NATIONAL ASSOCIATION OF Manufacturers

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Input to the Investment Protections and Dispute Settlement Provisions of the EU Commission's Draft "Trade in Services, Investment and E-Commerce"

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Nov. 3, 2015

Comments of the

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The National Association of Manufacturers (NAM) is the largest manufacturing association in the United States, representing over 14,000 manufacturers small and large in every industrial sector and in all 50 states. NAM members include many companies that trade with and invest in Europe, as well as European companies that manufacture in the United States.

The NAM strongly supports the negotiation of a high-standard and ambitious Transatlantic Trade and Investment Partnership (TTIP) agreement between the United States and the European Union that will eliminate barriers to trade and investment and set high standards for the protection of innovation and property in accordance with the strong standards that the United States and European Union have long embraced.

Given the importance of transatlantic investment to manufacturers in the United States, the NAM is providing these comments on the investment provisions of the EU Commission's draft "Trade in Services, Investment and E-Commerce" text released in September 2015 ("draft EU investment text").[1]

Investment is a critical driver of economic growth and jobs in both the United States and EU, and in developing countries around the world. The conclusion of high-standard investment provisions in free trade agreements or as part of investment treaties has been documented to advance such job-creating investment both in studies examining data on investment flows and in surveys of businesses making investment decisions.[2]

The United States and EU have an important opportunity to set high standards for the protection of property and investment through the TTIP that support economic activity and jobs, while reflecting our own core principles and helping to influence investment instruments being negotiated around the world. Contrary to claims of critics focused on cases that have not been decided, the fact is that the experience of EU member states and the United States has been highly positive under existing investment instruments that have reinforced basic rule-of-law standards with our international partners. The overall strength of these investment instruments is an important marker of the United

[1] Accessed at http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf.

[2] Several studies are reviewed by the European Federation for Investment Law and Arbitration (EFILA). EFILA, "A response to the criticism against ISDS" at 38-41 (17 May 2015) (EFILA Response), accessed at http://efila.org/wp-content/uploads/2015/05/EFILA_in_response_to_the-criticism_of_ISDS_final_draft.pdf.

States' and EU's embrace of the rule of law and commitment to strong enforcement when governments fail to live up to the most basic standards of non-discrimination, fair treatment and the protection of private property. While many critiques have been made, the facts are very clear. U.S. and EU investment instruments are not a threat to good government or the right to regulate in the public interest; in fact, they promote it and promote growth and jobs as well.

The NAM welcomes efforts that will improve the scope and coverage of investment rules and investor-state dispute settlement (ISDS) enforcement procedures and provides below its assessment of the draft EU investment text. The NAM urges, however, that the Commission reconsider several aspects of its approach in its draft investment text which, if adopted, would represent a major reversal in the EU's embrace of the most fundamental elements of the rule of law and would not form an adequate basis on which to negotiate high-standard and commercially meaningful new investment agreements. Similarly, the NAM urges the U.S. government to reject those items noted below if they are proposed in the TTIP negotiations.

The NAM notes that the recent draft only covers the investment protection and dispute settlement provisions of the investment chapter, while the access provisions were presented previously.[3] These comments will focus only on the investment protection and dispute settlement provisions.

Definitions Specific to Investment Protection

In general, the definitions section provides strong and broad coverage for the types of investment that should be covered in the TTIP investment chapter. The 2012 U.S. Model Bilateral Investment Treaty (Model BIT or model investment text), which serves as the U.S. model text, provides a broader set of definitions that should also be incorporated into a final TTIP, including with respect to "protected information," and "territory" that should also be considered in the final agreement.

Section 2: Investment Protection

Article 2: Investment and Regulatory Measures/Objectives

Paragraph 1 prohibits any provision of the investment protection section from affecting the "right of the Parties to regulate within their territories through measures necessary to achieve legitimate public objectives . . . ." This provision is not necessary nor appropriate to include in an investment text and would be damaging to the protection of investment and rule of law that promotes economic activity and jobs.

[3] The EU Commission presented a chapter on investment and services that contains provisions on national treatment, most-favored nation treatment, senior boards of directors and performance requirements. EU Commission Proposed Chapter on Trade in Services and Investment, and E-Commerce (July 2015), accessed at http://trade.ec.europa.eu/doclib/docs/2015/july/tradoc_153669.pdf.

