

INTERNATIONAL INVESTMENT DISPUTE SETTLEMENT
FROM AD HOC ARBITRATION TO A PERMANENT COURT

No. 95, April 2015

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Foreword

Many countries have concluded agreements with other countries to protect their mutual foreign investments. These treaties offer protection to foreign investors from unwarranted interference by the government of the country in which they are investing. Almost always the agreements contain provisions on how disputes between states and foreign investors can be resolved. Usually, international arbitration is one of the possibilities.

The settlement of disputes between investors and states through international arbitration (known as investor-state dispute settlement (ISDS)) has functioned well in various ways. Nonetheless, the present ISDS system has given rise to concerns and justified criticism. This is currently a matter of debate worldwide. The negotiations about the Transatlantic Trade and Investment Partnership (TTIP) have fuelled public debate about ISDS in the Netherlands and elsewhere. These concerns and the identified failings of the system have led some countries to terminate their investment protection agreements (IPAs) and others to try to improve ISDS. At the same time, the business community regards ISDS as a necessary tool for effective investment protection.

As noted above, the discussion is also taking place in the Netherlands. Following debates in the House of Representatives, the Minister for Foreign Trade and Development Cooperation commissioned a study by researchers Tietje and Baetens. In a letter to the House of Representatives of 25 June 2014 the Minister responded to some of their suggestions for mitigating the risks of ISDS.¹ The business sector, the trade unions, civil society and the media have also entered the debate.

No one disputes that foreign investments deserve protection. However, questions arise about whether the conditions of ISDS meet the rule-of-law requirements and whether the possibility of ISDS proceedings can make states reluctant to exercise their right to regulate out of fear of receiving large claims for damages from investors. Together these developments show that there is every reason to reconsider the way in which this form of dispute settlement is structured and that there is momentum for change.

In view of the global and public debates about ISDS, the AIV decided in its meeting of 7 November 2014 to prepare an advisory letter on international arbitration in disputes between investors and states from a rule-of-law perspective. The AIV hopes that this letter will contribute to the political and public debate on ISDS.

On 7 November 2014 the AIV established a combined committee chaired by Professor B.E.P. Myjer to prepare this advisory letter. The other members were Professor M.T. Kamminga (Human Rights Committee), Professor J.B. Opschoor (Development Cooperation Committee), W.L.E. Quaedvlieg (European Integration Committee), C.G. Trojan (European Integration Committee) and Ms H.M. Verrijn Stuart (Human Rights Committee). The executive secretary was J. Smallenbroek. The combined committee was also assisted by Ms L. Warnier and Ms E. Smit (trainees). Ms S.A. Blank (Ministry of Foreign Affairs) acted as civil service liaison officer of the combined committee.

1 House of Representatives of the States General 21501-02 no. 1397.

The combined committee owes a debt of gratitude to the experts whom it consulted while preparing this letter: Professor A.J. van den Berg (arbitrator and partner in Hanotiau & van den Berg), Mr H.H. Siblesz (Secretary-General of the Permanent Court of Arbitration) and Mr B.W. Daly (Deputy Secretary-General of the Permanent Court of Arbitration).

The combined committee has experienced at first hand how TTIP and ISDS have suddenly become a subject of almost constant interest to politicians, civil society and the media. Not only were there many new publications during the period in which this advisory letter was being prepared, but additional positions were explored or adopted at both European level and by the Dutch Minister for Foreign Trade and Development Cooperation.² A plan published by the Minister and her counterparts from Denmark, France, Germany, Luxembourg and Sweden states, among other things, that governments have and retain the right to regulate and that the quality and independence of arbitrators must meet high standards. In addition, they advocate the establishment of a permanent secretariat for dispute settlement.³ As a result, the combined committee has not formulated new ideas on a number of points and has instead confined itself to commenting on these additional positions.

The AIV adopted this advisory letter at its meeting of 10 April 2015.

