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The TPP's Investment Chapter: Entrenching, Rather Than Reforming, a Flawed System

Lise Johnson
Columbia Law School, Columbia Center on Sustainable Investment, ljj2107@columbia.edu

Lisa E. Sachs
Columbia Law School, Columbia Center on Sustainable Investment, lsachs1@law.columbia.edu

Columbia Center on Sustainable Investment
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Lise Johnson, Lisa Sachs*

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Introduction

During and following the negotiations of the Trans-Pacific Partnership (TPP), the USTR assured stakeholders that novel features in the TPP's investment chapter would respond to legitimate concerns about the investor-state dispute settlement mechanism (ISDS). Indeed, in our analysis on *Investor-State Dispute Settlement, Public Interest, and US Domestic Law*, we highlighted a number of serious shortcomings of investment treaties and their ISDS protections, including the impact that ISDS has on the development, interpretation, and application of domestic law. Now that the TPP has been publicly released, we can see that unfortunately none of these shortcomings has been resolved. In fact, in some areas, we even see a further evisceration of the role of domestic policy, institutions, and constituents. In their current form, the TPP's substantive investment protections and ISDS pose significant potential costs to the domestic legal frameworks of the US and the other TPP parties without providing corresponding benefits.

In "Upgrading & Improving Investor-State Dispute Settlement," the USTR highlights how the "TPP upgrades and improves ISDS" and "closes loopholes and raises standards higher than any past agreements." Below, we respond to the USTR's claims, showing that ISDS in TPP has not been improved as USTR suggests. There are a number of problems from previous trade agreements that have been carried over into the TPP, and new provisions added to the TPP that do not appear in other US FTAs and that raise additional concerns. A forthcoming brief will discuss those issues in more depth; this note focuses specifically on the particular improvements that the USTR claims to have made to ISDS.

*Lise Johnson is the head of investment law and policy at CCSI, and Lisa Sachs is the Director.

Claims and Responses

USTR Claim: "Right to regulate. New TPP language underscores that countries retain the right to regulate in the public interest, including on health, safety, the financial sector, and the environment." (Point 1).

Unfortunately, while the TPP might "underscore" that countries retain the right to regulate in the public interest, the agreement does not actually protect that right.

In article 9.15, the TPP states, "Nothing in [the Investment 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." (emphasis added)

That article provides no real protection. Rather, it simply notes that the government can regulate in the public interest as long as, when doing so, the government complies with the Investment Chapter's requirements regarding treatment of foreign investors and investments. The words, "otherwise consistent with this Chapter," thus negate any protections otherwise purported to be given under that article. Consequently, and as under other investment treaties with ISDS, good faith measures taken in the public interest can still be successfully challenged under the agreement as violating the TPP's investor protections. That means a continued risk of claims that we've seen, such as claims seeking damages for:

- efforts to strengthen and enforce environmental obligations;
- efforts to restrict imports of adulterated drug products;
- efforts to regulate and restrict smoking;
- zoning measures relating to investment in or near protected areas;
- measures regarding location and design of hazardous waste facilities, and transport of hazardous waste;
- efforts to restrict profits of pharmaceutical companies;
- application of bankruptcy law;
- judicial decisions interpreting domestic intellectual property law and policy; and
- government efforts to regulate tariffs and terms of service for essential public utilities.

Notably, the provision here can be contrasted with the TPP's treatment of other specific measures and policy issues. In the article on exceptions, for example, the TPP parties agreed to prevent investors from arguing that taxation measures violate the infamously vague and problematic fair and equitable treatment ("FET") obligation (discussed further below). That decision to carve out taxation from the FET obligation evidences the state parties' unwillingness to trust ISDS tribunals with the broad powers such tribunals otherwise have to interpret that potentially expansive FET obligation. Environmental, health, and safety measures – while similarly complex and important of matters of law and policy – are not similarly safeguarded from the uncertainties of ISDS decisions.

Likewise, when investors challenge certain measures relating to financial services regulation, officials of the state parties to the treaty have the right to decide whether a "prudential measures" exception applies. Any determination the government officials make is binding on the tribunal. Again, this evidences the states' unwillingness to permit ISDS tribunals to decide complex issues with significant policy implications. In contrast, there is no such filter mechanism in the TPP for other areas of public interest regulation, such as environmental protection and public health, which would help to preserve the policy space of the state parties.

A third narrow issue that the TPP protects against ISDS challenges is liability for "tobacco control measures". This provision, adopted in response to the particularly controversial cases Philip Morris and its affiliates have filed against Australia[1] and Uruguay[2] to challenge those countries' anti-tobacco regulations, aims to protect government action in one important area of health policy; in so doing, it implicitly recognizes that the TPP's investment protections and ISDS mechanism can be used to challenge good faith, non-discriminatory measures taken to address undeniably serious issues of public concern, despite the language in article 9.15. While "tobacco control measures" are indeed deserved of protection from investor claims, so, too, are other measures to address environmental, health, and safety concerns, which necessarily remain vulnerable to challenge.

With the TPP, we thus see governments taking some steps to protect their ability to take action in certain discrete areas. Given the specific exclusions and filter mechanisms for taxation, financial services, and tobacco-related measures, the omission of other public-interest related measures from those explicit carve outs means that other measures remain exposed to claims. So despite the claim that the TPP preserves the right of states to regulate in the public interest, many crucial areas of law such as environmental and health-related measures, which been targets of a number of ISDS cases filed to date, are not similarly safeguarded from investors' challenges.

USTR Claim: "Burden of proof. TPP explicitly clarifies that an investor bears the burden to prove all elements of its claims, including claims on the minimum standard of treatment (MST)." (Point 2).

USTR Claim: "Expectations of an investor. TPP explicitly clarifies that the mere fact that a government measure frustrates an investor's 'expectations' does not itself give rise to an MST claim."(Point 4).

[1] Philip Morris Asia Limited v. Australia, UNCITRAL, PCA Case No. 2012-12. More information about this case is available at http://www.italaw.com/cases/851.

[2] Philip Morris Brands Sàrl v. Uruguay, ICSID Case No. ARB/10/7. More information about this case is available at http://www.italaw.com/cases/460.

