authority does not also "create any rights protected under domestic law".[27]

On the other hand, and despite such attempts to narrow and clarify the protections provided by the US model BIT, there remains significant debate and uncertainty as to the content of such terms as "fair and equitable treatment".[28] That lingering uncertainty leaves open the possibility that an arbitral tribunal might interpret the language of an EU-US investment chapter expansively, despite the addition to the treaty text of cautionary footnotes and annexed clarifications. In turn, continued uncertainty as to the content of international investment law means that investors may have an incentive to bring 'long-shot' claims against the UK, in particular where the investor has suffered large damages. In some cases, a long-shot claim may result in an arbitral interpretation and application of treaty text that goes beyond UK domestic law.

For example, the tribunal in the recent case of *Occidental v. Ecuador II* read into the fair and equitable treatment provision of the US-Ecuador BIT an obligation on the state to treat the investor "proportionately" when the state exercises a contract-based right to terminate its commercial relationship with the investor upon the investor's breach of the contract.[29] While the principle of proportionality has some operation as a ground of review in the administrative law of the UK, English *contract* law does not require an innocent party to exercise a right to terminate a contract proportionately. If one party breaches a contract and if that breach creates a right to terminate, the innocent party is entitled to exercise that right to terminate at its discretion.[30] While there are other complexities in *Occidental II* that may bear on how the case would be resolved if it had been litigated under the English law of contract, we think a dispute akin to *Occidental II* may well be decided differently if it were litigated under English law. As such, the case provides a helpful illustration of the point that apparently restrictive concepts such as the minimum standard of treatment required by customary international law are sometimes interpreted by arbitral tribunals in ways that can grant foreign investors more generous rights than would be recognised under UK law.

The EU appears to have recognised that vague investment treaty terms like "fair and equitable treatment" give ISDS tribunals a great deal of leeway to rule against host states if they wish.[31] The Commission has proposed that EU investment agreements "will set out precisely what elements are covered and thus prohibited" under the fair and equitable standard. The Commission proposes that the fair and equitable treatment would be defined as covering

[25] 2012 US model BIT, Annex A.

[26] 2012 US model BIT, Annex B.

[27] 2012 US model BIT, Art. 1 footnote 2.

[28] Kläger (2011, pp. 87-88) (discussing the failure of the US model BIT's clarifications on the meaning of "fair and equitable treatment" to actually clarify the meaning of the phrase).

[29] *Occidental v Ecuador II*, ICSID Case No. ARB/06/11, Award, 5 October 2012 [383].

[30] *Union Eagle Ltd v Golden Achievement Ltd* [1997] AC 514 per Lord Hoffmann.

[31] See the EU Commission Fact Sheet, "Investment Protection and Investor-to-State Dispute Settlement in EU agreements", November 2013 (http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf).

issues such as "manifest arbitrariness, abusive treatment (coercion, duress or harassment), or failure to respect the fundamental principles of due process".[32] While we agree that the standard formulation of fair and equitable treatment could certainly be improved to make its content more certain (and to make tribunal holdings more predictable *ex ante*), the Commission's proposed clarifications would still leave tribunals significant discretion to interpret such terms as "arbitrariness" or "duress" expansively. This is especially so as the current draft suggests that the application of such principles should take into account "legitimate expectations" of the investor that are based on "specific representations" made by officials of the host state.

Despite the potential of expansive interpretations of uncertain treaty text, an EU-US investment chapter would still probably *by design* confer greater rights on US investors that they would be entitled to under UK law, at least in certain areas. The general rule in the UK is that legislation passed by Parliament cannot be challenged in the courts. This is relevant also when considering political costs, as noted below, as investment tribunals authorised to override acts of Parliament is politically sensitive. Moreover, while the actions of the executive can be challenged in UK courts, pecuniary remedies are only rarely awarded in such cases (Craig, 2012). In both respects, the position under an EU-US investment treaty would differ from the position under UK law.

Overall, our view is that the UK faces meaningful risk that US investors will seek to invoke an EU-US investment chapter's ISDS provisions to bring claims against the UK government, and that EU member states with weaker legal systems will face even greater risk. This assessment is primarily due to i) the large amount of US investment in the UK, and in the EU more generally; ii) the fact that US investors appear to have been relatively aggressive in bringing actions against other states, including Canada, under investment protection instruments that are likely to be very similar to an EU-US investment chapter; and iii) the continued uncertainty over the proper meaning of key concepts in international investment law, such as 'fair and equitable treatment'. In particular, investors can be expected to bring some number of 'long-shot' claims against the UK, some of which the UK may lose.

