Trading Views: Real Debates on Key Issues in TPP – The Investment Chapter

Remarks of Theodore R. Posner

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Just over six years ago, I was honored to testify before the Ways and Means Committee on a topic very similar to the one under consideration today.[1] In preparing for today's Forum, I reviewed my earlier testimony. While there have been important developments since May 2009, the key points I wish to make today are essentially the ones I made back then. In particular:

1. Treaty-based and trade agreement-based investment rules provide important protections to U.S. persons and companies seeking to invest overseas, and these rules do not encroach on the ability of governments to regulate in the public interest.

2. Investor-State arbitration is a fair, neutral, effective mechanism for resolving disputes that may arise over the interpretation and application of investment rules.

3. Investment rules and investment dispute settlement implicate issues of broad public interest which must be taken into account in designing the rules and dispute settlement procedures.

4. The investment-related negotiating objectives set forth in the Trade Act of 2002 reflected a well-balanced position, taking into account both the interests of the Federal and State governments in preserving their regulatory prerogatives and the interests of U.S. investors in robust, rule-based protections when they invest overseas. That balance was carried into the 2004 Model BIT and continued, with only modest changes, in the 2012 Model BIT. It also is reflected in the recently enacted Bipartisan Congressional Trade Priorities and Accountability Act of 2015.[2]

5. The recently concluded Trans-Pacific Partnership Agreement alters the balance in ways that could result in a modest weakening of investor protections. But, on the whole, the TPP largely preserves the balance reflected in U.S. trade negotiating objectives and in the Model BIT.

6. Of greater concern are proposals made by the European Commission for an investment chapter in an eventual Transatlantic Trade and Investment Partnership agreement. These would alter the balance more significantly in ways that would weaken the protections

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[1] *See* Investment Protections in U.S. Trade and Investment Agreements, Hearing before the Committee on Ways and Means, U.S. House of Representatives, Serial 111-20, 111th Cong., 1st Sess. at 22-34 (May 14, 2009).

[2] *See* Pub. L. No. 114-26 § 102(b)(4), 129 Stat. 319, 324 (June 29, 2015).

afforded by the existing BITs between the United States and nine EU Member States[3] and should be of concern.

I will say a few words on each of these points, focusing on the most significant innovations in TPP and flagging the most concerning proposals being put forward by the European Commission.

First, investment disciplines in treaties and trade agreements provide valuable protections to U.S. individuals and companies. These rules put investors' relationships with foreign governments on an international law footing. They codify investors' entitlement to the most fundamental rights, including the right to be free from nationality-based discrimination, the right to be treated fairly and equitably, and the right to be compensated for direct and indirect expropriations. Although critics profess concern about encroachment on regulatory prerogatives, it is difficult to see how adhering to any of these standards would interfere with a government's right to regulate. In other words, it is difficult – perhaps impossible – to think of a situation in which a government would be forced to choose between adopting or implementing a regulation to advance a legitimate public interest, on the one hand, and abiding by its trade agreement investment obligations, on the other.

Second, investor-State arbitration is a fair, neutral, and effective mechanism for resolving disputes over investment obligations. The alternative usually will be local courts. Even where the local judiciary is well regarded, it is difficult to avoid the perception of home-field bias. Moreover, international arbitration affords other advantages, including rules and procedures that are common across multiple jurisdictions and enforceability of awards across multiple jurisdictions.

[3] Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, and Slovakia.

Third, while investment rules govern relationships between governments and foreign investors, they surely affect the interests of a broader group of stakeholders. The rules ought to reflect those broader interests. In my view, they do. Provisions such as the clarification on when a regulatory act results in a compensable taking and the greater transparency in investor-State arbitration are the direct result of efforts to take account of the broader public interest.

Fourth, the remarkable consistency from the Trade Act of 2002, to the 2004 Model BIT, to the 2012 Model BIT, to the Trade Act of 2015 suggests to me that we have found an appropriate balance between protecting the interests of U.S. persons that invest overseas while maintaining the prerogatives of government to regulate in the public interest. In the 13 years since the United States articulated modern investment-related negotiating objectives in the Trade Act of 2002, no dispute settlement proceeding or other event has shown that balance to be skewed and in need of repair.

Fifth, this then brings us to the TPP. As set forth in Chapter 9, TPP's investment provisions are largely similar to the current U.S. model. But there are important differences, and they tend to weaken investment disciplines as compared with the U.S. model. These differences may not be dramatic, but they are notable, because the rationale for departing from the U.S. model is not clear. Do these changes make TPP objectionable? Probably not. But their practical application – in particular, their interpretation in eventual dispute settlement proceedings – warrants careful monitoring. It should not be presumed that similar departures from the U.S. model should be adopted in future agreements. Let me mention a few examples of provisions of concern.