These two changes ostensibly try to narrow tribunals' interpretations of the "fair and equitable treatment" or "FET" obligation.[3] The FET obligation has morphed over roughly the last 15 years from a relatively unknown and unused protection into the most common standard on which investors initiate and succeed on challenges to conduct by all branches (executive, legislative, and judicial) and levels (local, state, and federal) of government.

Many of the concerns about how investment treaty protections and ISDS favor foreign investors' rights and expectations over broader public interest aims are based on the increasing use of the FET standard, so improvements to this provision are essential. Unfortunately, the language added to the TPP text fails to address these concerns.

As the text of the TPP itself recognizes, the first "change" is language that merely confirms the standard rule in ISDS disputes: the investor bears the burden of establishing its claims. This is nothing new. It simply reiterates what is generally understood, so as hopefully to limit disputes on this point.

Importantly, however, expansive interpretations of the FET provision are not due to a failure by tribunals to impose a burden of proof *on the claimant*, but are due to the common practices of tribunals to treat that burden as being satisfied with only minimal evidence.[4] In light of the ease with which arbitrators have determined that they can identify the elements of an FET claim, merely reiterating the standard rule that the claimant has the burden to establish those elements will likely have little effect on reducing tribunal overreach.

The second change regarding the FET obligation not only fails to constitute an improvement but actually represents a step backward from previous US positions. In previous cases, the US has clearly asserted that investors' "legitimate expectations" are not elements of the FET obligation[5] and "impose no obligations on the State" under that provision.[6] In contrast, the new language, which states that a breach of an investor's "expectations" does not *alone* give rise to an MST claim, implicitly recognizes that "expectations" may in fact be relevant to establishing a violation of the FET standard.

[3] Because the treaty states that the "FET" obligation incorporates and does not require conduct beyond that mandated under the "minimum standard of treatment", this note uses the terms "FET" and "MST" interchangeably.

[4] This can be seen in recent cases decided under US treaties in which the tribunals determined that the FET obligation prohibits "arbitrary" conduct, vaguely defined. *See, e.g.*, Teco v. Guatemala, ICSID Case No. ARB/10/23, Award, December 19, 2013, para. 454; Bilcon v. Canada, PCA Case No. 2009-04, Award on Jurisdiction and Liability, March 17, 2015, paras. 442-444. This can also be seen in cases in which tribunals have determined that the FET obligation protects investors' "expectations". *See, e.g.*, Bilcon, paras. 427-454. *See also*, Mesa v. Canada, PCA Case No. 2012-17, Second Submission of the United States, June 12, 2015, paras. 14-19 (stating that the tribunal erred in determining the contents of the FET obligation based on reference to other tribunal decisions rather than state practice and opinio juris).

[5] Spence Int'l Inv. LLC v. Costa Rica, ICSID Case No. UNCT/13/2, Submission of the United States of America, April 17, 2015, para. 17.

[6] *Id*. para. 18. *See also* Mesa v. Canada, PCA Case No. 2012-17, Second Submission of the United States, June 12, 2015, para. 18.

This new language codifies – rather than corrects – problematic decisions such as the March 2015 NAFTA award in *Bilcon v. Canada*.[7] In that case, the majority of the tribunal[8] indicated that interference with investors' economic "expectations", standing alone, would not violate the FET obligation but was a factor to take into account in determining whether there had been a breach of that treaty provision.[9] Applying that approach, the tribunal gave disproportionate legal significance to the allegedly "reasonable expectations" of the investors that had been generated by non-binding statements of certain Canadian officials and general promotional materials designed to help the region attract new mining investments. Those "reasonable expectations", the tribunal determined, were later frustrated by federal and provincial environmental approvals processes, which ultimately resulted in decisions by federal and provincial officials to deny the investors their requested environmental permits. That the governments' actions frustrated the investors' "legitimate expectations" led the tribunal to conclude that Canada violated the NAFTA's FET obligation.

This case is instructive for assessing the TPP's "improvement": while the TPP states that the interference with an investor's "expectations" will not, *on its own*, constitute a violation of the FET obligation, it leaves the door wide open for future application of the *Bilcon* approach. Under that approach, a tribunal identifies what it considers to be reasonable or legitimate expectations – which may have been generated by a wide range of even non-binding government conduct and need not rise to the level of actual "rights" – and then strictly scrutinizes government actions or inactions to determine whether the investors' expectations were wrongly frustrated.[10] Frustration of investor "expectations" thus remains a key factor that can be used by tribunals to distinguish between government conduct that does, and does not, violate the FET obligation.

In summary, while there are two minor changes to the text of the FET obligation in the TPP, those changes are far from being adequate to ease – much less resolve – valid

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[7] Bilcon v. Canada, PCA Case No. 2009-04, Award on Jurisdiction and Liability, March 17, 2015

[8] One arbitrator in this case dissented, critiquing the majority's review of the facts and its application of the FET obligation. According to the dissenting arbitrator, the majority's approach is a "significant instruction into domestic jurisdiction," "will create a chill on the operation of environmental review panels," and will result in investors being able to "import[] a damages remedy that is not available under Canadian law." (para. 49). Even more problematically, the dissenting arbitrator stated, the majority's decision was an "intrusion into the environmental public policy of the state." (*Id.*). Bilcon v. Canada, Dissenting Opinion of Professor Donald McRae, March 10, 2015.

[9] *Id.*

[10] *See also Bilcon*, para. 572. In *Bilcon*, the tribunal added that when investor "expectations" are frustrated, that is considered to be a "special circumstance[]" in which changes in or application of government law and policy are more likely to be successfully challenged. The tribunal noted that some tribunals "express a cautious approach about using investor expectations to stifle legislative or policy changes by state entities that have the authority to revise law or policy." It added, however, that such authority is "not absolute; breaches of the [FET obligation] might arise in some special circumstances" such as when they are "contrary to earlier specific assurances by state authorities that the regulatory framework would not be altered to the detriment of the investor." Tribunals' protection of *expectations* (as opposed to *rights*) generated by "specific assurances" provides investors greater protection against regulatory change than they are provided under US domestic law. See Lise Johnson and Oleksandr Volkov, *Investor-State Contracts, Host-State "Commitments" and the Myth of Stability in International Law*, 24 AM. REV. INT'L ARB. 361 (2013)

concerns about the risk that investors will continue to be able to use this provision to expand the strength of their economic "expectations" at the expense of broader public interests.

