Investor-State Dispute Settlement under the Trans-Pacific Partnership

By Ko-Yung Tung*

I. INTRODUCTION

The United States is currently in the last stages of its negotiations with eleven other countries in the Pacific Rim region (namely Japan, Australia, Mexico, Canada, Malaysia, Chile, Singapore, Peru, Vietnam, New Zealand and Brunei Darussalam) to conclude a regional trade and investment regime, popularly known as the Trans-Pacific Partnership (“TPP”). With the United States and Japan having the largest and the third largest economies of the world, the TPP would encompass approximately forty percent of global gross domestic product.2 The European Union, by contrast, accounts for only about eighteen of global GDP.3

While the negotiations for the Trans-Pacific Partnership Agreement (“TPP Agreement”) have been conducted in secrecy, a draft of its investment chapter recently was leaked by WikiLeaks.4 This article will briefly highlight some salient points of the investor-state dispute settlement (“ISDS”) provisions in the leaked draft of the investment chapter of the TPP Agreement.

Two important caveats are necessary at the outset—first, there is some dispute whether the WikiLeaks leaked version is authentic and whether it is a current draft as of the date on the version (purported to be “January 20, 2015 draft”); and second, what form the final ISDS of the TPP Agreement will take is still unknown, and even whether the TPP will come to fruition at all, given the politics of the United States, let alone those of the other eleven countries.5 For purposes of this article, the so-called January 20, 2015 draft will be referenced.

II. SOME NOTABLE PROVISIONS

A. Standards of Investment Protection

1. An Expansive Definition of “Investment”.

Despite the fact that an “investment” is the core element of investment treaties, early treaties did not define what constituted an “investment” that was to be protected by the treaty. For example, the 1965 treaty establishing the International Centre for the Settlement of Investment Disputes (“ICSID Convention” or sometimes referred to as the “Washington Convention”) merely states that “[t]he jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment….”8 The travaux preparatoires indicate that this omission of a definition was intentional to allow each arbitral tribunal the power to make its own determination whether there was a purported investment protected by the treaty. Similarly, early Bilateral Investment Treaties (“BIT”) either failed to define what constitutes an “investment” for purposes of those treaties or provide a simple definition. This absence or brevity of a definition of a protected “investment” in many treaties has resulted in divergent and conflicting arbitral rulings, for example, whether an “investment” meant only “in the ground” assets such as a power plant but not a “paper” asset such as debt bonds issued by a company.

The draft ISDS provisions of the leaked TPP Agreement reflect, in the main, the “state of the art” of ISDS law and practices. With over 3,000 separate and discrete investment treaties extant currently,7 it is no surprise that there are different wordings of similar provisions, varying interpretations of the same or similar provisions, and even conflicting rulings of the same or similar provisions by arbitral tribunals. To resolve many of these problems, the investment chapter of the TPP Agreement clarifies some of the definitions and introduces some of the best practices from previous investment treaties. To this extent, the investment provisions of the TPP Agreement may be regarded as the “state of the art.”

The investment chapter (Chapter II) of the TPP Agreement is divided into two parts. Section A identifies what is protected and what are the protections. Section B provides for international arbitration to resolve any disputes between an investor of a state party against a host state party arising from a breach of those protections.

The essential objective of any investment treaty is to protect foreign investments and foreign investors of a treaty signatory state in host treaty signatory states. As with other investment treaties, the core normative protections afforded by the TPP Agreement are (a) “national treatment,” (b) “most-favored-nation treatment,” (c) “minimum standard of treatment,” and (d) compensation for expropriation.6 The ISDS provisions of the TPP Agreement allow an investor from a TPP member state to bring a binding arbitration proceeding against a host TPP member state if the host country has breached any of these normative protections.

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The TPP Agreement seeks to avoid ambiguity with an extensive definition of a covered investment by providing both normative elements as well as specific examples. While it defines “investment” broadly to mean “every asset that an investor owns or controls, directly or indirectly,” it is qualified by a normative criteria that an investment must have “the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.” Specific examples of investments are listed to avoid past conflicting rulings. These examples include financial instruments such as bonds, loans, futures, options and derivatives, as well as intangible assets such as intellectual property rights, licenses, and permits.

The extensive definition of investment in the TPP Agreement should go a long way to avoid ambiguities and conflicting arbitral rulings, and to provide influential authority to the interpretation of “investment” in other investment treaties.