Investment protections – from national treatment and "fair and equitable treatment" to compensation for expropriation – are all longstanding principles of both domestic U.S. and European legal systems and international law. Such standards, like domestic law, provide limited constraints of governments to protect fundamental rights. In negotiating these investment instruments from their earliest days, EU member states and the United States have long ensured their own right as sovereign states to regulate in the public interest. In no way do these investment instruments undermine a government's legitimate right to regulate in the public interest, including to promote health, environmental, safety and public welfare objectives.

Contrary to the claims of the critics, there has simply been no case, ever, that has found that a government's generally applied, non-discriminatory regulatory measure taken in the public interest has violated the core investment rules, such as fair and equitable treatment. A scholarly review of NAFTA cases concluded that not one single case has undermined a government's legitimate right to regulate in the public interest or chilled regulatory activity.[4]

Also it is important to note that most cases do not actually involve broad-based government legislative or regulatory measures. To the contrary, as the latest report by the United Nations Conference on Trade and Development (UNCTAD) highlighted, "[t]he two types of State conduct most commonly challenged by investors in 2014 were cancellations or alleged violations of contracts and revocations or denials of licenses." This has been the long-term trend of the relatively small number of cases – 608 cases – that have been brought under more than 3,000 international agreements for over 40 years.[5]

This Article 2.1 provision is not only unnecessary, it will have highly negative impacts by nullifying the core protections of the underlying investment text. Under this provision, a Party could claim that it is pursuing "measures necessary to achieve legitimate policy objectives" but is doing so in a discriminatory manner that conflicts with the basic national treatment or most-favored nation treatment obligations or in a manner that expropriates without compensation or violates other core provisions. As the Commission itself recognized in the original consultation, government regulatory action should not be taken in a manner that violates fundamental rights. That too is what the fair and equitable treatment standard and other model investment standards require.

Furthermore, including this standard would mean that U.S and EU investors have lower standard protections in each other's market than other investors from other countries already enjoy through pre-existing investment agreements and would set a highly negative precedent as both the U.S. and EU engage in other investment negotiations.

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[4] *See, e.g.,* Prof. Dr. Christian Tietje & Prof. Dr. Freya Baetens, "The Impact of Investor-State Dispute Settlement in the Transatlantic Trade and Investment Partnership (2014), accessed at http://media.leidenuniv.nl/legacy/the-impact-of-investor-state-dispute-settlement-isds-in-the-ttip.pdf; Gary Sampliner, "Arbitration of Expropriation Cases under U.S. Investment Treaties – A Threat to Democracy or the Dog that Didn't Bark?" **ICSID Review Foreign Law Journal**.

[5] UNCTAD, World Investment Report 2014, accessed at http://unctad.org/en/publicationslibrary/wir2014_en.pdf.

Finally, this provisions sets the wrong precedent as the United States and EU continue investment negotiations with third countries around the globe.

The NAM strongly urges, therefore, that this provision and the related paragraphs dependent on this provision be eliminated from the text and not be included in the final TTIP.

Article 2(4) would also exclude the discontinuation of EU state aid from any ISDS claim. This blanket exclusion is not appropriate as such cases should be viewed on a case-by-case basis.

Article 3: Treatment of Investors and of Covered Investments

The requirement to provide "fair and equitable treatment" to investors and investment is regarded as "the most common general absolute standard of treatment in the BITs"[6] and it has long been noted that "[n]early all recent BITs require that investments and investors covered under the treaty receive 'fair and equitable treatment.'"[7] For manufacturers, this provision is among our highest priorities.