The FET obligation has only figured in ISDS jurisprudence for 15 years, but has inspired disproportionate ire, uncertainty, litigation, and liability in that time. With the TPP, it is crucial to avoid entrenching and exacerbating well-recognized existing problems, and to seize the opportunity to make real improvements.

One such improvement would be to exclude the FET obligation altogether, or to exclude it from ISDS and leave it only subject to state-to-state dispute resolution. Alternatively, the TPP could clearly rein in the standard so that it is expressly limited to a protection against denial of justice after exhaustion of local remedies – a much narrower, but still significant protection.[11]

USTR Claim: "Dismissal of frivolous claims. TPP includes a new standard permitting governments to seek expedited review and dismissal of claims that are manifestly without legal merit." (Point 3).

USTR Claim: "Expedited review and dismissal of claims. As in U.S. courts, TPP allows panels to review and dismiss certain unmeritorious claims on an expedited basis." (Point 12).

USTR Claim: "Attorney's fees for frivolous claims. A panel may award attorney's fees and costs in cases of frivolous claims." (Point 13).

These three provisions attempt to address the same problem: how to prevent, or ensure relatively prompt dismissal of, frivolous or meritless investor claims. While it is better to

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[11] Indeed, this narrower view of the FET obligation would be consistent with positions taken by the United States in ISDS disputes, in which US attorneys have stated that the FET obligation does not reach far, if at all, beyond the obligation not to deny justice to foreign investors. In *Spence v. Costa Rica*, for example, the United States explained:

> Currently, customary international law has crystallized to establish a minimum standard of treatment in only a few areas. One such area, which is expressly addressed in Article 10.5, concerns the obligation to provide "fair and equitable treatment," which includes, for example, the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings.

Spence, Submission of the United States of America, April 17, 2015, para. 13. *See also* Apotex Holdings Inc. v. United States, ICSID Case No. ARB(AF)/12/1, Counter-memorial on Merits and Objections to Jurisdiction of Respondent United States of America, December 14, 2012, para. 353. ("Sufficiently broad State practice and opinio juris thus far have coincided to establish minimum standards of State conduct in only a few areas, such as the requirements to provide compensation for expropriation; to provide full protection and security (or a minimum level of internal security and law); and to refrain from denials of justice. In the absence of an international law rule governing State conduct in a particular area, a State is free to conduct its affairs as it deems appropriate.").

Experience with ISDS disputes to date illustrates that unless the treaty itself clearly limits the scope of the FET obligation, arbitrators are willing to interpret it expansively.

have such provisions than not, these provisions, as drafted, will not have an appreciable effect on limiting such claims.

First, some other agreements, including the US-DR-CAFTA[12] and US-Peru FTA,[13] already have very similar provisions regarding dismissal of meritless claims, as do ICSID's Arbitration Rules, which govern many ISDS cases.[14] The US-DR-CAFTA and US-Peru FTA, for example, state:

> … a tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim submitted is not a claim for which an award in favor of the claimant may be made under Article 10.26 [Awards].[15]

In the TPP, the text adds the words in bold:

> … a tribunal shall address and decide as a preliminary question any objection by the respondent that, as a matter of law, a claim submitted is not a claim for which an award in favour of the claimant may be made under Article 9.28 [Awards] **or that a claim is manifestly without legal merit**.[16]

The minor change in wording in the TPP does not represent a significant improvement over previous treaties.

Second, although the USTR states that the TPP's mechanisms for early dismissal of frivolous claims are based on the US Federal Rules of Civil Procedure, the TPP's protections for governments are actually significantly narrower than those provided under the Federal Rules.[17]

Third, even without the language in the TPP expressly stating that tribunals may award attorneys' fees and costs against investors that file frivolous claims (and respondent states that assert frivolous defenses), tribunals already had this power.[18] As data show, however, tribunals have been reluctant to use this authority.[19] Typically, tribunals order each side – the investor and the state – to bear its own costs (which on average amount to roughly $4.5 million for each side),[20] irrespective of who wins or loses. In some cases, such as when a claim or defense is obviously frivolous, the tribunals have ordered the losing

[12] Art. 10.20(4)-(6).
[13] Art. 10.20(4)-(6).

[15] US-DR-CAFTA, art. 10.20(4); US-Peru FTA, art. 10.20(4).
[16] Art. 9.22(4) (emphasis added).
[17] See discussion in LISE JOHNSON, NEW WEAKNESSES: DESPITE A MAJOR WIN, ARBITRATION DECISIONS IN 2014 INCREASE THE US'S FUTURE EXPOSURE TO LITIGATION AND LIABILITY 10-12 (CCSI January 2015), http://ccsi.columbia.edu/files/2014/03/Brief-on-US-cases-Jan-14.pdf.
[18] *See, e.g.*, ICSID Convention, art. 61(2); 2010 UNCITRAL Arbitration Rules, art. 42. Other US treaties pre-dating the TPP have also included this provision. See US-DR-CAFTA, art. 10.20(6).
[19] Matthew Hodgson, *Counting the Costs of Investment Treaty Arbitration*, 9 GLOBAL ARB. REV., March 24, 2014. http://globalarbitrationreview.com/news/article/32513/.
[20] *See id*. (finding that average costs for respondent states were US$ 4,437,000 and US$ 4,559,000 for claimants).

party to pay the legal fees and costs of the winning party. Tribunals, however, have been more likely to require losing states to cover the costs of winning investors, than to require losing investors to cover the costs of winning states.[21] Simply reiterating the power of tribunals to award costs in favor of states is not likely to change these trends.

USTR Claim: "Arbitrator ethics. TPP countries will provide detailed additional guidance on arbitrator ethics and issues of arbitrator independence and impartiality." (Point 5).

