Second Thoughts

Investor-State Arbitration between Developed Democracies

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Abbreviations and Acronyms

AANZFTA	ASEAN-Australia-New Zealand Free Trade Agreement
AB	Appellate Body (of the World Trade Organization)
ACCI	Australian Chamber of Commerce and Industry
AFTINET	Australian Fair Trade & Investment Network Ltd.
ALBA	Bolivarian Alliance for the Peoples of Our America
AMLA	Adams Mine Lake Act
ASEAN	Association of Southeast Asian Nations
AUSFTA	Australia-United States Free Trade Agreement
BITs	bilateral investment treaties
BOE	Boletín Oficial del Estado [Official Gazette]
BRIC	Brazil, Russia, India and China
BRTAs	bilateral and regional trade agreements
BTD	Bipartisan Trade Deal
Canada-US FTA	Canada-United States Free Trade Agreement
CCP	Code of Civil Procedure
CER	Closer Economic Relations
CETA	Comprehensive Economic and Trade Agreement
ChAFTA	China-Australia Free Trade Agreement
CAFTA-DR	Dominican Republic-Central America Free Trade Agreement

CIETAC	China International Economic and Trade Arbitration Committee
CIGI	Centre for International Governance Innovation
CJEU	Court of Justice of the European Union
CPC	Code de procédure civile (Québec)
DFAT	Department of Foreign Affairs and Trade
DSB	Dispute Settlement Body (of the World Trade Organization)
DSU	Dispute Settlement Understanding (of the World Trade Organization)
ECHR	European Court of Human Rights
ECT	Energy Charter Treaty
EFILA	European Federation for Investment Law and Arbitration
EFTA	European Free Trade Association
EPA	economic partnership agreement
EU-Vietnam FTA	European Union-Vietnam Free Trade Agreement
FADE	Fondo de Titulación del Déficit del Sistema Eléctrico
FCN	friendship, commerce and navigation
FDI	foreign direct investment
FET	fair and equitable treatment
FIP	feed-in premium
FIPA	Foreign Investment Protection Agreement
FIRA	Foreign Investment Review Act
FIT	feed-in tariff
FPS	full protection and security
FTA	free trade agreement
FTAA	Free Trade Agreement of the Americas
FTC	Free Trade Commission

GAC	Global Affairs Canada
GAL	global administrative law
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of Other States
ILO	International Labour Organization
ILRP	International Law Research Program
IIAs	international investment agreements
IIL	international investment law
IISD	International Institute for Sustainable Development
ILC	International Law Commission
IPAs	investment protection agreements
ISA	investor-state arbitration
ISDR	investor-state dispute resolution
ISDS	investor-state dispute settlement
JRP	joint review panel
JSCOT	Joint Standing Committee on Treaties
KAFTA	Korea-Australia Free Trade Agreement
Korea-EFTA FTA	Korea-European Free Trade Association Free Trade Agreement
KORUS	United States-Korea Free Trade Agreement
KOTRA	Korea Trade Investment Promotion Agency
LCIA	London Court of International Arbitration

MAI	Multilateral Agreement on Investment
MFAA	Manganese-based Fuel Additives Act
MFN	most-favoured nation
MIGA	Multilateral Investment Guarantee Agency
MMT	methylcyclopentadienyl manganese tricarbonyl
MNEs	multinational enterprises
MST	minimum standard of treatment
MTBE	methyl tert-butyl ether
NAFTA	North American Free Trade Agreement
NGOs	non-governmental organizations
NSW	New South Wales
NT	national treatment
OAS	Organization of American States
OECD	Organisation for Economic Co-operation and Development
PC	Productivity Commission
PCA	Permanent Court of Arbitration
PCBs	polychlorinated biphenyls
PMRA	Pest Management Regulatory Agency
PROFEPA	Procuraduría Federal de Protección al Ambiente
RD	Royal Decree [Real Decreto]
RDL	Royal Decree Law [Real Decreto Ley]
RFP	request for proposal
ROK	Republic of Korea
RTAs	regional trade agreements
SADC	Southern African Development Community
SCC	Stockholm Chamber of Commerce