2 House of Representatives of the States General 21501-02 no. 1481.

3 See annexe to letter to the House of Representatives of the States General 21501-02 no. 1465.

I Introduction

The history of investment protection can be divided into various stages. Before 1959 there were no specific investment protection agreements (IPAs). The first IPA was concluded in 1959. Since the late 1960s provisions for international arbitration for the settlement of disputes between investors and states have been included in IPAs. Gradually, more and more use has been made of ISDS. Now the main question is what changes are needed to the investment protection system. In this advisory letter ISDS means only dispute settlement through international arbitration, not through domestic courts.

History

As long ago as the 17th century, states concluded Treaties of Friendship, Commerce and Navigation to regulate their mutual economic relationships in the broad sense. In the 19th and early 20th centuries, views differed on the standard for protection of foreign investments. Western countries considered that international law entailed a minimum standard, which they believed all states should apply, even if it afforded greater protection than domestic law. However, Latin American countries adhered to the Calvo doctrine, which stated that aliens and their property were subject to the law of the country in which they were present and that the protection provided should be equal to the protection given to citizens of that state. This doctrine excluded foreign intervention and international arbitration.

The first IPA was concluded between Germany and Pakistan in 1959. Subsequently, the number of IPAs increased rapidly, especially after the disintegration of the Soviet Union and the economic transition in East European countries. In due course, more and more Latin American countries were also prepared to conclude IPAs.

The first IPAs contained no provisions on the settlement of disputes between states and investors. At that time, foreign investors could submit a dispute to a court in the host state or hope that their own government would be prepared to defend their interests by diplomatic means. International arbitration for disputes between investors and states is a relatively new phenomenon. The obligation to exhaust local remedies before resorting to ISDS fell into disuse. ISDS was increasingly used in parallel with actions before local courts. Kuijper gives three reasons for the emergence of ISDS.⁴ First, investors were dependent on the willingness of their home state to defend their interests against another state. However, as home states did not stand up for all their investors, this resulted in arbitrariness. Second, Western governments and investors considered that courts in capital-importing states were insufficiently independent and lacked the necessary expertise and that proceedings were too expensive. Third, direct access to ISDS would make proceedings faster and more efficient. Since the 1990s, ISDS has been a largely standard part of all IPAs.⁵

4 P.J. Kuijper, *Study on Investment Protection Agreements as Instruments of International Economic Law*. In: *Investor-state Dispute Settlement (ISDS), Provisions in the EU's International Investment Agreements*, volume 2, Policy Department DG External Policies, September 2014, p. 23.

5 S. Hindelang, *Study on Investor-State Dispute Settlement (ISDS) and Alternatives of Dispute Resolution in International Investment Law*. In: *Investor-state Dispute Settlement (ISDS), Provisions in the EU's International Investment Agreements*, volume 2, Policy Department DG External Policies, September 2014, p. 48, particularly footnote 29.

These agreements provide benefits not only for investors but also for states. Investors can count on better protection. For states an IPA is a feature of a favourable investment climate which enables them to attract foreign investment. This helps to boost economic growth and employment.

In 1965 the emerging system of IPAs was supplemented by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Washington Convention), which created the first multilateral framework for settling disputes between investors and states. This Convention, which established the International Centre for Settlement of Investment Disputes (ICSID), entered into force on 14 October 1966. Subsequently, in 1976, the United Nations Commission on International Trade Law (UNCITRAL) too adopted rules for international commercial arbitration, which were later also applied to disputes between states and investors.

ISDS is therefore a relatively young phenomenon and has been used intensively only in the last few decades. The first case was registered with ICSID in 1972, and until the turn of the century the number of new cases each year could be counted on the fingers of one hand.⁶ The number of disputes between investors and states settled through international arbitration is on the increase. Now there are a few dozen new cases each year. This increase is probably attributable to the worldwide increase in direct foreign investment and the growth in the number of IPAs. As international arbitration law is therefore still very much in the development stage, some issues have not yet crystallised.

Investment protection can be regulated in various types of treaties. Some free trade agreements also regulate investment protection. And while some IPAs regulate both investment protection and market access, others only provide for the protection of investments. The abbreviation IPA is used below for all types of agreement that provide for investment protection.