This is a very important potential development. Private arbitrators are not bound by the same rules of independence, impartiality, and public integrity that domestic systems require of judges. And despite the fact that very serious concerns have been raised about arbitrator ethics in ISDS disputes for years,[22] there has been no serious effort among the arbitration community to commit to any meaningful self-regulation. As the TPP does not actually resolve this issue but punts it back to the parties to address in the future, it remains to be seen whether this provision will actually help to resolve these concerns about arbitrators.

USTR Claim: "Clarifying rules on non-discrimination. TPP explicitly clarifies that tribunals evaluating discrimination claims should analyze whether the challenged treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives." (Point 6).

Recent NAFTA decisions such as *Bilcon v. Canada* and *Apotex II v. United States*[23] illustrate the very real need to prevent continued abuse of treaties' non-discrimination standards (i.e., the national treatment obligation and the most-favored nation treatment obligation). The TPP, however, does not provide an adequate solution.

The non-discrimination obligations in investment treaties aim to prevent states from discriminating against covered foreign investors/investments, whether that discrimination is in favor of domestic investors/investments (the national treatment obligation) or in favor of other foreign investors/investments (the most-favored nation treatment obligation). However, rather than using those non-discrimination obligations to protect against and recover for *nationality-based discrimination*, foreign investors and investments are using those treaty provisions to challenge *any* disparate government treatment.

In *Bilcon v. Canada*, for example, the investors successfully argued to the tribunal that Canada had violated the national treatment obligation because officials had denied their environmental permit for a controversial mining project, while other mining projects had been allowed to proceed. As Canada highlighted, those other environmental approvals

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[21] *Id*.

[22] NATHALIE BERNASCONI-OSTERWALDER ET AL., ARBITRATOR INDEPENDENCE AND IMPARTIALITY: EXAMINING THE DUAL ROLE OF ARBITRATOR AND COUNSEL (IISD 2010).

[23] Apotex Holdings and Apotex Inc. v. United States, ICSID Case No. ARB(AF)/12/1, Award, August 25, 2014 [hereinafter "*Apotex II*"]. This case is discussed *infra*, n.26.

had involved proposals for projects of different scope, in different locations, and raising different concerns. Those differences, Canada, argued, meant that the Bilcon project was not in "like circumstances" with other mining projects, and that the government was justified in treating the Bilcon project differently than other mining projects.

The tribunal, however, disagreed with Canada. The tribunal determined that the "adverse treatment" accorded to the Bilcon investment as compared to other "similar" extractive industry projects was not "a rational government policy," and was inconsistent "with the investment liberalizing objectives of the NAFTA."[24] The tribunal therefore found that Canada had violated the national treatment obligation. Notably, the tribunal reached this conclusion even though it declined to conclude that Canada's decisions denying the Bilcon project's environmental permits were motivated by any intent to discriminate against the investors based on their nationality.[25]

This case evidences how non-discrimination obligations can be used by investors and tribunals to second-guess regulatory decisions and prevent strengthening of environmental and other standards over time.[26] Even in cases where there is no evidence of nationality-based discrimination, states can be held liable.

The risk of claims is particularly high in the context of administrative enforcement actions that often and, in some cases, necessarily result in disparate treatment of different actors. As Judge Richard Posner has explained, public agencies must use their resources efficiently.[27] Depending on the context, this may mean that an agency will prioritize

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[24] *Bilcon*, para. 724.
[25] *Bilcon*, paras. 685-731.
[26] Another dispute raising these issues was *Apotex II v. United States*, ICSID Case No. ARB(AF)/12/1. In *Apotex II*, the Canadian claimant alleged that the US Government violated the most-favored nation treatment obligation when the Food and Drug Administration (FDA) restricted imports of its pharmaceutical products due to sub-standard manufacturing practices. The Canadian company did not dispute that it had in fact violated relevant manufacturing standards; rather, it argued that the US violated the NAFTA's non-discrimination obligation by restricting its imports but not similarly restricting imports from other overseas drug manufacturers that had similarly violated required manufacturing standards.

Reviewing Apotex's claims, the ISDS tribunal agreed that US regulators did treat foreign drug manufacturers differently when taking enforcement actions against various problem companies located in different parts of the world. Based on that finding of disparate treatment, and despite the lack of any evidence of government intent to discriminate on account of nationality, the tribunal stated it *would find* the US Government liable for breaching its non-discrimination obligations unless the Government could establish that the various companies were not in "like circumstances" and that the Government therefore could legitimately accord them different treatment.

Ultimately, the tribunal agreed with the US Government that the companies were not in "like circumstances"; nevertheless, the tribunal's willingness to second guess the Government's action absent any allegation that the FDA's enforcement decisions were erroneous, and absent any evidence that they were motivated by the investor's nationality, highlights how vulnerable states are to litigation and potential liability arising out of enforcement actions taken against foreign-owned companies. Given the reality that governments lack the resources to investigate and prosecute all violations of the law, and must exercise their discretion regarding when, how, and against which company or companies to take action, these types of claims may become common strategies for companies trying to frustrate enforcement decisions.
[27] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 662-665 (5th ed 1998).

taking action based on such factors as how easy or cost-effective the case will be to prove (which may also depend on the resources the defendant is willing to expend to defend the case), how important the case is for setting precedent, the severity of the violation, and/or the gains to the agency that will be generated through enforcement. Allowing a foreign investor to challenge any instance of disparate treatment on the ground that other projects were allowed to proceed or were not sanctioned (or not sanctioned as severely) for violations of the law, and allowing tribunals to scrutinize enforcement decisions based on their (unreviewable) conceptions of what is "rational" or "legitimate", undermines the very nature and means of administrative enforcement.

In order to prevent future similar cases, one approach for the TPP could have been to clearly specify that a foreign investor seeking to recover on a non-discrimination claim must establish that the government *discriminated against it on account of its nationality*. Yet the language in the TPP contains no such requirement.