2. A Clarified Scope of Most-Favored-Nation Treatment. The “most favored nation (“MFN”)” treatment standard requires that a host state treat the investor or investment of another member state as favorably as any other investor or investment of another state, whether or not that other state is a member of the TPP Agreement. Generally the MFN treatment was accorded only to substantive norms. However, there have been diverging rulings by arbitral tribunals, as well as academic debate, as to whether the MFN treatment encompasses only substantive provisions, or whether it covers both substantive and procedural aspects, such as a prerequisite that the claimant first pursue domestic remedies before resorting to ISDS under the treaty.

The TPP Agreement makes clear that only substantive normative treatment is protected under its MFN clause. Specifically, in the definition of MFN, a new subparagraph has been added: “For greater certainty, the treatment referred to in this Article does not encompass international dispute resolution procedures or mechanisms such as those included in Section B of Chapter II of the TPP Agreement.”

3. Clarification of the Definition of “Minimum Standard of Treatment”. The North American Free Trade Agreement (“NAFTA”) and many other investment treaties require that a host state accord foreign investments a “minimum standard of treatment,” which NAFTA defines as “treatment in accordance with international law, including fair and equitable treatment and full protection and security.” There are disputes concerning what constitutes “international law”—whether it refers only to treaties and conventions or also to unwritten customary international law and practices. The TPP Agreement settles this dispute by expanding on the standard by referring to “applicable customary international law principles” and clarifying that the “fair and equitable treatment” and “full protection and security” standards are not in addition to “customary international law minimum standard of treatment of aliens” but are subsets of that minimum standard. An annex to the provision further adds “customary international law’ generally and as specifically referenced in Article II.6 (Minimum Standard of Treatment) results from a general and consistent practice of States that they follow from a sense of legal obligation. The customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the investments of aliens.”

This expansive definition of “international law” allows for an organic evolution of the scope of minimum protection.

4. A Balancing of Domestic Environmental, Health and other Regulatory Objectives. Investment treaties have been attacked for allegedly prioritizing the protection of foreign investments and investors over the interests of the host country’s citizens. To buttress this claim, public health advocates and environmentalists often point to two widely publicized cases—the Philip Morris v. Australia case and the Methanex v. U.S. case.

In the Philip Morris case, Australia had enacted its Tobacco Plain Packaging Act requiring all tobacco sold in Australia to be packaged in plain packages bearing graphic health warnings. Philip Morris, a major U.S. tobacco producer, through its Hong Kong subsidiary, brought an investor-state arbitration proceeding against Australia contending that such Act violated the Australia-Hong Kong BIT. Australia and other critics of ISDS saw this as a challenge to Australia’s sovereignty over its public health. This case is still ongoing as of this writing.

In the Methanex case, the Governor of the State of California had issued an executive order calling for the phasing out of the gasoline additive methyl tertiary butyl ether (“MTBE”) based on public health concerns. Methanex Corporation, a Canadian
company with a facility in California, was the largest producer of methanol, an ingredient in MTBE. It brought an ICSID case against the U.S. alleging violations of foreign investment protection afforded by NAFTA. The ICSID tribunal ruled in favor of the U.S. under Article 1101(1) on the grounds that in adopting the ban California did not intend to harm foreign methanol producers. Nonetheless, this case has been raised by critics of ISDS as a possible example of a foreign investor having a superior position vis-à-vis a domestic citizen's concerns.

In an attempt to address such criticism, the TPP Agreement specifically provides that “[n]othing in this Chapter shall be construed to prevent a Party from adopting, maintaining, or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health, or other regulatory objectives.” Further, Annex II-B on expropriation adds that “Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations, except in rare circumstances.” Whether this provision will obviate this clash of interests will be tested in future arbitral cases. The provision on its face does not seem to resolve this conflict as the regulatory measure that is allowed must be “otherwise consistent with this Chapter,” which provides for the protection of foreign investments and investors. So, it would appear that the domestic regulatory measures may be interpreted as being subordinate to the other provision of the investment chapter.

5. **Encouragement of Corporate Social Responsibility.** Investment treaties have also faced criticisms in the areas of labor standards and social safety nets. Critics have maintained that trade and investment treaties have accelerated the “race to the bottom,” moving jobs to the cheapest labor markets with the least protections for workers. Article II.16 attempts to address this issue by stating that: “The Parties reaffirm the importance of each Party encouraging enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate into their internal policies those internationally recognized standards, guidelines and principles of corporate social responsibility that have been endorsed or are supported by that Party.” It remains to be seen whether the critics will be satisfied by this “voluntary” encouragement.