Article 3 of the draft EU investment text provides the basic obligation that government provide "fair and equitable treatment and full protection and security" to each other's investors that is included in thousands of international instruments. The draft EU investment text includes a strong list of ways that a Party could breach the FET standard, which provides a somewhat representative list of ways that investors have been treated contrary to this standard. The NAM seeks a more open-ended approach, rather than a non-exhaustive list, to ensure that new and unexpected forms of mistreatment are not mistakenly allowed to proceed without review. Furthermore language focuses on the most egregious actions such as a "*fundamental* breach of due process," "*fundamental* transparency," "*manifest* arbitrariness," and "targeted decimation." The terms "fundamental," "manifest" and "targeted" are unnecessary and should be removed from the final language. The language contained in Article 3.4 also includes a provision dealing with the expectations an investor may have relied upon in making an investment. It is our view that this is evidence that the reviewing panel must review rather than just "should" and this provisions should be revised accordingly. The provisions of paragraph three, which appear to allow for the revision of the list, should not be used, however, to eliminate items from this list which are all examples of violations of this core standard.

Article 3 of the draft EU investment text also provides another important protection to ensure that governments accord "full protection and security" to foreign investors and investment. The NAM welcomes this provision, but urges that the EU eliminate the restriction that it be limited to "physical" security. Given increasing cyber theft and other

[6] Kenneth J. Vandevelde, **Bilateral Investment Treaties: History, Policy, and Interpretation** (2010) at Sec. 5.2.
[7] Rudolf Dolzer & Margrete Stevens, **Bilateral Investment Treaties** 58 (1995).

activities that may not be classified as purely physical, it is important that manufacturers have a commitment to be protected from these harms as well.

Nevertheless, the NAM is very concerned by the apparent attempt to limit these protections further in Article 3.1 by appearing to require that they be consistent with Article 2 (right to regulate). For the same reasons as discussed above, that linkage should be eliminated from any final TTIP as should Article 2.1 and its related provisions.

Article 4: Compensation for Losses

International investment treaties and agreements typically provide provisions requiring governments to treat foreign investors and investment in a non-discriminatory manner when it comes to broader conflicts in a country. In general, the draft EU provision on this issue comports with the high standards of protection sought by manufacturers in the United States.

Article 5: Expropriation and Annex I

The expropriation provisions are among the most important in the investment rules to ensure that foreign governments cannot expropriate (directly or indirectly) investments without compensation. Expropriation provisions are included in thousands of BITs worldwide and have been included in all of the U.S. and EU member state instruments for decades.

The main expropriation provisions contained in Article 5 of the draft EU investment text generally represent the standards of compensation for expropriation required by investors, except in the following areas, which the NAM would urge to be eliminated:

- Article 5.5, raises uncertainty whether enforcement of this provision would be limited to domestic courts rather than ISDS. That uncertainly should be eliminated.
- The second sentence of Article 5.7 indicates that a determination that measures are inconsistent with the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) “does not establish that there has been an expropriation.” This language is not necessary as there are several requirements to show an expropriation in the case of a taking of intellectual property rights. Including this sentence is, however, harmful by creating ambiguity as to protection of intellectual property rights under the expropriation provisions. The NAM, therefore, urges this sentence not be included in the TTIP investment chapter.

The NAM is also concerned by language in Annex I that could limit inappropriately disciplines on indirect expropriation by failing to include key factors to be considered as to whether an action is an indirect expropriation, including the extent to which the government action interferes with reasonable investment-backed expectations and the character of the government action. These factors, which are part of U.S. jurisprudence

on takings, are important to ensure a full review of the government's action and are currently included in the U.S. model investment text. As discussed in regard to the fair and equitable treatment standard, the use of the word "manifestly" is not an appropriate limitation as it focuses only on the most egregious cases.

Annex II covers the restructuring of public debt. While the type of restructuring covered by this annex is limited, such a blanket exclusion from investment obligations is not appropriate given a country could continue to discriminate or otherwise act contrary to the substantive obligations in those circumstances as well.

Article 6: Transfers

Strong free-transfers provisions are also vital to ensure that investors can invest in the first place and repatriate monies back to their home countries. For manufacturers, these provisions are of particular importance given the substantial capital investment that is required in the manufacturing sector. Free-transfer provisions are included in most of the world's BITs and are important not only for the investor and the investor's home country, but also to promote investment and investor confidence.

It should be noted that U.S. investment chapters already contain a robust exception (from the transfers article and all other obligations) that permits governments to take appropriate action for prudential reasons, including to ensure the stability of the financial system. The use of capital controls have been found to be harmful to the country imposing the controls by weakening investor confidence, lowering investment flows and artificially reducing pressure for countries to make other needed economic reforms. Several studies have also found that the use of capital controls by developing countries tends to hurt the poorest and least politically connected in those countries.