Moreover, so long as the investor has some chance of success, the mere act of filing an arbitral claim may give the US investor leverage against the UK government in terms of encouraging the UK government to settle the case, even if only to avoid litigation costs and any possible damage to the UK's reputation as a welcoming environment for foreign investment. This is an important point. For example, in the well-known Ethyl NAFTA litigation, Canada settled the case by agreeing to pay the US investor USD 13 million. Thus, while we do not expect the UK to incur many high-value awards in favour of US investors, this does not mean the UK will not incur considerable litigation-related costs under an EU-US investment chapter. These include the costs of more favourable settlements than would otherwise be agreed, as well as fees to lawyers and tribunals. The latter are expected to average at approximately USD 4 million per claim per party, as discussed below. We view it as virtually certain that such costs under an EU-US investment chapter will be higher than under the status quo, as we assume that currently the vast bulk of existing US investment in the UK is not covered by an investment treaty. In contrast, under an EU-US investment chapter, all US investment in the UK would be covered.

Our analysis, as applied to other EU member states, would obviously depend on whether investments in those other member states are already covered by a US investment treaty and

[32] Ibid.

on the quality of the domestic legal system. But the UK illustration is important, as we expect that some EU member states will have legal systems that are of generally lower quality than that of the UK and, as such, at greater risk of adverse awards.

3.3 Legal costs

We expect that the EU and its member states would be able to develop a defence capacity of a quality roughly comparable to that of the US and Canada, especially given that EU government institutions are unlikely to engage in the kinds of mistreatment of US investors that are likely to be viewed as clear or egregious violations of international law. However, it must be recalled that the EU and its member states are likely to incur additional costs (lawyers' fees; tribunal fees) in defending itself against investor lawsuits. Whether the EU itself or a particular member state will bear the costs of ISDS litigation will depend on EU regulations governing cost allocation (European Commission, 2012). We do not discuss intra-EU cost allocation here as our focus is on the costs and benefits of ISDS as to the EU and its member states considered collectively. More precisely, our analysis focuses on the magnitude of legal costs, and the way they are distributed between investors (in their capacity as claimants in ISDS proceedings) and the EU and the member states (in their capacity as respondents).

A recent OECD scoping paper on ISDS reported the results of a survey showing that total "legal and arbitration costs for the parties in recent ISDS cases have averaged over USD 8 million [or USD 4 million per party] with costs exceeding USD 30 million in some cases." (OECD, 2012, p. 18). These figures are consistent with a briefing by the law firm Allen & Overy, which puts average costs at slightly over USD 4 million per party, with minor variations of tribunal costs as between cases under differing sets of procedural rules (Hodgson, 2012). Additional costs (such as the costs to the government of maintaining an office dedicated to investment-treaty defence) would add some amount of 'overhead' to the per-dispute averages reported in the OECD report. It should also be noted that ISDS costs can be significantly higher than the average figure mentioned above. For example, in the recent *Abaclat* decision on jurisdiction, the claimants had spent some USD 27 million on their case to date, and Argentina had spent about USD 12 million (OECD, 2012). These costs were solely for a decision addressing jurisdiction but not the merits. In our own experience, costs for the respondent states and claimants are roughly equivalent on average, albeit with significant variation between cases. This impression is broadly consistent with available evidence.[33]

Moreover, international investment law is currently *not* characterised by reliable a 'loser pays' rule as to costs, and "it is widely recognised that outcomes on cost shifting in ISDS cases are highly uncertain". (OECD, 2012, p. 21). Even when investors are required to pay the costs of the tribunal, considerable legal fees can still be borne by the 'winning' party. In *Plama v Bulgaria*, for instance, Bulgaria had to spend more than USD 6 million in legal fees in a case the Bulgarian government 'won'.[34]

On the other hand, EU treaty negotiators appear to be considering the inclusion of language on cost shifting in TTIP that would establish a 'loser pays' rule.[35] Depending on the specific

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[33] Between USD 100,000 and USD 350,000 higher on average, depending on whether outlying cases are excluded from average figures.

[34] *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB/03/24, Award, 27 August 2008.