SDMI	S.D. Myers, Inc.
SMC	St. Marys Cement
SMVNCA	St. Marys Votorantim Cimentos
SOE	state-owned enterprise
SSA	state-to-state arbitration
STC	Sentencia del Tribunal Constitucional
STS	Sentencia del Tribunal Supremo
TAA	Trade Adjustment Assistance
TCC	Trammel Crow Company
TFEU	Treaty on the Functioning of the European Union
TPA	Trade Promotion Authority
TPP	Trans-Pacific Partnership
TPS	Trade Policy Statement
TRIMS	Trade Related Investment Measures (of the World Trade Organization)
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UPS	United Parcel Service
USTR	United States Trade Representative
US Trade Act of 2002	US Bipartisan Trade Promotion Authority Act of 2002
WEF	World Economic Forum
WTO	World Trade Organization

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Armand de Mestral

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Foreword

Oonagh Fitzgerald

This magnificent collection of essays, *Second Thoughts: Investor–State Arbitration between Developed Democracies,* has the honour of being the first international law book produced by the International Law Research Program at the Centre for International Governance Innovation (CIGI). It has been two years in the making, with CIGI Senior Fellow Armand de Mestral first raising the topic at the program's earliest consultations to develop its research agenda. At the time, developments in Europe, North America and Australia had conjured up substantial academic, political and civil society debate about investor-state arbitration (ISA), with vocal critics asking why developed democracies should provide foreign investors with special procedural and substantive rights not enjoyed by local investors. Armand proposed to explore this issue by inviting noted academics and practitioners from a wide range of developed democracies to examine how this issue appeared from their respective vantage points. A conference to present the draft papers was held in Ottawa, Canada, in September 2015, just days after the release of Europe's proposal for an investment tribunal for the US-EU Transatlantic Trade and Investment Partnership. When the EU Ambassador to Canada Her Excellency Marie-Anne Coninsx spoke at the conference about the importance of this development to enhance the legitimacy of ISA, it was evident Europeans were hopeful to see a similar addition to the Canada-EU Comprehensive Economic Trade Agreement (CETA).

While the research papers were being finalized, peer reviewed, edited and published as individual CIGI papers, the ISA storm swirled in national capitals, periodically eddying into crisis, then abating. Cases brought by foreign corporations to challenge domestic regulations on health, safety and the environment, such as Vattenfall against Germany, Clayton/Bilcon against Canada and Philip Morris Asia Limited (Hong Kong) against Australia, generated significant consternation in many quarters. When an international investment tribunal "magically" appeared in the legally scrubbed CETA, in the spring of 2016, the authors of this collection and other noted practitioners and academics wrote a series of CIGI commentaries exploring whether the investment tribunal represented a "cosmic or cosmetic" change to the institution of ISA. As we look back on 2016 and the finalized book goes to print, the question "whither ISA" seems to have deepened into existential crisis: the Brexit vote suggested that the nation that arguably launched globalization through the British Empire no longer was convinced

of its benefits; CETA almost fell apart due to Wallonia's objections over even its reformed ISA provisions; and the US presidential election was run and ultimately won on promises of scrapping the Trans-Pacific Partnership Agreement, re-opening the North American Free Trade Agreement, and recreating jobs lost to globalization and China's ascendancy as manufacturer to the world.