Development of momentum for change

As ISDS has been used more frequently, the system's shortcomings have become apparent. The criticism of ISDS comes from various quarters – from academics, practising lawyers (who have experience of the system as either attorney or arbitrator), non-governmental organisations and interest groups. The criticism focuses mainly on rule-of-law aspects. Critics also point to the risk that states may become reluctant to implement policy for fear of being confronted with large financial claims from investors. The main rule-of-law issues concern the consistency of arbitral awards, the independence and impartiality of arbitrators and the transparency of international arbitration, all of which have a bearing on the legitimacy of ISDS. Although no decisions have yet been given in the cases of *Vattenfall v. Germany* and *Philip Morris v. Australia*, these arbitrations have led to a growing fear among some parts of civil society in Western countries that investors may claim substantial damages in response to democratic decisions taken in the public interest.

Some countries have drawn political conclusions from their objections by withdrawing from ISDS. Bolivia, Ecuador and Venezuela have formally denounced the Washington Convention (Bolivia in 2007, Ecuador in 2009 and Venezuela in 2012). Venezuela also abrogated its IPA with the Netherlands with effect from 1 November 2008. Over a

6 World Investment Report 2014, *Investing in the SDGs: an Action Plan*, p. 124.

period of years Australia concluded IPAs that made no provision for ISDS, as the then government did not wish to accept provisions that might limit its right to regulate, for example in the social and economic fields.⁷ However, the present Australian government does not exclude international arbitration as an element of IPAs. Indonesia has not renewed its IPAs with various countries, including the Netherlands, as of 1 July 2015, but intends to start negotiations on modernising its bilateral IPAs. The Netherlands, Spain, Germany and Switzerland are among the countries with which South Africa has not renewed its IPAs. In most of the cases mentioned here, the reason given by the states concerned is that ISDS is undesirable and unnecessary and that disputes between states and investors must be resolved through domestic courts.

Other countries too are starting to wonder whether ISDS is desirable and necessary. A few decades ago, IPAs were concluded between capital-exporting Western countries with a well-developed legal system on the one hand and capital-importing developing countries with a weak legal system on the other. At that time, there was no debate about ISDS in Western countries because the need for it seemed obvious. Nowadays, however, Western countries are also concluding IPAs with one another. Critics assert that in these relationships ISDS would be a superfluous tool because the states concerned have well-functioning legal systems. They also argue that ISDS would provide a form of legal redress for foreign investors which is not available to national investors.

Since the entry into force of the North American Free Trade Agreement (NAFTA) in 1994, more and more voices, in the United States too, are calling for changes to ISDS.⁸ For example, under the Trade Act 2002, which has now come into force, the government is set the target of negotiating the establishment of an appellate body for ISDS and is authorised to be transparent about all disputes between investors and the US administration. A public debate has arisen on whether ISDS poses a threat to the discretionary powers of government to set policy. *Public Citizen* argues, for example, that 'ISDS provisions elevate individual foreign corporations and investors to the same status as sovereign governments, empowering them to privately enforce a public treaty by skirting domestic courts and directly "suing" signatory governments for compensation', for example over health and environmental safeguards which 'the foreign firms believe undermine their investor rights'.⁹

In the European Union (EU) the public and political debate about ISDS has been prompted, above all, by the negotiations between the EU and the United States on the Trans-Atlantic Trade and Investment Partnership (TTIP), a wide-ranging economic agreement which is intended, among other things, to harmonise legislation, minimise trade tariffs and protect investments. ISDS will probably form part of that agreement. The EU has recently concluded free trade agreements with Singapore (the EU-Singapore Free Trade Agreement) and Canada (the Comprehensive Economic and Trade Agreement / CETA), both of which

7 Gillard Government Trade Policy Statement: *Trading our way to more jobs and prosperity*, April 2011, p. 14.

8 G.A. Alvarez and W.W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 *Yale Journal of International Law* 365 (2003). See: <http://www.law.yale.edu/documents/pdf/sela/Chapter_IV-D-2_Investment_Arbitration.pdf>.