The current transfers provisions in the draft EU investment text appear to provide protections and rules comparable to the U.S. investment model. The NAM is concerned, however, by the EU's indication that other provisions will be added, which will require additional review and potential exceptions. The NAM will provide input on such provisions when they are made available.

Article 7: Observance of Written Commitments

Investment is oftentimes undertaken through a foreign investor contracting with a foreign government, where that contract provides assurances and expectations that are a prerequisite to the investment of millions or billions of dollars. Manufacturers view, therefore, provisions to ensure that foreign governments not breach such agreements as particularly important to be included in investment rules, subject to the investor-state enforcement mechanism.

Article 7 of the draft EU investment text provides an obligation for the government or an entity acting on its behalf not to breach contracts between an investor and the government. Manufacturers support the breadth of coverage of government obligations

envisioned by this provision, which covers “any contractual written commitment.” Yet, it is not entirely clear what the requirement “through the exercise of government authority means” in the second part of this provisions that describes the breach. From the perspective of manufacturers, any type of breach of a contractual commitment by a government or a covered state-owned entity should be prohibited by the investment rules. This provision should, therefore, be clarified and strengthened in the final TTIP.

Section 3: Resolution of Investment Disputes and Investment Court System

Manufacturers also view neutral, objective investor-state dispute settlement (ISDS) as a vital part of any investment agreement, including the TTIP with respect to all sectors. The ISDS enforcement mechanism ensures that disputes are not politicized and provides investors the ability to seek redress for violations of the basic investment protections and access provisions and breaches of investment contracts between the host government and the investor. Binding ISDS provisions also help promote discussions between the investor and government that oftentimes lead to a resolution of potential arbitration disputes before any complaint is ever filed. ISDS mechanisms are included in most of the world’s over 3,000 investment agreements, including EU member state agreements and the Energy Charter Treaty.

The draft EU investment text proposes a wholesale change in the ISDS model, essentially proposing the elimination of arbitration and a neutral referee, replacing it with the establishment of a court-like procedure. As the NAM explained in previous submissions, there is no justification for any of these changes. There are, in fact, no identified actual problems with the nature of the panelists or the operation of ISDS panels in a neutral and legitimate manner. Consider that:

- ISDS panels are already governed by a robust set of rules designed to safeguard against conflicts of interest, both actual and perceived. Those rules, established by the World Bank International Centre for Settlement of International Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL), or other arbitration fora, provide clear mechanisms to safeguard against conflicts of interest, including comprehensive disclosures by persons nominated to serve on arbitral tribunals, opportunities to challenge and remove arbitrators at the outset or during an arbitration and even an opportunity to challenge the final award as defective due to an undisclosed conflict on the part of an arbitrator.[8]

[8] Article 14 (1) of the ICSID Convention (Conv.) requires that “[p]ersons designated to serve on Panels shall be persons of high moral character . . . who may be relied upon to exercise independent judgment.” ICSID Arbitration Rule (AR) 6 requires an arbitrator to sign a declaration and make full disclosure of any “circumstance that might cause [his] reliability for independent judgment to be questioned by a party.” ICSID Conv. Art. 57 and AR 9 provide for disqualification of an arbitrator on a party’s motion. Similarly, Art. 11 of the UNCITRAL Rules requires an arbitrator candidate to “disclose any circumstances likely to give rise to justifiable doubts as to his or her impartiality or independence.” Art. 12 provides for a challenge to an arbitrator “if circumstances exist that give rise to justifiable doubts as to the arbitrator’s impartiality or independence.” ISDS tribunals also tend to follow the International Bar Association Guidelines on Conflicts of Interest in International Arbitration. Where there is a conflict of interest that

- Claims that the system is somehow rigged in favor of investors are contradicted by the evidence of the operation of these panels, including the following:

    - States win much more often than investors. UNCTAD stated in its annual World Investment Report of 2014 that of the 274 total concluded cases under ISDS ever, "approximately 43% of cases were decided in favour of the State, 31% in favour of the investor and 27% were settled" and in cases reaching the final merits, 53 percent of cases were decided for governments.[9]
    - Awards are much smaller than the amounts claimants seek;
    - Dissents, even from State-appointed arbitrators, are extremely rare; and
    - The European Federation for Investment Law and Arbitration (EFILA) included a full-scale analysis of this issue and found that this criticism lacks any evidentiary basis.[10]

- Claims that the system produces divergent results from different tribunals requires a brand new appeals mechanisms ignores the variety of different treaties and fact situations that tribunals consider and the fact that ICSID already provides for review of tribunal decisions through its annulment process. According to the EFILA analysis, there is a generally "high degree of consistency amongst tribunal decisions."[11]

- Claims that ISDS somehow bypasses domestic courts ignores that ISDS is not a review of a domestic law or judicial system, but rather whether a country is in compliance with an international agreement. A country's compliance with its international obligations in the context of trade and investment issues is simply not an issue that can adjudicated in domestic courts in the U.S. or in many other countries as well. Given that ISDS panels can order no change in any law or regulation, there is simply no basis to claim this the system bypasses domestic rules.

For these reasons, the NAM sees no basis for the wholesale changes in procedures envisioned by the draft EU investment text. Not only are these changes not needed, they will be damaging to investment flows, investment rules and add unnecessary costs to the system to the detriment particularly of the smallest investors. Furthermore, these changes, if adopted, would set the wrong precedent with third countries with which the United States and EU are negotiating investment agreements. Identified below are provisions in this new proposal that are of the most significant concern by manufacturers in the U.S.:

Article 1: Scope and Definitions

goes uncorrected during the course of an arbitration, an award can be challenged under an ICSID annulment proceeding (ICSID Conv. 52) or set aside (New York Convention, Article V).

[9] UNCTAD, World Investment Report 2014, supra note 5.
[10] EFILA Response, supra note 2 at 4-12.
[11] Id at 13.

The draft EU investment text appears not yet to be final on the scope of commitments that will be subject to dispute settlement, but suggests it will be far more limited than the model U.S. investment text. From the NAM's perspective, it is important that all of the following protections are subject to full investment dispute settlement by an investor and state-to-state dispute settlement to provide the type of high-standard and comprehensive outcome on this issue that will set a strong precedent for all future agreements.

- National treatment, both pre- and post-establishment for all investments;
- Most-favored nation treatment, both pre- and post-establishment;
- Fair and equitable treatment and full protection and security;
- Compensation for losses;
- Expropriation;
- Transfers;
- Observance of written commitments;
- Performance requirements; and
- Senior management and boards of directors.

Article 9: Tribunal of First Instance

Article 9 of the draft EU investment text proposes the creation of a new court for the adjudication of investment disputes brought by a foreign investor from the U.S. or EU against the other government. There would be a total of 15 judges, five that are nationals of the United States, five that are nationals of an EU member state and five that are nationals of third countries. Judges would be appointed for six years by a U.S. and EU committee and are required to possess qualifications to serve in judicial office and demonstrated expertise in international law. International investment expertise is only identified as a desirable but not mandatory trait. Judges would be paid on retainer to be shared equally by the two Parties and the amount of other fees and expenses would be determined by the arbitration facility, which could be later transformed into a regular salary. ICSID shall act as the Secretariat to the Tribunal and its expenses shall be split by the two Parties.

The proposed new tribunals are not only unnecessary, they will create new limitations and add complexity and costs to proceedings that will undermine, rather than enhance the credibility and neutrality of investment dispute settlement. In particular:

- This system of judges will eliminate the neutral referee function of the existing arbitration system. Under the current arbitration system, the government and the investor each choose an arbitrator and those two arbitrators choose the third. This system provides a neutral referee, limiting both pro-government and pro-investor bias as much as possible. If governments were permitted to choose all of the eligible judges, as the EU proposal would require, it would eliminate investor input from the process and impair its impartiality to provide a neutral referee for the review of investment disputes. In essence, the EU proposal

essentially seeks to eliminate the arbitration model that has long well served the United States and EU member states.