Armand de Mestral has gathered a spectacular global team of leading trade and investment experts to elucidate this controversial issue at a critical moment when the developed world is having serious second thoughts about the legitimacy of ISA. Following Armand's introduction to the debate, Canadian authors Céline Lévesque, Charles-Emmanuel Côté, David Schneiderman and Armand consider Canada's past, present and future relationship with ISA and debate its consistency with domestic constitutional principles. David Gantz, Marc Bungenberg, Carmen Otero García-Castrillón, Csongor István Nagy, August Reinisch, Luke Nottage, Shotaro Hamamoto and Younsik Kim elucidate political and legal perspectives in the United States, Germany, Spain, the countries of Eastern Europe, the European Union, Australia, Japan and South Korea. Hugo Perezcano and Ucheora Unwuamaegbu discuss how the developing world might react if developed democracies were to back away from ISA between developed countries. Armand de Mestral concludes the collection with consideration of options for future negotiations by developed democracies such as Canada. Each contributing author provides detailed, country-specific information about the most important ISA cases and the relevant political context. This book is a global juridical tour de force that leaves the reader with all the information necessary to form his or her own conclusions as to the path forward.

Second Thoughts is a timely, in-depth, global review of the current state of ISA between developed democracies. It is a must-read for ISA defenders and detractors, for those who hope to continue to ply their trade as arbitrators or litigation counsel before ISA panels, as much as it is for those who hope to see ISA significantly reformed or eventually eradicated. This collective work inevitably raises questions about the future of ISA in developing countries as well. Several of the contributors are now working on a second phase of CIGI international law research focusing on perspectives and approaches to ISA in the developing world.

Second Thoughts could not come at a more critical time. Some of the great free-trading nations are turning inward, while other nations and institutions contemplate how to make trade more inclusive. As the world contemplates the future of globalization, the questions and doubts about ISA are only growing in relevance, importance and urgency.

Oonagh Fitzgerald
Director of the International Law Research Program
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December 2016

Introduction

Armand de Mestral

Foreign investment protection agreements have steadily increased in number and complexity since the first modern agreement was signed between Germany and Pakistan in 1959. Today, they take the form of at least 3,000 bilateral investment treaties (BITs) and several hundred investment protection chapters in bilateral and plurilateral regional trade agreements (RTAs). These treaties set out standards of treatment of foreign investment and foreign investors that the host state guarantees to respect, thus committing itself to respect several different standards of conduct designed to attract and keep foreign investment in its territory. The great majority of these agreements include dispute settlement provisions. Some of these provisions rely on traditional state-to-state dispute settlement, but the great majority have come to provide for investor-state arbitration (ISA). Under this system, the treaty serves as the basis for claims from foreign investors who allege that they have suffered economic harm as a result of an alleged violation of one or more of the various standards of treatment set out in the treaty.

Investment protection treaties, whether bilateral or plurilateral, are reciprocal in character: each state agrees to offer the same protections to foreign investors and foreign investments in their territory. The original purpose of foreign investment protection treaties was to protect capital invested by investors from developed market-economy countries in the territory of developing host states. This was done for a variety of reasons. One general purpose — although its efficacy is still debatable — was to attract foreign investment into the host country. Another equally debatable purpose was to retain the investment by offering guarantees of treatment designed to reassure the investor that the investment was not to be subject to capricious or arbitrary treatment. Perhaps the most plausible reason for signature of a BIT by the government of a developing country is to serve notice to all its agencies that foreign investment is not to be subject to capricious treatment. A further purpose, often advanced in support of foreign investment protection agreements, was to guarantee that in the event of a dispute the matter will be settled according to preordained rules, before a neutral forum and before neutral judges chosen by the parties. This reflected the fear that the administrative procedures or standards of judicial independence often left something to be desired in many newly independent countries, and that investment disputes could not be left to be decided by the institutions of the host state alone.

The move to guarantee the terms on which foreign investment would be received in developing countries received considerable encouragement from the Washington Consensus of 1989. This reflected a major policy shift by developing countries away from the policies of import substitution and autonomy of the New International Economic Order, then promoted by the United Nations Conference on Trade and Development (UNCTAD), toward policies based on liberal trade and economic development theories promoted by the World Bank and its agencies. This also accompanied the movement to join the General Agreement on Tariffs and Trade (GATT) after 1986, and the World Trade Organization (WTO) when it was created in 1994. This process of widening the net of foreign investment protection agreements was also promoted by the trend to include investment protection chapters in RTAs on the model of Chapter 11 of the North American Free Trade Agreement (NAFTA).