9 *Public Citizen, Myths and Omissions: Unpacking Obama Administration Defenses of Investor-State Corporate Privileges*, October 2014, p. 2. See: <<http://www.citizen.org/documents/ISDS-and-TAFTA.pdf>>. Consulted on 30 March 2015.

contain provisions on ISDS. Neither of these agreements has yet been ratified. As a result of the public debate on TTIP, particularly ISDS, the European Commission decided to hold an online public consultation in 2014, which produced around 150,000 replies. A report on the consultation was published in January 2015.¹⁰ The EU will continue the consultations.

The debate on ISDS within the EU is also important for another reason. Since the Treaty of Lisbon entered into force, foreign direct investment has been a competence of the Union and no longer of the member states (article 207 of the Treaty on the Functioning of the European Union). This means, for example, that in the long term a European IPA with third countries will replace the bilateral IPAs of the member states. Existing IPAs between a member state and a third country will, in principle, remain in force until an IPA between the Union and the same third country enters into force. As the EU has this new competence, it is now searching for a modern model for settling disputes between investors and states that takes account of new experiences and ideas. The EU's public consultation on ISDS as part of TTIP will contribute to this.

The European Commissioner for Trade, Cecilia Malmström, stated in a speech to the European Parliament on 18 March 2015 that the EU is aiming to incorporate ISDS into TTIP in the same manner as in the CETA text, with a few additions. She suggested that the freedom of states to pursue public policy objectives could be better protected, that the choice of arbitrators should be limited to a list of highly qualified lawyers, that provision should be made in TTIP for an appellate body, and that investors should be compelled to choose between domestic courts and ISDS from the outset. She also informed the European Parliament that her staff were investigating the possibility of setting up a multilateral permanent investment court.¹¹

In the Netherlands too, TTIP has prompted political and public debate on international arbitration for the settlement of disputes between investors and states. For example, the House of Representatives of the States General has passed a motion¹² by a large majority calling on the Minister for Foreign Trade and Development Cooperation to commission research into the potential social and environmental risks and the consequences of ISDS for the Netherlands and into the financial risks for the Dutch state. In June 2014 the same Minister sent a report to the House of Representatives¹³ that had been prepared by researchers Tietje and Baetens. In her letter submitting the report to the House, the Minister (Lilianne Ploumen) formulated various ideas on how ISDS could be modernised. In February 2015 the Minister stated, among other things, that she was in favour of a permanent court for the settlement of disputes between states and investors.¹⁴

10 See: <http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf>.

11 See: <http://europa.eu/rapid/press-release_SPEECH-15-4624_en.htm>. Consulted on 30 March 2015.

12 House of Representatives of the States General, 33750-XVII, no. 42.

13 House of Representatives of the States General, 21501-02, no. 1397.

14 House of Representatives of the States General, 21501-02, no. 1465.

The Platform of Authentic Journalism, the Transnational Institute (TNI) and the Centre for Research on Multinational Corporations (SOMO) state in a document that ISDS has many failings.¹⁵ For example, under ISDS foreign investors have the right to sue states if the corporate interests of a business are adversely affected by government policy. The document argues that ad hoc tribunals of commercial lawyers may then assess such claims without heeding the public interest and award damages which could run into many hundreds of millions of euros.

The European Trade Union Confederation stated in a discussion with European Commissioner Malmström that in view of the substantial investments by both sides, new procedures for ISDS in TTIP were unnecessary.¹⁶ The Dutch Trade Union Confederation (FNV) fears that ISDS will undermine the laws and regulations that protect employees. If profits were threatened by rules and regulations, companies might use ISDS as a way of pressuring governments into repealing or modifying them.¹⁷

The debate about ISDS has been in progress among academics, practising lawyers and policymakers for much longer.¹⁸ This is apparent from the many documents that can be found on the websites of the United Nations Conference on Trade and Development (UNCTAD) and the Organisation for Economic Cooperation and Development (OECD). These provide ideas for improving ISDS. In recent years this debate has already resulted in substantial changes to IPAs. One example is the US model bilateral investment treaty. Another is the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada: this draft agreement contains many more provisions on investment protection and ISDS than older IPAs. Moreover, most of the terms are more clearly defined. Likewise, the freedom of states to set policy is better protected in CETA than in older IPAs. Negotiations on this agreement have been under way since 2009. The negotiations on the text have now been concluded and the text is currently undergoing what is termed a 'legal scrubbing', which still provides scope for incorporating technical improvements.