[35] See the European Commission Fact Sheet, "Investment Protection and Investor-to-State Dispute Settlement in EU agreements", November 2013 (http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf).

text (for example, is cost shifting allowed only for 'frivolous' losing claims or for all losing claims?), the provision – if the US agrees to it – may significantly reduce litigation costs for the EU and its member states, either by shifting government expenses to the losing investor, or by discouraging investors from bringing claims in the first place. But it should be realised that a 'loser pays' rule will also leave the EU and its member states potentially liable for the *investors'* legal costs in the event that the US investor wins. Whether a 'loser pays' rule will result in a net benefit or cost to the EU over the status quo of each side pays its own costs will depend on assumptions about the distribution of losers and winners and the likely magnitude of the costs on each sides.

In their commissioned study by the Dutch Government, Tietje and Baetens (2014, p. 75) suggest that the cost to a host state of defending an investor-state arbitration may well be less than the costs of defending the same claim if it had been brought in the courts of the host state. They rightly point out that the costs of the court proceedings themselves (as opposed to the parties' legal costs) are always borne by the state, whereas in arbitration the costs of the tribunal are either divided between the parties or borne by the losing party. Nevertheless, we have doubts that investor-state arbitration is a more cost-effective procedure for resolving disputes, either from the perspective of a host state or from the perspective of society as a whole. In our view, it is impossible to say whether investor-state arbitration is more cost-effective than resolving disputes through national court proceedings in the absence of significantly more comprehensive evidence than is currently available.

First, EU countries will need to maintain court systems regardless of whether they agree to ISDS in TTIP or, indeed, any other investment treaty. This has important implications for how the avoidable cost of resolving disputes through arbitration rather than national courts should be calculated. Regardless of whether ISDS is included in investment treaties, all the fixed costs of maintaining a court system – for example, those associated with the construction of court buildings and the appointment of judges – are already incurred. The only institutional costs avoided through arbitration are the variable costs incurred in relation to the particular dispute in question – for example, the value of the time that judges and other court officials would have spent on the case had it been resolved in court.

Second, the parties' legal and witness costs (party costs) constitute the vast majority of the costs associated with investment treaty arbitration (Hodgson 2014). Average tribunal costs were USD 746,000 – less than 10% of the total costs of the proceedings. While we are not aware of any equivalent data in relation to the costs of national court proceedings (which may, in any case, vary significantly by country), the data we have for arbitration suggest that any assessment of the relative costs of arbitration and national court proceedings must take into account any differences between party costs in the different types of proceedings.

Third, there are reasons to think that party costs associated with domestic litigation will generally be lower than those associated with litigating the same dispute through investor-state arbitration. This is because most European countries have well-developed systems of administrative, corporate and contract law. In contrast, arbitration under investment treaties involves the application of vague and imprecise standards, such as the obligation to provide 'fair and equitable treatment'. Lack of clarity in the applicable law is likely to increase the range of factual and legal questions at issue in a dispute, which would tend to increase party costs.

To give an example, a challenge to Australia's tobacco plain-packaging laws, brought by Japan Tobacco International, proceeded to final judgment in Australia's highest court in less than a year from the initiation of the claim. In contrast, by the time of this publication it has taken more than three years for the challenge to Australia's tobacco plain-packaging laws brought

to investor-state arbitration by Philip Morris to reach a hearing on *preliminary objections*. While this example is not necessarily representative, it illustrates the need for further evidence about the average party costs of comparable investor-state disputes that are litigated in national courts.

Fourth, Tietje and Baetens (2014, p. 75) suggest that arbitral proceedings are more likely to conclude with a complete and final resolution of a dispute, reducing the costs of subsequent proceedings. We think better evidence is needed before such a claim can be made. Whilst it is normally possible to appeal the decisions of a national court of first instance, it is also possible to challenge the decisions of arbitral tribunals. As Tietje and Baetens note, the decisions of ICSID (International Centre for Settlement of Investment Disputes) tribunals are subject to annulment proceedings under the ICSID Convention. The decisions of non-ICSID tribunals are also subject to challenge in the form of set-aside and recognition proceedings in national courts. In the past, many investor-state arbitral decisions have been the subject of expensive and protracted proceedings in national courts. For example, the award in *BG v Argentina* was the subject of further proceedings in both the US Court of Appeals and the US Supreme Court. Any overall comparison of the costs of proceedings would need to consider the full range of possibilities for further litigation following the decisions of both arbitral tribunals and courts of first instance, the costs of such further proceedings, and the frequency with which these procedural options are pursued.