Rather, the TPP's language is similar to that in previous US treaties. The national treatment obligation, for example, states:

> Each Party shall accord to covered investments treatment no less favourable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.[28]

In order to purportedly clarify interpretation and application of the Investment Chapter's non-discrimination obligations, the TPP text adds a footnote stating that, when determining whether different groups of investors or investments are in "like circumstances" and are, therefore, entitled to equal treatment, the tribunal is to look at the "totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives."[29]

This new language will not be effective in preventing future *Bilcon*- and *Apotex II*-[30] type cases. Instead of requiring investors to establish nationality-based discrimination, this language invites foreign investors to pressure governments by bringing speculative claims through ISDS and asking tribunals for a second opinion on whether they agree that government actions or policies differentiating between investors (on grounds other than nationality) were "legitimate".

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[28] Ch. 9, art. 9.4(2).

[29] Ch. 9, n.14. There is also a "Drafter's Note on Interpretation of 'In Like Circumstances' under Article II.4 (National Treatment) and Article II.5 (Most-Favoured-Nation Treatment)." That note, however, similarly fails to clearly indicate that discrimination on account of nationality is a required element to establish a breach. Moreover, the legal force of this "Drafter's Note" is unclear. Unlike, for example, Annex 9-A, which clarifies the TPP parties' "shared understanding" on the meaning of "customary international law," and Annex 9-B, which confirms the parties' "shared understanding" on the meaning of an expropriation, the "Drafter's Note" is not made part of the TPP's text.

[30] *See supra* n.26.

Notably, this standard under the TPP differs markedly from the standard for establishing discrimination on account of race or nationality in violation of the Equal Protection Clause of the US Constitution. To establish that a facially neutral law that has disparate impacts on different individuals or entities violates Constitutional protections against race- and nationality-based discrimination, a plaintiff must prove an intent or motive to discriminate on those grounds.[31] The US Supreme Court has also explained that discriminatory intent or motive is more than an "awareness of consequences. It implies that the decisionmaker … selected or reaffirmed a particular course of action at least in part 'because of,' not merely 'in spite of,' its adverse effects upon an identifiable group."[32]

Under these standards, if there were a US environmental law that, on its face, equally applied to all foreign- and domestic-owned firms, but that resulted in more domestic-owned firms being granted environmental permits than foreign-owned firms, the foreign firms could argue that the government's disparate treatment of their applications violated the Equal Protection Clause. To succeed on their claim, they would need to establish that the disparate treatment was motivated by the government's intent to discriminate against the firms based on their nationality. Under the TPP, in contrast, no such showing would need to be made. In contrast to the claim by USTR that the protections in investment treaties "are designed to provide no greater substantive rights to foreign investors than are afforded under the Constitution and U.S. law,"[33] the rights given to foreign investors to challenge any law, regulation, or action that affects it differently from other investors are substantially greater than the rights provided all investors under US domestic law.

USTR Claim: "Scope of available damages. TPP explicitly limits damages that an investor can recover to damages that an investor has actually incurred in its capacity as an investor, to address concerns about claimants seeking ISDS damages arising from cross-border trade activity." (Point 7).

This is a useful clarification. The United States, Mexico, and Canada had already made this argument before NAFTA tribunals; but, despite agreement by all three NAFTA parties on this point, at least one tribunal has rejected their position.[34]

Through this clarification, the TPP states prevent future tribunals from similarly adopting their own idiosyncratic interpretations and disregarding states' intent.

USTR Claim: "TPP also includes a range of important additional ISDS safeguards. Many of these safeguards go beyond what was included in past trade deals like NAFTA. These key ISDS safeguards include:

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[31] Washington v. Davis, 426 U.S. 229, 243-245 (1976).
[32] Pers. Adm'r of Mass. v. Feeney, 442 U.S. 256, 279 (1979) (internal citations omitted).
[33] USTR, "Fact Sheet: Investor-State Dispute Settlement" (March 2015), https://ustr.gov/about-us/policy-offices/press-office/fact-sheets/2015/march/investor-state-dispute-settlement-isds.
[34] *See* Cargill v. Mexico, ICSID Case No. ARB(AF)/05/2, Award, September 18, 2009, pp. 125-160; *see also* Mexico v. Cargill, Court File No. C52737, Factum of the Intervenor of the United States of America, December 31, 2011 (Ont. Ct. App.), pp. 12-14.

Transparency. TPP requires ISDS panels to 'conduct hearings open to the public' and to make public all notices of arbitration, pleadings, submissions, and awards. (Point 8).

Public participation. Members of the public and public interest groups—for example, labor unions, environmental groups, or public health advocates— can make amicus curiae submissions to ISDS panels 'regarding a matter of fact or law within the scope of the dispute.'" (Point 9).

Since the NAFTA was concluded over ten years ago, there have been significant improvements in a number of treaties to increase transparency of ISDS. Nevertheless, the language on transparency in the TPP represents a step backward as compared to other recent US trade agreements. Moreover, the fact remains that ISDS is a process that excludes a range of interested and affected stakeholders.

First, the TPP adds language not contained in other US trade agreements which states that each government "should endeavor to apply [its laws on freedom of information] in a manner sensitive to protecting from disclosure information that has been designated as protected information" in ISDS proceedings. This provision can potentially be used to prevent information submitted or issued in the ISDS proceedings from being disclosed to the public even if such information could otherwise be released to the public under the US Freedom of Information Act.

Second, in the US (as in many other countries), agreeing to ISDS in the first place represents a significant shift of power to the federal executive branch (the "Government") to decide how to litigate and resolve investor-state disputes. This shift of power comes at the expense of a wide variety of other stakeholders both within and outside of that branch, including state and local governments, and citizens impacted by investments.

Given the myriad effects any given ISDS dispute can have on a wide range of government agencies, private sector industries, and various non-governmental organizations, there is a legitimate concern about whether the Government is actually willing and able to represent adequately all of those stakeholders' interests.[35] Indeed, as US courts have stated, when an individual's or entity's "concern is not a matter of 'sovereign interest,' there is no reason to think the government will represent it."[36]

Under domestic law, to ensure that such diverse concerns are in fact represented in US court cases, US statutes and court doctrines guarantee that, in appropriate cases, private individuals and entities can actually intervene in and become party to a case involving the Government in order to protect their own interests.[37] ISDS, however, provides no such

[35] Kleissler v. United States Forest Serv., 157 F.3d 964, 974 (3d Cir. Pa. 1998); *see also* Am. Farm Bureau Fed'n v. United States EPA, 278 F.R.D. 98, 111 (M.D. Pa. 2011).