Investments and ISDS: the Dutch interest

Dispute settlement between states and investors has a special significance for the Netherlands. This is because the Netherlands is among the world's top 20 sources and recipients of foreign direct investment (FDI). According to UNCTAD data, the Netherlands ranked ninth in terms of FDI outflows in 2013 with a figure of USD 37 billion. It is also one of the largest recipients of FDI, ranking sixteenth in 2013 with inflows of USD 24 billion.¹⁹ The Netherlands has concluded a large number of IPAs (about 90) with other countries. Claims against states which are settled through international arbitration are

15 Platform of Authentic Journalism, TNI and SOMO, *Feiten of fabels, 7 claims over TTIP* (Fact or Fable: 7 Claims about TTIP), June 2014, <http://somo.nl/publications-nl/Publication_4085-nl>, pp. 22-26.

16 See: <<http://www.etuc.org/press/level-trans-atlantic-investment-shows-isds-not-necessary>>.

17 See: <http://www.fnv.nl/site/nieuws/webassistent/l.vermeulen/meer_beroeepsziekten_door_handelsverdrag_ttip/ttip_de_snelweg_naar_slechtere_arbeidsomstandigheden_in_europa.pdf>.

18 See, for example, M. Waibel (ed.), *The Backlash against Investment Arbitration: Perceptions and Reality*, Kluwer Law International, Alphen aan den Rijn, 2008.

19 World Investment Report 2014, *Investing in the SDGs: an Action Plan*, p. xv.

submitted relatively frequently by Dutch investors, partly because the Netherlands is the seat of the head offices of a fairly large number of multinationals. However, the Netherlands has not yet had to defend itself against a claim of an investor before an international arbitral tribunal.

Structure of this advisory letter

Almost all IPAs offer foreign investors the possibility of settling disputes with host countries through international arbitration. How the international ISDS system works is explained in chapter II. This includes discussion of the substantive standards, procedures and fora. Chapter II also examines the relationship with arbitration at the national level. Statistical data are presented at the end of the chapter.

Chapter III discusses the main concerns about and criticisms of ISDS expressed in the international debate from the rule-of-law perspective. The solutions put forward in the literature are also considered in relation to each topic. Furthermore, the establishment of an international investment court is discussed as a possible alternative to ISDS in the longer term.

Chapter IV contains the summary, conclusions and recommendations.

This advisory letter does not systematically compare the settlement of disputes about foreign investments by domestic courts with ISDS. Its main aim is to contribute to the debate on how the ISDS system can be improved. As TTIP is one of the factors which led to the preparation of this letter, ISDS is considered at various places in the context of TTIP and the investment relationship between the United States and the EU.

II The ISDS international system

International law distinguishes between two types of international dispute settlement: diplomatic (such as negotiation or mediation) and legal (arbitration and litigation). Legal forms of dispute settlement lead to a judgment binding on the parties. Arbitration differs from litigation by virtue of its ad hoc nature and because the parties themselves appoint the arbitrators and may themselves to some extent decide on the procedure to be followed. Arbitration is therefore seen as a form of ‘party-led’ judicial proceedings.

ISDS differs from commercial arbitration in that it relates to disputes between investors and states, not between private parties. As a result, ISDS arbitration is of a special and sensitive nature.

II.1 Substantive law

The worldwide legal framework for protecting investments from unjustified government action is highly fragmented. There is no multilateral treaty setting down substantive criteria for the protection of investments. Although the OECD decided in 1995 to formulate a Multilateral Agreement on Investment, the negotiations ultimately failed to produce a multilateral agreement on investment protection. The IPAs are the main source of international arbitration law. There are more than three thousand bilateral IPAs, as well as some regional IPAs such as the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the United States, and the Comprehensive Investment Agreement of the Association of Southeast Asian Nations. The Energy Charter Treaty (ECT) also protects investments.