### B. Salient Dispute Settlement Procedures

Section B of the investment chapter of the TPP Agreement spells out the procedures and standards for investor-state dispute settlement, including clarifications to prior ambiguities and conflicting rulings as well as innovations to address perceived inadequacies of the past practices.

1. **Australia Opt Out.** Perhaps the most glaring point is that Australia has opted out totally from the arbitrations provision. A footnote to Section B states “Section B does not apply to Australia or an investor of Australia. Notwithstanding any provision of this [TPP] Agreement, Australia does not consent to the submission of a claim to arbitration under this Section.” Intriguingly, this footnote is further noted “<<xx note: deletion of footnote is subject to clarifications to prior ambiguities and conflicting rulings as well as innovations to address perceived inadequacies of the past practices.>>,” hinting that negotiations are still ongoing on whether or not Australia will sign up to the mandatory arbitration provisions.

While Australia has in the past entered into BITs that contain mandatory international arbitration, recently she has been reluctant. Perhaps its ongoing experience in the *Philip Morris* case described above has soured her on submitting investor-state investment disputes to international arbitration.

2. **Imposition of a Cooling Off Period.** The TPP Agreement imposes a mandatory six-month consultation and negotiation period prior to submission to international arbitration. This condition in the TPP Agreement may reflect the participation of many Asian state parties who are culturally reluctant to resolve disputes through litigation and prefer a conciliatory process for dealing with disputes. To buttress this preference, the TPP ISDS stipulates that if the applicable investment agreement (such as a build-own-transfer project contract for an airport) provides for alternate dispute settlement mechanism, the claimant must have pursued that mechanism for at least one year prior to filing for arbitration.

3. **Expanded Allowance of Amicus Briefs.** As early BITs and arbitral conventions have their origins in amity, commerce and navigation treaties and in commercial arbitration procedures, they have been silent on whether a tribunal may accept submissions by non-parties, such as amici curiae, as disputes under
amity, commerce and navigation treaties were dealt directly between the state parties whereas commercial arbitrations were private matters between the parties. However, in recognition that many investor-state arbitration proceedings involve public issues and other stakeholders, recent investment treaties, such as ICSID29 and the 2012 U.S. Model BIT,30 explicitly permit a tribunal, in its discretion, to accept amicus submissions. As the standards that a tribunal may apply or the considerations that a tribunal may consider in deciding whether or not to allow amicus submissions have not been clear and tribunals have differed on this point, the TPP Agreement sets the standards and procedures for amicus submissions.31

First, the tribunal must consult with the parties about a potential amicus submission. Second, the submission must pertain to “a matter of fact or law within the scope of the dispute.” Third, the submission must be of assistance to the tribunal “in evaluating the submissions and arguments of the disputing parties,” and must not introduce any arguments or positions not proffered by the disputants. Fourth, the amicus entity must fully disclose its affiliations and sources of support. Fifth, the disputing parties shall be afforded the opportunity to respond to such amicus submissions. Lastly, “[t]he tribunal shall ensure that the submission does not disrupt or unduly burden the arbitral proceedings, or unfairly prejudice any disputing party” (italics added). Since an amicus submission is usually supporting one side of the dispute to the detriment of the other party, it will be interesting to see what a tribunal considers “unfair prejudice” to one of the parties.

4. Increased Transparency of Arbitral Proceedings. One of the vaunted virtues of arbitration over judicial litigation is anonymity and the non-public aspects of commercial arbitration. Most BITs and other investment treaties in the past have required the consent of both parties to allow any transparency to the proceedings. However, recognizing that investor-state arbitrations are fundamentally different from disputes between private parties as investor-state disputes often implicate public policy, the TPP Agreement, similar to the U.S. Model BIT, mandates public disclosure of notices, pleadings and awards, and provides for arbitration hearings to be open to the public.32 A party may, with the tribunal’s permission, nonetheless keep “protected information” from public disclosure. While increased transparency may mollify some of the critics of the past ISDS practice of non-disclosure, it may also increase criticisms as more people will be made aware of controversial ISDS cases.

5. Compulsory Consolidation of Related Cases. One of the criticisms lodged against ISDS arbitrations is that similar cases, sometimes with the very same parties, facts and issues, could result in different awards from different tribunals. This problem was highlighted in the Lauder cases.