All in all, we are less than convinced about the claim of Tietje and Baetens that comparable domestic court/law proceedings involve lower costs for the host state than investment arbitration. The claim is impossible to test without comparable data. But given our comments above, there are reasons to expect that it is in fact the other way around.

3.4 Risk of reduced policy space

The inclusion of ISDS-backed investment protections in the TTIP would impose costs on the EU to the extent that it prevents the EU and its member states from regulating in the public interest. This potential cost encompasses both the effect of TTIP on legislative decision-making (e.g. if the existence of ISDS-backed investment protections dissuaded a state from enacting new tobacco control laws) and the effect of TTIP on executive decision-making (e.g. if the existence of ISDS-backed investment protections dissuaded a regulatory agency from shutting down a foreign-owned hazardous waste facility on account of the investor's failure to comply with environmental conditions attached to its operating permit). We use the term 'policy space' to refer to this potential cost.

Assessing the extent of this cost raises two initial conceptual difficulties. The first of these stems from the fact that the EU itself and the EU member states are already bound by their own systems of law. Insofar as the TTIP 'constrains' the EU and its member states from adopting or applying policy measures that are, in any event, prohibited by other laws, no 'policy space' is lost. A useful first approximation is the principle that investment treaties only restrict a state's policy space insofar as they prohibit the EU and the member states state from acting in a way that would otherwise be permissible. Therefore, any assessment of political costs associated with TTIP must begin with a close legal analysis of the provisions of the TTIP in light of comparable provisions of EU law,[36] and the law of the member states. However, this

[36] For an example of such an exercise focusing specifically on EU law, see Kleinheisterkamp (2012).

is only a starting point for the analysis. Constitutional principles aside, national laws are subject to regular change, whereas the terms of TTIP would be exceedingly difficult to amend.

A second conceptual issue concerns valuation of the 'cost' that the additional restrictions imposed by an investment treaty would place on the member state's policy space. One of the most contentious issues in existing legal and academic debates about investment treaties is whether the constraints they impose on the exercise of government powers should be understood as 'costs' or, rather, as standards of 'good governance' that it would be in the interest of every state to meet, even in the absence of investment treaties (Bonnitcha, 2014, sec. 2.4.3). This debate raises complex and contested questions about the manner and extent in which governments should intervene in their economies. In this paper we do not propose an overarching theory of desirable and undesirable forms of government regulation. All the member states of the EU are democracies. We suggest that, in a democracy, the appropriate benchmark for valuing the cost associated with any restriction on policy space is the government of the day's own assessment of the public interest. Accordingly, the impact of TTIP's investment protection provisions on EU policy space can be understood as the extent to which the treaty prevents the EU and the EU member states from adopting or applying policies that the relevant government would have preferred to apply in the absence of the treaty.

Assessing the likely size of this cost raises many of the same issues that were considered in our assessment of the likely economic cost of adverse arbitral awards under TTIP. Given the sheer size of the stock of US investment in the EU, the likelihood of disputes between US investors and the EU and its member states is high. The composition of US investment in the EU is also potentially relevant because investments in particular sectors have proven more likely to result in investment treaty disputes in the past. We note that there are substantial stocks of US investment spread across almost every sector of the EU economy, including sectors that have proven particularly prone to investment treaty claims in the past.

In reconciling our assessment of the political costs associated with lost policy space under an EU-US investment treaty and our assessment of the economic costs associated with adverse arbitral awards, it is important to acknowledge the risk of double-counting the same costs. If the EU and the EU member states fully comply with their obligations under TTIP, they would not incur any economic costs as a result of adverse arbitral awards. However, they may refrain from regulating in ways that they would otherwise regard as desirable. In contrast, if the EU and the EU member states ignore the risk of claims under TTIP, they will not suffer from any reduction in policy space *in practice*. They would, instead, expose themselves to the risk of economic costs associated with adverse arbitral awards. In practice, we think the risk of ISDS is likely to affect the behaviour of EU member states in a way that falls somewhere between these two extreme scenarios.