[36] Mausolf v. Babbitt, 85 F.3d 1295, 1303 (8th Cir. Minn. 1996).

[37] FED. R. CIV. P. 24(a) (under which a moving party can intervene in a dispute as a matter of right if it "claims an interest relating to the property or transaction that is the subject of the action, and is so situated that disposing of the action may as a practical matter impair or impede the movant's ability to protect its interest, unless existing parties adequately represent that interest"), and 24(b) (under which a court may

safeguards. There is no right for interested or affected domestic constituents to intervene in those Government-defended arbitrations. Under the language of the TPP, the only avenue that interested or affected individuals or entities can pursue to ensure their positions are raised before an ISDS tribunal is to try to make a submission to the tribunal as an *amicus curiae*, a potentially useful, but relatively powerless option that the tribunal has significant latitude to allow or disallow.[38] Consequently, the vast range of constituents that may be affected by ISDS disputes must simply hope that the Government represents their interests in ISDS cases when adopting litigation strategies or settlement options.

As has been recognized by US courts and commentators, giving the government such broad powers to unilaterally determine what arguments to make and what settlements to adopt can significantly – and negatively – impact the rights and interests of non-parties to the litigation.[39] Indeed, it has been often noted that the government's efforts to dispose of cases through settlements are not always consistent with public interests.[40] In this context, as one academic has noted, "consent of the *Government*" to resolve a case is not necessarily the same as "consent of the *governed*."[41] Accordingly, some mechanisms exist in US law for public and court oversight of settlement agreements and consent decrees. These include state and federal rules requiring the Government to give the public notice of and an opportunity to comment on certain settlement agreements the

permit a moving party not covered by 24(a) to intervene if it "has a claim or defense that shares with the main action a common question of law or fact.").

[38] Federal legislation implementing US trade agreements also include provisions regarding the relationship between state and federal law. Implementing legislation for the NAFTA, for example, states that "the States will be involved (including involvement through the inclusion of appropriate representatives of the States) to the greatest extent practicable at each stage of the development of United States positions regarding matters [that directly relate to, or will have a direct impact on, the States] … that will be addressed … through dispute settlement processes provided for under the Agreement." 19 U.S.C.S. § 3312(b)(5). Such provision, however, does not constitute a guarantee that the affected US state's positions will prevail.

[39] *See, e.g.*, Michael T. Morley, *Consent of the Governed or Consent of the Government? The Problems with Consent Decrees in Government-Defendant Cases*, 16 U. PA. J. CONST. L. 637, 647-649 (2014); *see also* Kleissler v. United States Forest Serv., 157 F.3d 964 (3d Cir.1998); United States v. Union Elec. Co., 64 F.3d 1152 (8th Cir. 1995).

[40] Recognizing this reality, there are federal and state law checks over certain settlement agreements entered into by the government; these require government settlements of disputes to be in the public interest, and permit judicial review of settlements to ensure that requirement is satisfied. *See, e.g.*, 42 U.S.C.S. § 9622 (requiring settlement agreements under the Comprehensive Environmental Response, Compensation, and Liability Act to be in the public interest); United States v. Akzo Coatings of Am., 949 F.2d 1409, 1435 (6th Cir. 1991) ("[I]n addition to determining whether a [consent] decree is rational and not arbitrary or capricious, we must satisfy ourselves that the terms of the decree are fair, reasonable and adequate -- in other words, consistent with the purposes that CERCLA is intended to serve.' … Protection of the public interest is the key consideration in assessing whether a decree is fair, reasonable and adequate."). New Jersey Dep't of Envtl. Protection v. Exxon Mobil Corp., UNN-L-3026-04, 23, Super. Ct. N.J. (August 25, 2015) ("New Jersey caselaw concerning settlements shows that New Jersey courts generally review settlements to ensure fairness, reasonableness, consistency with the governing statute, and public interest."). *See also* Morley, *supra* n.39 (discussing concerns regarding consent decrees and settlement agreements).

[41] Morley, *supra* n.39 (emphasis added).

Government might enter into,[42] and doctrines preventing enforcement of settlement agreements that try to skirt or otherwise violate the law.[43]

The rules of ISDS in the TPP, however, do not include those protections. There is no mechanism for public oversight of proposed or actual settlement agreements agreeing to pay funds or to reverse existing laws or policies. Indeed, even if the Government's commitment in a settlement agreement were illegal or unconstitutional under US law, the Government would still likely be bound to that settlement agreement as a matter of international law and could be held liable under the TPP for violating the settlement.[44] The power of the Government to determine whether and how to try to settle ISDS claims, therefore, is largely unchecked.

One can imagine, for example, a decision by the Government to settle an ISDS case brought by a foreign investor challenging a state environmental law banning use of a particular chemical deemed harmful.[45] In that settlement, the company would agree to drop its case if the Government conceded that the chemical was in fact safe, and committed to take action against the state to invalidate the state's law if the state did not do so itself.[46] The state (and/or entities within it such as environmental groups or the environmental protection agency), might maintain serious legitimate concerns regarding the safety of the chemical, and contend that the measure was in fact consistent with the TPP. Nevertheless, those entities would not have been a party to the ISDS arbitration, nor would they have been able to control the Government's defense of the ISDS case or its

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[42] See *supra* n.40.

[43] Morley, *supra* n.39, at 644, 683-688.

[44] *Id*. If US law governed the settlement agreement, several doctrines may result in the settlement agreement being deemed void or unenforceable. If entered into in the context of the TPP, however, the parties could presumably decide to have the settlement agreement controlled by non-US law. Yet even if governed by and illegal under domestic law, ISDS cases decided to date indicate that that would not prevent a tribunal from attempting to hold the Government to the terms of the settlement agreement. (Railroad Development Corp. v. Guatemala, ICSID Case No. ARB/07/3, Award, June 29, 2012, para. 234; Kardassopolulos v. Georgia, Decision on Jurisdiction, July 7, 2007, paras. 182-184). If the settlement agreement were invalidated by a domestic court, the investor would then likely be able to pursue damages against the Government.