The facts of the Lauder cases involved an investment that Ronald Lauder, a U.S. businessman, had in a Dutch company, CME Czech Republic BV (“CME”), which owned a Czech television channel, TV Nova. In the first case, Mr. Lauder himself brought an UNCITRAL arbitration proceeding against the Czech Republic alleging expropriation under the U.S.-Czech BIT. In the second case, CME, Mr. Lauder’s controlled company, brought a separate arbitration proceeding against the Czech Republic under the Dutch-Czech BIT for the same allegation. In the first Lauder case, the London tribunal essentially ruled in favor of the Czech Republic.33 Ten days later, the Stockholm tribunal found in favor of CME.34 The Czech Republic challenged the CME award in the Swedish appeals court, as that arbitration proceeding took place in Stockholm, pursuant to UNCITRAL rules. The Swedish court denied the appeal, noting that the parties were not technically identical and that the claims were brought under two different, though similar, BITs before two separate tribunals.

Normally consolidation of arbitral proceedings is not possible unless all the parties agree, or the applicable agreement provides for it. To its regret (one assumes), the Czech Republic had refused to consolidate the two cases. Fortunately, the TPP Agreement, like NAFTA, provides that “Where two or more claims have been submitted separately to arbitration...and the claims have a question of law or fact in common and arise out of the same events or circumstances, any disputing party may seek a consolidation order...” At the request of a disputing party, the Secretary General of ICSID establishes a consolidation tribunal, which will decide whether consolidation requirements are met and that consolidation would further the “interest of fair and efficient resolution of the claims,” and if so found, take jurisdiction of the consolidated claims.

6. Possibility of an Appellate Body. One of the often-stated advantages of arbitration over judicial litigation is that an arbitral award is final, without recourse to appeal, hence resolution of a dispute is faster and more economical. On the other hand, the finality of an arbitral award, without the possibility...
of an appeal, can be seen as a major shortcoming of arbitration vis-à-vis judicial litigation. The problems arising from parallel arbitral proceedings and inconsistent legal findings by different arbitral tribunals, as seen in the Lauder cases described above and the Argentine gas cases briefly summarized below, have given rise to calls for the creation of an appellate body, similar to the one afforded in trade disputes under the World Trade Organization. The Argentine gas cases involved four different American energy companies, but essentially the same claims under the U.S.-Argentina BIT of 1991 under ICSID, arising out of the same actions of the Argentine Republic. The claimants in those cases were CMS Transmission Co., LG&E Energy Corp., Enron Corp., and Sempra Energy International. Briefly, each of the American companies had invested in Argentina's gas companies when that industry was privatized. However, when the Argentine economy collapsed in 2001, the Argentine Government took certain economic measures, such as the delinking of the parity between the U.S. dollar and the Argentine peso, the imposition of exchange controls, and the denial of U.S.-based consumer price index adjustment provision in their gas supply agreements. The American investors all brought separate arbitrations under the 1991 U.S.-Argentina BIT, claiming that the measures taken by Argentina violated the “fair and equitable treatment” protection and were essentially tantamount to expropriation, among other claims. Argentina claimed that those measures were permitted under the “necessity” clause of the 1991 U.S.-Argentina BIT (the so-called “non-precluded measure” or “NPM”), which provided that “This Treaty shall not preclude . . . measures necessary for the maintenance of public order, . . . or the protection of its own essential security interests.”

The CMS, Enron and Sempra arbitral tribunals all ruled that Argentina’s economic measures had violated the “fair and equitable” treatment guaranteed under the 1991 US-Argentina BIT and that the NPM was inapplicable. However, the LG&E case tribunal, while finding that the Argentine measures violated the “fair and equitable treatment” standard, held that it was not liable during the period of necessity as the NPM absolved Argentina during that period. Argentina submitted the other three awards for annulment proceedings as permitted by Article 52 of the ICSID Convention. The ad hoc annulment committee in the CMS case, while severely criticizing the analysis of the first tribunal, upheld the original award on the grounds that it was not an appellate body. The Sempra annulment committee, however, annulled the award on the basis of “manifest excess of power” for failing to identify and apply Article XI of the BIT. The Enron annulment committee annulled the original award also on the basis of “manifest excess of power” but for the award’s failure to refer to Article 25 of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts of the International Law Commission. Without going into detailed analysis of each of the tribunal’s findings and annulment proceedings, suffice it to say for this purpose that, in the four cases based on the same facts and the same BIT, each came out differently—some diametrically opposed, and some in nuanced, technical ways.

With divergent arbitral decisions, it would be difficult for a sovereign state to devise public policies that would be uniform and assure that its measures do not breach its international obligations to foreign investors. If an appellate body for ISDS were available as some proponents have argued, the appellate body would have been able to review these four awards. A final ruling by such an appellate body would have been able to bring consistency to the results, thereby treating all similarly situated investors uniformly, providing a clear guidance for the respondent host state with respect to its economic measures, and furthering the development of investment treaty law.