In the early years of the negotiation of foreign investment protection treaties, virtually all were made between developed market economies and developing countries. The assumption was thus that investment would flow in one direction and that the formally reciprocal rights and duties would obviate the need to protect foreign investments in developed market-economy countries. Any disputes that did occur related in fact to problems encountered by First World investors in developing countries. The other category of countries making foreign investment protection agreements in the early years were communist countries within the sphere of interest of the Soviet Union or China seeking to attract capital from developed market-economy countries. Thus, in the early years, the flow of capital was almost exclusively from the developed to the developing worlds and, although the BITs were framed in reciprocal terms, there was no expectation that capital would flow in the opposite direction and that investors from developing countries would be seeking the protection of these treaties. Slowly, this has changed. One of the first major changes occurred when the United States and Canada, which had already concluded a free trade agreement in 1988 that contained a path-breaking investment chapter — not, however, ISA — decided to enter into NAFTA with a developing country, Mexico, in 1994. NAFTA Chapter 11 does include ISA in its Part B. In the same year, many developing countries took on limited investment protection agreements, as they joined the WTO, under which they were committed to the General Agreement on Trade in Services and the Agreement on Trade Related Investment Measures. The Energy Charter Treaty (ECT), which also emerged in 1994, deals with the cross-border supply of energy. This treaty has been ratified by two organizations (the European Union and the European Atomic Energy Community) and 53 countries of Western Europe, the Balkans, Belarus, Ukraine, the Caucasus, the Central Asian republics and countries as far afield as Mongolia and Australia. Russia signed but has declined to ratify the treaty. A striking feature of the ECT is that it binds countries characterized by different political systems and of various levels of democratic and economic development to ISA.

The result of these developments is that no longer do investment protection commitments apply only to developing countries. This process has been furthered by the negotiation of a number of RTAs between developed countries such as Japan and Switzerland, Australia and

the United States, or various investment protection treaties negotiated by South Korea with other developed countries. A further important development has been the emergence of China as a major foreign investment protection treaty maker, committing itself to ISA. It has signed more than a hundred BITs with other developing countries, recently signed a BIT with Canada containing ISA, and has entered negotiations with the United States and the European Union.

The evolution of the pattern of foreign investment protection treaties has had the effect of committing developed countries to obligations between themselves to protect foreign investors and foreign investments that were originally only designed for the relationship between rich and poor states. Slowly but surely, during the last 20 years, a type of agreement designed to deal with investment protections between developed and developing countries has been extended to cover the relationship between developed democracies. NAFTA Chapter 11 is no doubt the best example, one in which a form of dispute settlement designed to protect capital in developing countries became applicable in two of the most developed (and litigious) democracies in the world. There was no intention to seek further judicial protections of American investment in Canada — Mexico was the object of NAFTA Chapter 11 — but the result was to make the ISA remedy of Chapter 11 available to Canadian and American investors against their respective governments and not just against Mexico. A similar pattern has emerged under the ECT, which also contains investment protections and a right to invoke ISA against member states.

The adoption of ISA procedures in NAFTA and the ECT has led to some 40 arbitral claims against Canada under NAFTA and some 25 against the United States, compared to 20 against Mexico. Similarly, the fact that the ECT binds many states that are now members of the European Union has led to a considerable number of arbitral claims by investors of one EU country against other EU governments, although it is clear that the original intention of these governments in signing the ECT was to protect their energy investments in countries east of the European Union. The ECT has been the legal basis for more than 50 claims, an increasing number being against eastern EU member states, and in recent years even against Germany and Spain.