There are other ways in which the treaty could affect EU policy space. We have noted the size of US outward FDI stocks in the EU and the fact that US investors seem particularly likely to rely on their legal rights as a bargaining tool. If TTIP did include ISDS, we expect that the EU and its member states would be regularly faced with US investors opposing new policies on the grounds of the treaty. This opposition could be expressed either through lobbying, through submissions to government inquiries or by initiating arbitration proceedings under the treaty. To the extent that these activities encouraged EU decision-makers to modify or abandon preferred measures, it would count as a political cost of the treaty. In assessing the ability of US investors to persuade the EU or its member states to modify or abandon preferred policies, two considerations are relevant: the quality of legal advice available to the EU and its members

states' decision-makers; and the extent to which the EU-US investment treaty grants US investors greater rights than they would otherwise have under relevant EU and national law.

We do not have access to any direct measure of the quality of legal advice available to EU member states. It may be that there is a degree of variation in the internal legal capacity of member states. We would expect member states with stronger internal legal capacity to be better placed to manage tactical use of threats of litigation by US investors, insofar as those threats lack legal foundation.

On the other hand, the availability of high-quality legal advice may make governments of the member states *more* likely to amend or withdraw policies when those policies raise serious risks of non-compliance with the investment protection provisions of TTIP. A clear example of this phenomenon is the recent announcement by New Zealand relating to its policy on tobacco plain-packaging. While the New Zealand government has made it clear that its preferred policy would be to introduce tobacco plain-packaging, in light of legal objections raised by tobacco companies it has decided to delay the enactment of legislation until after the investment treaty claim concerning Australian tobacco plain-packaging, *Philip Morris v Australia*, has been resolved (Turia, 2013; Wilson, 2014). Similarly, in *SD Myers v Canada* the Canadian government revoked a ban on hazardous waste exports to the US after a US investor initiated arbitration.[37] The Canadian government judged – correctly as it turned out – that it was likely that the measure would be found to be inconsistent with NAFTA. A third example of this potential political cost associated with investment treaties is the case of *Ethyl v Canada*, a claim brought by a US investor under NAFTA. It seems that this claim played at least some role in encouraging the Canadian government to abandon the environmental measure that was the subject of the dispute (Tienhaara, 2009). The settlement agreement required the payment of damages (as noted above) and the withdrawal of the measure, thereby entailing both economic and political costs to Canada.[38] In short, in circumstances where a foreign investor opposes a preferred government policy on the basis of an investment treaty, and where that policy is at serious risk of non-compliance with the investment treaty, developed states comparable to the EU member states have amended, delayed or withdrawn preferred policies.

In this light, the second question – the extent to which TTIP would grant US investors in the EU more generous legal rights than they would otherwise have under relevant EU and national laws – assumes particular importance. In earlier sections of this chapter we observed that an EU-US investment treaty would likely follow the US model BIT in including text that limits and clarifies the substantive protections provided by the treaty. These clarifications redress some of the most obvious ways in which an EU-US investment chapter could confer greater rights on US investors that are otherwise available under the law of some EU member states – notably, some of the broader interpretations of the doctrine of 'legitimate expectations' adopted by earlier arbitral tribunals. Nevertheless, in our section on Economic Costs, we identified particular ways in which an EU-US investment treaty would still grant US investors legal rights that they would not otherwise have in particular member states, referring to the example of the UK. For example, this could strengthen the bargaining position of US investors in negotiations to settle contractual disputes with the EU member states.

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[37] *SD Myers v Canada* Partial Award, 13 November 2000.

[38] There are some complications in assessing the extent of political cost implied by the events surrounding the Ethyl case, as the abandoned measure, in its original form, was also ruled inconsistent with Canadian law.

3.5 Risk of controversial claims

Another potential political cost concerns the possibility that high profile claims against EU member states may provoke controversy within domestic political systems. Disputes resolved through investor-state arbitration may be the subject of public controversy especially if the investor's claims or the arbitral tribunal's decision are seen as threatening the government's policy space in sensitive areas.

The evaluation of this potential cost should of course be handled with great caution. In a democratic society, the fact that a policy, judicial decision or – in the present circumstances – a claim before an arbitral tribunal becomes the subject of popular debate and controversy should not be understood as constituting a cost in itself. Disagreement about public affairs is a normal and healthy incident in democratic government. Nevertheless, if the controversy around a *specific* claim against a party triggers widespread opposition to treaties and international cooperation *in general*, then in extreme cases this backlash could limit the ability of the government of the day to pursue preferred policies on the international plane.