- **Minimum standard of treatment and legitimate expectations**: A key obligation of a host State is the obligation to "accord to covered investments treatment in accordance with applicable customary international law principles, including fair and equitable

treatment and full protection and security."[4] The prevailing view over the past decade is that there is a close link between this obligation and an investor's legitimate, investment-backed expectations. Thus, if a government induced an investor to make or maintain an investment by creating certain expectations and then acted contrary to those expectations, it could be breaching its obligation to accord fair and equitable treatment. But the TPP drafters appear to have severed, or at least weakened, that link. Thus, in Article 9.6.4, they provided that "the mere fact that a Party takes or fails to take an action that may bet inconsistent with an investor's expectations does not constitute a breach of [the Minimum Standard of Treatment] Article, even if there is a loss or damage to the covered investment as a result." This departure from the U.S. model is of particular concern.

- **National treatment and most-favored-nation treatment**: Another core obligation is the obligation to accord national treatment to investors and investments "in like circumstances" with a country's own investors and investments and to accord most-favored-nation treatment to investors and investments "in like circumstances" with investors and investments of third countries. [5] The "in like circumstances" qualifier is meant to ensure that when the treatment of different investors or investments is being compared, the comparison is "apples-to-apples." To date, this concept has not been controversial. Yet the TPP drafters purported to qualify the "in like circumstances" concept by instructing interpreters that it "depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate public welfare objectives."[6] The meaning of this qualifier is ambiguous. Depending on how it is invoked and interpreted, it could be cause for concern. In particular, it could be used to defeat claims of nationality-based discrimination involving apples-to-apples comparisons, where the government asserts "legitimate public welfare objectives" as the basis for providing less favorable treatment to a foreign investor or investment.

- **Investor-State arbitration and burden of proof**: It is a truism in international arbitration – as in other systems of adjudication – that a party asserting a fact has the burden of proving that fact. Nevertheless, the TPP drafters expressly provided that "if an investor of a Party submits a claim under this Section, including a claim alleging that a Party breached Article 9.6 (Minimum Standard of Treatment), the investor has the burden of proving all elements of its claim, consistent with general principles of international law applicable to international arbitration."[7] This statement could turn out to be a harmless expression of a widely accepted principle. However, the fact that the TPP Parties felt a need to make the statement could be misused to suggest that an investor faces an elevated

[4] TPP, Art. 9.6.1.

[5] TPP, Arts. 9.4 & 9.5.

[6] TPP, Art. 9.4 n.14.

[7] TPP, Art. 9.22.7.

burden of proof in cases involving the minimum standard of treatment. That would be deeply concerning.

- **Investor-State arbitration and measure of damages**: Another departure from the U.S. model when it comes to investor-State arbitration concerns the measure of damages. Article 9.28.2 provides that "if an investor of a Party submits a claim to arbitration under Article 9.18.1(a) (Submission of a Claim to Arbitration), it may recover only for loss or damage that it has incurred in its capacity as an investor of a Party." Again, this could be a harmless restatement of what already is understood to be the case. On the other hand, one must ask why the drafters felt the need to include this provision. The ambiguity created by the new text could be misused in an attempt to draw distinctions between damages incurred by a party "in its capacity as an investor" and damages incurred in other capacities (for example, as an exporter of goods or services from its home territory). Such distinctions are likely to prove difficult to establish and ultimately could leave investors with less-than-full remedies for breaches by host States.

Let me stress that while these examples of ways in which TPP departs from the U.S. model are concerning, they probably are not deal-breakers. Hopefully, their impact will be modest. But they do bear careful monitoring.

Of greater concern – and this is my final point – are certain innovations that the European Commission has proposed in relation to the TTIP negotiation. Unlike the TPP provisions I have mentioned, several of the Commission's proposals represent a more dramatic and more concerning departure from the U.S. model. Let me mention two.

- **Minimum standard of treatment**: The Commission's proposal would expressly and narrowly circumscribe the conduct that could be considered to breach a country's obligation to accord fair and equitable treatment.[8] Unless conduct is covered by one of five categories on a closed list, then it would not constitute a denial of fair and equitable treatment. And while the Commission would allow for certain investor expectations to be "take[n] into account,"[9] it is ambiguous how the frustration of such expectations would relate to the conduct that could be considered to breach the fair and equitable treatment obligation.

[8] European Union proposal for Investment Protection and Resolution of Investment Disputes, Art. 3.2 (Nov. 12, 2015).

[9] *Id.*, Art. 3.4.

- **Investment court**: As has been widely publicized, the EU would replace investor-State arbitration with a permanent investment court.[10] While many of the details of this newly proposed institution remain unclear, what is clear is that only States, and not investors, would have a role in appointing judges to the court. And the party autonomy in composing a tribunal suitable for the adjudication of a particular dispute – which is characteristic of arbitration as we now know it – would be eliminated entirely. Concerns regarding the investment court are compounded by the proposed creation of an appellate tribunal, the mechanics of which – including, for example, the absence of any mechanism for remand when an appeal is well-founded – are problematic.

While certain of the TPP provisions warrant close monitoring, the TTIP provisions that the European Commission has proposed are more concerning. As I stated at the outset of my remarks, the key challenge in developing a treaty- and trade agreement-based investment policy is achieving an appropriate balance between investor protections and regulatory prerogatives. In my view, the United States has found that balance. While the TPP investment chapter alters that balance somewhat, it does so in ways that should be modest in their effect. The impact of certain EU proposals is likely to be far more significant.

[10] *Id*., Art. 9.