Thus, a legal procedure designed to deal with the relationship between developed and developing countries has come to be available for claims in a significant number of developed democracies among themselves. There has always been some criticism in developing countries of the ISA obligations assumed by their governments, but, with a few notable exceptions such as Venezuela, this criticism has been fairly muted. Interestingly, as long as the obligations were essentially upon developing countries, there was absolutely no criticism of ISA in the European countries that invented the procedure, and no criticism was reported in the United States, Canada, Japan, Korea or Australia. While the true object of the ISA procedure was the protection of foreign investments in developing countries, there was scant concern expressed in developed democracies of the largely theoretical potential of arbitral claims by foreign investors from developing countries against their governments. The situation changed radically when it became clear that the governments of developed democracies could be and were actually being sued.

When American investors realized that they could seek arbitration against the Canadian government, and vice versa, the first to object were these very governments, who responded to questions about the situation with some embarrassment. Even more outraged were various civil society environmental and anti-globalization groups, which became concerned that ISA might be directed against domestic public policies governing public health, the environment, agriculture, municipal governance, water management and other politically sensitive issues. What had seemed unobjectionable when directed against developing countries was later characterized as a threat to democracy and the right of governments to make democratic public policy choices. This has long been the case in Canada and, since the European Union was given competence over direct foreign investment in 2009, there has been increasing concern that foreign multinational corporations would use ISA against their governments to challenge domestic policies dealing with sensitive social and environmental policies. Such concerns were central to the objections voiced by members of the Belgian Walloon Regional Parliament as the basis for delaying their approval of the Canada-EU Comprehensive Economic and Trade Agreement (CETA) in October 2016.

Are guarantees of fair treatment of foreign investment and investors, and especially ISA, incompatible with the values of developed democracies? It is very difficult to accept the view that developed democracies cannot assume obligations of fair treatment of foreign investors and investment. European Union law does so in a number of significant ways — in particular, by guaranteeing the right of establishment and the free movement of services, capital and persons. Ever since the Canada-United States Free Trade Agreement of 1988 was drafted to include a chapter on the protection of services and a related chapter on investments, or since the Agreement Establishing the World Trade Organization was drafted to include commitments on services and investments, it has been clear that reasonable treatment of foreign investments is an essential concomitant of the commitments that governments were willing to make on the protection of internationally traded services. Once the protection of services is included in a trade agreement, it is artificial to exclude the protection of investments. This has become a feature of WTO law, even more so in the 600 RTAs that have followed since the establishment of the WTO in 1994. Trade in services and the protection of foreign investments are indissolubly linked.

It is difficult to criticize the logic of protecting foreign investments generally in trade agreements, but the inclusion of ISA as a means of settling disputes over the treatment of foreign investment has proven to be much more controversial. Recourse to ISA has provoked such a strong reaction in a number of developed democracies that one is compelled to ask whether it is appropriate to employ this form of dispute settlement in disputes involving claims by foreign investors from one developed democracy against decisions by the public authorities of another. Is there something fundamentally flawed with recourse to ISA in this context? Is it an attaint to the democratic process? Is it an attaint to the integrity of the domestic courts? Is it an unacceptable privilege granted to foreign investors in societies based on values of equality? Does it grant undue respect to the protection of property and contract? Does it create rights that are not normally protected by the constitutions of developed democracies? These and many other questions have been raised about ISA in general and against recourse to ISA in developed democracies in particular.