US investors have brought controversial claims against other developed countries arising from: banking regulation (*Genin v Estonia*); domestic ownership and domestic content requirements on media organisations (*CME v Czech Republic*); regulation of the trans-boundary movement of hazardous waste (*SD Myers v Canada*); regulation of national monopolies (*UPS v Canada*); the ability of private health providers to operate alongside a host state's public health system (*Howard and Centurion Health v Canada*); the phasing out of carcinogenic pesticides (*Chemtura v Canada*); invalidation of patent rights (*Eli Lilli v Canada*); and plain-packaging regulation (*Philip Morris v Australia,* via Hong Kong BIT). While the majority of these claims were resolved in favour of respondent governments, the fact that US investors are known to frequently bring controversial claims is important, as a particularly sensitive case can provoke a broader political backlash. EU investors, as well, have brought numerous highly controversial claims arising from, for instance, affirmative action policies (*Foresti et al. v South Africa*); reactions to financial crises (*Marfin v Cyprus & Postova banka and Istrokapital v Greece*); and the phase-out of nuclear energy (*Vattenfall v Germany*).

The US government itself has realised that sensitive claims can result in a political backlash. When a Canadian company, Loewen, filed a NAFTA claim concerning its treatment by a Mississippi state court, one of the arbitrators was told informally by the US Department of Justice that "if we lose this case, we could lose NAFTA".[39] Similarly, if a US investor seeks to override an act of one or more European parliaments, or files a claim concerning sensitive areas of public regulation, such as environmental or public health regulation, this could potentially provoke a political response with systemic consequences for the ability of the EU to support investor-state arbitration in agreements where it is more necessary than in the TTIP. Perhaps an even-greater risk is the possibility that controversy about investor-state claims could reduce the level of political support within the EU for international economic cooperation on matters where the potential benefits are much greater – for example, trade liberalisation.

[39] See the discussion in Schneiderman (2010).

Conclusion

Based on our analysis, we conclude that including an investment protection chapter in TTIP that is accompanied by ISDS is unlikely to generate significant economic or political benefits for the EU. Our analysis also suggests that the inclusion of such provisions would lead to significant economic and political costs for the EU. While it is important not to exaggerate the scale of potential costs, our overall assessment is that the costs are highly likely to exceed any potential benefit to the EU. Accordingly, we would suggest that unless ISDS is accompanied by considerable concessions by the United States so as to offset ISDS-related costs, it would be prudent for the EU to consider alternatives.

One of the authors has previously recommended a number of pragmatic proposals – such as relying on inter-state dispute settlement or, at a minimum, restricting recourse to investment arbitration through a significant local litigation requirement and a comprehensive state 'filter' of claims (Kleinheisterkamp & Poulsen, 2014). If such proposals fail to attain support, another option would be to simply exclude investment protections from the agreement. The economic benefits of a transatlantic free trade agreement could be considerable for the EU, as outlined elsewhere in this volume, but hardly any of those benefits are likely to accrue from the investment protection chapter. Excluding such a chapter may thereby be politically prudent if it prevents further opposition to the TTIP based on a set of rules which are not necessary to protect American investment in Europe or European investment in the United States.

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About the CEPS-CTR Project: TTIP in the Balance

The Centre for European Policy Studies (CEPS) and the Center for Transatlantic Relations (CTR) at the School for Advanced International Studies (SAIS) of Johns Hopkins University in Washington, D.C. have set up a joint project to explore the Transatlantic Trade and Investment Partnership (TTIP), under negotiation between the European Union and the United States. Its aim is to promote a deepening of the TTIP debate, a comprehensive approach – also sectorally – of the negotiations, a far more detached perspective on the substance of TTIP (than in numerous circles) and concrete analytical output as a support for negotiators on both sides. It also aspires to improve the quality of the policy discussions. The project is directed by Jacques Pelkmans from CEPS and Daniel Hamilton from CTR. It is expected that some 10 papers will be published on the websites of CEPS and of CTR between December 2014 and late March 2015, with the option of publishing more papers subsequently. Most or all papers will have both US- and EU-based authors. Both institutes support the project, which is co-funded by AMCHAM-EU, Repsol, the Konrad Adenauer Foundation, the European Commission and the Transatlantic Program of the German government, with funds from the European Recovery Program of the German Ministry for Economics and Technology. The organisation, substance and editing of the project results, however, are entirely independent.

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