- Identifying and choosing judges and members with judicial but no international investment expertise will limit substantially potential experts that are best able to handle complex cases. Indeed, limiting the qualifications to judicial experience is an inappropriately narrow restriction that would undermine the ability to have any actual international investment experts at all. Even more restrictive is the draft code of conduct annexed to the proposal that is likely to limit substantially the participation of anyone with international investment expertise at all. Indeed, there is a real question whether any current academic, lawyer, or arbitrator with any significant engagement in international legal or business affairs could ever satisfy the requirements of this code. The potential failure to include anyone with international investment expertise as part of the tribunal will negate the purpose of this proposal to produce quality decisions and jurisprudence to the detriment of the investment rules system and manufacturers in the U.S. and in Europe.
- Appointing judges and members for six years, especially those that are unlikely to have any or significant investment expertise, provides much less flexibility than the current arbitration system and could lead to decisions that are more problematic for the system.
- The new system is expected to create greater complexity and potentially costs for private-sector investors, with a particularly negative impact on the small- and medium-sized businesses that are the most frequent users of the ISDS mechanism.
- This system would likely limit the ability of investors to seek worldwide enforcement of awards. Decisions of the court or appeals tribunal would not quality as awards under the ICSID Convention (which is only limited to ICSID awards) and are unlikely to be considered “awards” under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the "New York Arbitration Convention.” It could take years, if not decades, to seek, let alone implement a new multilateral treaty with a reach as broad as the New York Arbitration Convention or ICSID to agree quickly on the enforcement of this new court’s judgments.

In making this proposal, the EU is also basically seeking to terminate the arbitration system, one that despite some loud claims to the contrary, has served the U.S., EU and many other nations well. It will undo the ability of the parties to choose arbitrators with actual expertise and will undermine the perception of neutrality that has governed this system for over 40 years. The NAM strongly urges that this approach not be included in the final TTIP and that the strong transparent process developed in the model U.S. investment text is used instead.

Article 10: Appeals Tribunal

Article 10 of the draft EU investment text would set up an Appeals Tribunal made up of six members, with similar nationality splits and payment terms as the Tribunal of First Instance, and also with six year terms.

Over the past decades, there has been increasing discussion of the potential development of an appellate or appeals mechanism for ISDS cases. Given the over 3,000 treaties, with differing terms, there is less than a clear consensus on whether such an approach would in fact create greater consistency in rulings by ISDS panels. Indeed, allegations of inconsistency are rare.

Notably, ICSID already has an annulment mechanism providing for appeals of ISDS decisions on specified grounds which are somewhat similar to what is proposed in Article 10.

From the NAM perspective, an appeals mechanism as proposed by the EU is simply not needed as the ICSID process already provides a comparable mechanism where needed. Furthermore, the creation of such a mechanism will add costs to the Parties and substantial delay to the resolution of disputes. Again, this is a change that will undermine, rather than enhance, the ability of small businesses to use this system. The NAM urges that no appeals mechanism be included in the final TTIP agreement.

Article 28 – Provisional Award

Article 28(4) would impose costs of the successful party to the losing party with some adjustments possible. This provision is both unnecessary and harmful. Arbitration panels already have the ability to award the payment of legal fees when justified, such as when a claim is considered frivolous. Such a “loser pays” rule is also impracticable as in many cases there is no clear “winner” as evidenced by the large number of cases that are settled prior to a ruling and where there are claims that one party wins and the other loses. This provision would have a disproportionately negative impact on small businesses seeking remedies for unfair government action, contrary to the objectives of ISDS by both the United States and the EU. The NAM urges that this provision not be included in the final TTIP agreement.

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The draft EU investment text proposes many major changes to the ISDS system that would damage the ability of investment rules to promote a strong rules-based system that provides an objective and neutral dispute settlement system that is important to spur and support high-quality investment and the jobs that such investment promotes. As such, it will undermine not only the ability of the TTIP investment rules to advance the U.S.-EU investment relationship and the economic growth both parties hope to catalyze, but it will send a strong negative signal to the third countries with which the U.S. and EU are negotiating as to the level of protections sought and the need for enforcement rules that emphasize neutrality and access by small businesses.

The NAM appreciates the opportunity to provide these comments and looks forward to working with both the U.S. government and the EU to advance a modern, transparent and strong investment chapter in the final TTIP agreement.