This volume sets out to examine the debate over recourse to ISA in a number of developed democracies and, pursuant to the mission of CIGI's Investor-State Arbitration project, sets out to determine whether recourse to ISA between developed democracies reflects good governance. The different aspects of the debate as it has taken place in Canada is examined in five parts. Part I contains the first introductory chapter (by the author of this introduction) and attempts to give an overview of the general debate surrounding recourse to ISA. Part II contains chapters by this author and three other Canadian experts. Céline Lévesque examines the investment tribunal that was inserted into CETA at the last minute, replacing traditional arbitral procedures. Charles-Emmanuel Côté reviews Canadian experience with Chapter 11 of NAFTA and David Schneiderman sets out an alternative approach to settling investment disputes. Part II is completed by two chapters, one examining whether Canadian courts could actually award remedies equivalent to NAFTA Chapter 11 and the other examining the impact of NAFTA litigation on subsequent Canadian policy. Part III contains chapters covering the debates in the United States, Germany, Spain, the countries of Eastern Europe, the European Union, Australia, Japan and South Korea, examined by experts familiar with the issues in those countries and territories. David Gantz, Marc Bungenberg, Carmen Otero García-Castrillón, Csongor István Nagy, Luke Nottage, Shotaro Hamamoto and Younsik Kim set out the political and legal issues that have been debated in their respective jutrisdictions. Part IV contains two chapters by authors familiar with Latin America, Hugo Perezcano, and Africa, Ucheora Unwuamaegbu, who address the question of the possible reaction of the rest of the world should developed democracies abandon ISA either between themselves or vis-à-vis the rest of the world. In Part V the author of this introduction sets out the options available to the government of Canada.

The chapters presented in this volume reflect different aspects of a complex debate. Do they answer the question as to the propriety of recourse to ISA between developed democracies? Perhaps not entirely. The topic is both complex and highly politicized, and it is possible for reasonable people to differ. The debate in Canada reflects Canadian experience with NAFTA Chapter 11. There is little doubt that the Canadian government is not happy to be sued, but there has been no inclination to withdraw. Rather, Canada has promoted a model Foreign Investment Protection Agreement (FIPA) that contains new and extensive language designed to protect regulatory sovereignty. The debate in the United States reflects NAFTA as well, but is also coloured by the multiple and sometimes conflicting interests of a superpower. The election of a new president always gives rise to speculation, but at the time of writing (February 2017) there appears to be no inclination on the part of the new US administration to back away from the long-held national position in favour of recourse to ISA. Australia is a particularly interesting case in that it is the only jurisdiction that has, for a time, made it policy to include ISA in some, but not all, of its investment agreements. Japan is a case where there was virtually total support for ISA, until the spectre of actions by American companies was raised in the Trans-Pacific Partnership Agreement. South Korea has long supported ISA in its treaties, but even there the threat of actions by American companies has caused some adverse political reaction. In almost every country surveyed, there is concern about the implications of

committing to ISA with the United States.

The European Union has witnessed the strongest reaction against ISA — perhaps because the European Union obtained authority over direct foreign investment in 2009, and was forced to decide whether to maintain the pattern set by the member state "gold standard" agreements negotiated over the previous 40 years or to strike out with new policies. Popular reaction to the *Vattenfall* litigation in Germany and public debate over the perceived dangers of actions by American multinationals quickly drove the European Commission toward the adoption of new policies that culminated in the drafting of Chapter 8 of CETA, adopting the protective language of the Canadian FIPA and the last-minute addition of an investment tribunal. But even this has not protected the Commission from criticism. ISA has been denounced in several EU countries, in particular in the Belgian region of Wallonia, as being anti-democratic and a threat to domestic regulatory authority, in the October 2016 debate over the signature of CETA by the European Union.

In all of these countries there is far more concern over the possibility of being sued by investors from other developed democracies than the potential for using ISA against the governments of developing countries. Indeed, it is fair to say that in developed democracies there was scant concern about ISA until it became likely that their own government might be sued. The potential for actions against developing countries has never been a major concern. Is this a paradox or, worse, rank hypocrisy?

The author of this introduction and general editor of this book has attempted to give his opinion on the principal questions in various chapters in this collection. The other contributors speak for themselves. They discuss the debates that have taken place in their respective jurisdictions. It is hoped that readers will have sufficient material to assist them in reaching their own conclusions, without being too strongly pushed in any one direction on these complex issues.