[45] *See, e.g.*, Jeremy Sharpe, *Representing a Respondent State in Investment Arbitration, in* LITIGATING INTERNATIONAL INVESTMENT DISPUTES: A PRACTITIONER'S GUIDE (Chiara Giorgetti ed., 2014) (citing the example of *Dow Agrosciences LLC v. Canada*, a NAFTA case, in which the parties agreed to a settlement agreement "memorializing withdrawal of [the investor's] arbitration claim and [the] Government of Quebec's statements concerning the safety of a certain pesticide." (*Id*. n.104). Like the TPP, the NAFTA contains language limiting arbitral awards to monetary remedies or restitution of property. This example is therefore also useful to show that different forms of relief can be agreed to in the context of settlement agreements.

[46] The settlement agreement could be embodied in an order issued by the tribunal. Although the TPP states that final *awards* may only award monetary damages or, in some cases restitution, the TPP recognizes that *orders* could order injunctive relief or other remedies. If the state ultimately failed to comply with the settlement agreement, an ISDS tribunal could also presumably issue an award of damages against the respondent state if the tribunal retained jurisdiction over the dispute or if the investor brought a separate case based on breach of the settlement agreement. As illustrated *supra*, note 45, there is also authority for the proposition that the treaties' provisions stating that awards may only order monetary damages or restitution do not prevent governments from agreeing to provide other forms of relief.

settlement decision.[47] If the state did not agree to comply with the terms of the order, the federal Government could potentially sue the state based on preemption grounds.[48] There is also a risk that the Government could withhold federal funds appropriated by Congress in order to try to compel compliance with the order. [49]

It is possible to envision many other cases in which the Government could sacrifice disfavored domestic laws or policies through decisions on how to defend and resolve ISDS cases. In short, the provision in the TPP calling for greater transparency and input by interested parties as *amicus curiae* is a step better than the total confidentiality of many ISDS cases under other treaties; but the provisions calling for governments to defer to tribunals' determinations on confidentiality are a step backward on transparency as compared to other recent US agreements and, overall, the ISDS mechanism continues to fall far short of ensuring that the interests of the various affected parties are represented.

USTR Claim: "Remedies. A government can only be required to pay monetary damages. ISDS does not and cannot require countries to change any law or regulation." (Point 10).

The US's investment treaties have long contained provisions stating that ISDS tribunals may only order payment of monetary damages or, in some cases, restitution. Thus, this is not a new development. Nevertheless, it is important to highlight some limits of this assertion.

First, while this may be technically true, the awards may be such that the government is effectively required to abandon or change its laws or regulations.

Second, as the TPP expressly recognizes, the tribunal can order other types of relief as "interim measures" while the dispute is pending.[50]

Third, respondent states defending the cases could presumably consent to provide other forms of relief as part of a settlement agreement recorded as part of a tribunal's order or award.[51]

[47] See *supra* n.38 (referring to US requirements to consult).

[48] Implementing legislation of the NAFTA and other US agreements recognize the ability of the United States to sue US states to declare a law or its application invalid. *See, e.g.*, 19 U.S.C.S. § 3312(b).

[49] See William S. Dodge, *Investor-State Dispute Settlement between Developed Countries: Restrictions on the Australia-United States Free Trade Agreement*, 39 VANDERBILT J. INT'L L. 1, 20-21 (2006):

> The National Conference of State Legislatures (NCSL) has sought assurances "that the federal government will not shift the cost of compensation under a Chapter 11 award to states whose measures are challenged and will not withhold federal funds otherwise appropriated by the Congress to a state as a means of enforcing compliance with provisions of NAFTA." The NCSL has also asked the federal government not to "seek to preempt state law as a means of enforcing compliance with NAFTA without expressly stated intent to do so by the Congress." The federal government has provided only the latter assurance.

(Internal citations omitted).

[50] Ch. 9, art. 9.22(9).

[51] *See supra* n.45.

Fourth, if the challenged measure is a measure taken by a local or state government entity, federal preemption may require the local or state government to actually abandon that measure.

USTR Claim: "Challenge of awards. All ISDS awards are subject to subsequent review either by domestic courts or international review panels." (Point 11).

Review and enforcement of international arbitral awards is primarily governed by two treaties – the New York Convention and the ICSID Convention – and the TPP does not change that.

Under each of those treaties, arbitral awards can only be challenged on narrow grounds. Errors committed by an ISDS tribunal when reviewing the facts or interpreting the law, for example, are not bases for overturning awards under either the New York Convention or the ICSID Convention.

The New York Convention allows challenges to arbitral awards to be brought before domestic courts, and also allows awards to be challenged on the grounds that they are inconsistent with public policy. The ICSID Convention, in contrast, does not permit challenges to be brought before domestic courts. Challenges must be brought before a new panel of private arbitrators. And unlike under the New York Convention, under the ICSID Convention, there is no possibility to challenge awards on the ground that they violate public policy.

Under both the New York Convention and ICSID Convention, challenges to awards are only very rarely successful. There is no system of appeals similar to what exists in domestic courts.

Notably, however, what is not reflected in the USTR's claim is that the TPP contains a new annex to the investment chapter, Annex 9-L, which further expands the role of arbitration and enforcement of arbitral awards under the New York and ICSID Conventions, and minimizes the role of domestic courts. More specifically, new provisions added in that annex dictate that certain contracts between the federal government and investors or investments[52] must be decided through arbitration.[53] Even if

[52] Article 9.18 of the TPP allows investors to arbitrate claims that the government has violated an "investment agreement." An "investment agreement" is defined in Article 9.1 as the following (explanatory footnotes omitted):

> **Investment agreement** means a written agreement that is concluded and takes effect after the date of entry into force of this Agreement between an authority at the central level of government of a Party and a covered investment or an investor of another Party and that creates an exchange of rights and obligations, binding on both parties under the law applicable under Article 9.24(2) (Governing Law), on which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself, and that grants rights to the covered investment or investor:
> (a) with respect to natural resources that a national authority controls, such as oil, natural gas, rare earth minerals, timber, gold, iron ore and other similar resources, including for their exploration, extraction, refining, transportation, distribution or sale;

the contract required litigation of any contract dispute in domestic courts, the investor would be able to override that provision and take its claim to international arbitration instead. If the foreign investor opts for arbitration, the government will have to comply with that choice, losing its right to defend the case before domestic courts, as well as its rights under domestic law to appeal decisions that incorrectly interpret applicable contract law or make errors in reviewing the relevant facts.