While no such appellate body has been created, the TPP Agreement (as does the U.S. Model BIT) makes room for the establishment of an appellate body in the future by providing that:

“In the event that an appellate mechanism for reviewing awards rendered by investor-State dispute settlement tribunals is developed in the future under other institutional arrangements, the Parties shall consider whether awards rendered…should be subject to that appellate mechanism. The Parties shall strive to ensure that any such appellate mechanism they consider adopting provides for transparency of proceedings similar to the transparency provisions established in Article II.23.”

Although this placeholder for an appellate body may be a nod towards some of the critics of TPP, for those who are proponents of establishing an appellate mechanism, it may be seen as regrettable that the
TPP member states did not take this opportunity to establish such a mechanism, given the high-stakes issues involving not only large sums of money but also important public policy issues.

III. CONCLUSION

The TPP is a bold and broad initiative by twelve Pacific Rim countries to establish a regime for more liberal trading and more protection for foreign investments and investors. The investment chapter of the TPP Agreement is the state of the art in the evolution of investment treaties. It remains to be seen whether the ISDS provisions of the TPP Agreement will live up to the goals and results vaunted by its supporters and avoid the various downsides predicted by its critics.

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Endnotes

1 China is not included as an original member of the TPP due to geo-political and economic reasons. J. Soble, Failure of Obama’s Trans-Pacific Trade Deal Could Hurt U.S. Influence in Asia, N.Y. Times, June 16, 2015.


7 Today there are, according to a recent survey by the United Nations Conference of Trade and Development (“UNCTAD”), 2,927 separate and disparate BITs and 349 other types of international investment agreements. International Investment Agreements Navigator, INVESTMENTPOLICYHUB.UNCTAD.ORG, (available at http://investmentpolicyhub.unctad.org/iia) (last visited June 11, 2015).


9 TPPA, supra note 4, Art. II.1 “Investment.”

10 Id.


12 Salini Construttori S.P.A. and Italstrade S.P.A. v. The Hashemite Kingdom of Jordan, ICSID Case No. ARB/02/13, Decision on Jurisdiction (Nov. 29, 2004), 20 ICSID Rev.—FILJ 148 (2005), and Plama Consortium Ltd. v. Republic of Bulgaria, ICSID Case No. ARB/03/24, Decision on Jurisdiction (Feb. 8, 2005), 20 ICSID Rev.—FILJ 262 (2005) (holding that only the substantive normative treatment is covered by the MFN clause).

13 Emilio Agustin Maffezini v. Kingdom of Spain, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction, ¶ 64 (N. 25, 2000), 5 ICSID Rep. 396 (2002).

14 TPPA, supra note 4, Art. II.5.


16 Id., Chap. 11, Art. 1105.

17 TPPA, supra note 4, Art. II.6.

18 TPPA, supra note 4, Annex II-A.


22 While Philip Morris is a U.S. headquartered company, it used its Hong Kong affiliate as the claimant as the Australia-Hong Kong BIT provided for international arbitration, as there is no BIT between the U.S. and Australia.


24 TPPA, supra note 4, Art. II.15.

25 TPPA, supra note 4, Annex II-B Expropriation (3)(b).

26 TPPA, supra note 4, Art. II.16.

27 TPPA, supra note 4, Arts. II.17, II.18(1).

28 TPPA, supra note 4, Art. II.18(3).

29 TPPA, supra note 4, Art. II.18(3).


31 TPPA, supra note 4, Art. II.22(3).

32 TPPA, supra note 4, Art. II.23.


35 TPPA, supra note 4, Art. II.27(1).


39 ICSID Convention Art. 52 provides that an award may be annulled if (1) the tribunal was not properly constituted; (2) the tribunal manifestly exceeded its powers; (3) there was a serious departure from fundamental rule of procedure; or (4) the award failed to state the reasons on which it was based. ICSID Convention, supra note 8.


41 ILC Articles on State Responsibility, Art. 25 provides:

1 Necessity may not be invoked...unless the act (a) is the only way...to safeguard an essential interest against a grave and imminent peril; and (b) does not seriously impair an essential interest [of other States] or of the international community as a whole.

2. In any case, necessity may not be invoked...if (a) the international obligation in question excludes the possibility of invoking necessity; or (b) the State has contributed to the situation of necessity.

42 For opposing views on this controversy, see sources cited supra note 37.

43 TPPA, supra note 4, Art. II.22(10).