Looking at implications for US law, these new requirements are a significant change from current practice and inconsistent with longstanding federal policy embodied in the Tucker Act. That law requires claims against the federal Government seeking compensation for contract breach to be litigated in the Court of Federal Claims and reviewed in the Federal Circuit.[54] To help enforce that policy, other courts scrutinize plaintiffs' claims to ensure that they do not seek to avoid "the Court of Federal Claims' exclusive jurisdiction" by artfully framing their complaints as tort instead of contract suits.[55]

> (b) to supply services on behalf of the Party for consumption by the general public for: power generation or distribution, water treatment or distribution, telecommunications, or other similar services supplied on behalf of the Party for consumption by the general public; or
> (c) to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams or pipelines or other similar projects; provided, however, that the infrastructure is not for the exclusive or predominant use and benefit of the government.

[53] Annex 9-L(A)(1). This provision provides that, even if the contract between the federal government entity and foreign investor/investment had a contractual provision that required litigation of any or all disputes in US courts, the TPP would override that exclusive forum selection clause and mandate arbitration of the dispute.

Annex 9-L(A) states:

> 1. An investor of a Party may not submit to arbitration a claim for breach of an investment agreement under Article 9.18.1(a)(i)(C) (Submission of a Claim to Arbitration) or Article 9.18.1(b)(i)(C) if the investment agreement provides the respondent's consent for the investor to arbitrate the alleged breach of the investment agreement and further provides that:
> (a) a claim may be submitted for breach of the investment agreement under at least one of the following alternatives:
>> (i) the ICSID Convention and the ICSID Rules of Procedure for Arbitration Proceedings, provided that both the respondent and the Party of the investor are parties to the ICSID Convention;
>> (ii) the ICSID Additional Facility Rules, provided that either the respondent or the Party of the investor is a party to the ICSID Convention;
>> (iii) the UNCITRAL Arbitration Rules;
>> (iv) the ICC Arbitration Rules; or
>> (v) the LCIA Arbitration Rules; and
>
> (b) in the case of arbitration not under the ICSID Convention, the legal place of the arbitration shall be:
>> (i) in the territory of a State that is party to the New York Convention; and
>> (ii) outside the territory of the respondent.

[54] See 28 U.S.C. §§ 1491(a)(1), 1346(a)(2). This law is referred to as the "Tucker Act". Tucker Act claims for $10,000 or less may also be litigated in federal district courts. Those claims, however, may only be reviewed on appeal in the Federal Circuit. See Union Pac. R.R. Co. v. United States ex rel. United States Army Corps of Eng'rs, 591 F.3d 1311, 1314-1315 (10th Cir. 2010).
[55] *Union Pac. R.R. Co.*, *supra* n.54, at 1314.

This policy and practice of centralizing judicial authority "has an obvious purpose—uniformity" in interpretation, application, and development of principles and norms of US contract law. [56] This enables the federal government to "use the same language in its contracts … and be confident that it will have the same contractual rights and obligations everywhere."[57]

The ISDS provisions in the TPP, however, abandon that policy, and allow international arbitral tribunals – not judges of the Federal Court of Claims – to interpret and apply US contract law. This gives ISDS tribunals the ability not even granted to other US state or federal courts to shape the meaning of US contract law and to issue decisions without any possibility of having their erroneous decisions appealed.

Other "Additions"

Many of the "upgrades and improvements" referred to by the USTR have been expressly or implicitly included in agreements since at least the NAFTA. These include the following:

> **USTR Claim: "Expert reports. A panel can consult independent experts to help resolve a dispute." (Point 14).**
>
> Similar language can be found in other treaties including the NAFTA (art. 1133), and US-Peru FTA (art. 10.24).
>
> **USTR Claim: "Binding interpretations. TPP countries can agree on authoritative interpretations of ISDS provisions that 'shall be binding on a tribunal.'" (Point 15).**
>
> This has been a common feature of US treaties since NAFTA (art. 1131), and can be an important mechanism for states to exert some control over arbitral tribunals. There appear, however, to be limits to its actual use. For example, although the provision has been included in the NAFTA and all other investment treaties/investment chapters concluded by the US since the NAFTA, this mechanism has only been used *once* to clarify the interpretation of a substantive protection. (It was used to clarify the meaning of FET under the NAFTA in 2001).
>
> **USTR Claim: "Consolidation. A panel can consolidate different claims that 'arise out of the same events or circumstances.' This protects against harassment through duplicative litigation." (Point 16).**

[56] *Id*. at 1315.
[57] *Id*.

While a useful provision, this was also included in the NAFTA (art. 1126) and has been a common feature of other US agreements concluded since that treaty (see, e.g., US.-Peru FTA, art. 11.25).

Conclusion

Overall, the US claims to have made a number of improvements to the ISDS system and investment protection standards included in the TPP. While reforms would of course be welcome, the changes that have been made to the TPP do not address the underlying fundamental concerns about ISDS and strong investment protections; in some cases, the changes represent just small tweaks around the margins, while in other cases, the provisions represent a step backwards. At their core, ISDS and investor protections in treaties establish a privileged and powerful mechanism for foreign investors to bring claims against governments that fundamentally affect how domestic law is developed, interpreted and applied, and sideline the roles of domestic individuals and institutions in shaping and applying public norms. For this reason, the TPP should drop ISDS altogether, or replace it with a new and truly reformed mechanism that addresses the myriad concerns that are still lurking in the TPP.