Although the substantive provisions of IPAs are very similar in broad outline, they do differ in some ways. Such agreements consist of three core elements: the duty to provide fair and equitable treatment, the prohibition of discrimination between foreign and national investors and/or investors from third countries and the imposition of conditions for expropriation. The prohibition of discrimination is intended to create a level playing field for all investors. In addition, an IPA offers reciprocal legal protection for investors. IPAs differ in the extent to which they provide for ISDS (e.g. by how they define the terms investment and investor) and other proceedings and in the consequences of breaches of the agreement.

IPAs do not usually specify any particular standard of investment protection, but instead refer to the criteria of domestic law and/or international law. An IPA usually mentions at least one of the three following concepts as a criterion for investment protection: national treatment, most-favoured-nation treatment (MFN) and/or fair and equitable treatment (FET). IPAs also provide that expropriation is permitted under certain conditions. International law does not prohibit the expropriation of foreign investments. A state may expropriate foreign property provided that this is done in the public interest, in a non-discriminatory manner, under due process of law and provided that compensation is paid. Expropriation may be carried out by transfer of title (i.e. ownership) or outright physical seizure of the property. Indirect expropriation may occur where a state takes measures that deprive an owner of the ability to manage or use his investment to such an extent that its economic value is permanently almost completely

destroyed.²⁰ This is explained in more detail in section III.1.

National treatment means that foreign investors have to be treated the same as national investors and may not be discriminated against. National treatment does not imply that the domestic courts have jurisdiction; this depends on other factors. It is a comparative standard: the standard treatment depends on how a national investor is treated in a comparable case. National treatment may provide insufficient protection by international standards, for example where domestic law provides wide scope for expropriation without adequate compensation. An example is the expropriation of farms in Zimbabwe.

MFN²¹ obliges states to treat foreign investors at least as well as an investor from the most favourably treated third country. It too is therefore a comparative standard. In this case the standard of treatment depends on how a different foreign investor would be treated in comparable cases. Tribunals differ in how they interpret the scope of this standard.²² Some limit its application to the substantive protection standards, whereas others also take into account IPA proceedings with third countries if this would afford investors greater protection.²³

UNCTAD states that the historical origins of FET can be found in the minimum standard of protection which must be provided to aliens under customary international law. However, FET is mentioned in many IPAs without any reference to international law and has in some cases been treated as an independent standard by arbitral tribunals. Instead of interpreting the term in the light of customary international law, these tribunals have defined its content by reference to its literal meaning. Tribunals sometimes interpret FET as the expectation of an investor that there will be regulatory stability. It follows that the state may not make substantial changes to its policy and legislation that adversely affect the economic value of the investment. Such an interpretation is at odds with the state's right to regulate as it sees fit.

According to UNCTAD, there has in practice been a degree of convergence in the interpretation of FET, regardless of the specific wording of the IPA concerned. Five main concepts are relevant to this interpretation:

- prohibition of arbitrariness;
- rights to due process;
- prohibition of discrimination on manifestly wrongful grounds such as gender, race or religious belief;
- prohibition of corrupt practices;

20 UNCTAD Series on Issues in International Investment Agreements II, *Expropriation*, United Nations, New York and Geneva, 2012, p. xi.

21 UNCTAD Series on Issues in International Investment Agreements II, *Most-Favoured-Nation Treatment: A Sequel*, United Nations, New York and Geneva.

22 O.K. Fauchald, *The legal reasoning of ICSID tribunals – an empirical analysis*, The European Journal of International Law, Volume 19, no. 2, p. 338.

23 UNCTAD Series on Issues in International Investment Agreements II, *Most-Favoured-Nation Treatment: A Sequel*, United Nations, New York and Geneva, p. xiv.

- protection of the legitimate expectations of investors, albeit balanced with the right of the host state to regulate in the public interest.

Although FET therefore has its origins in the standard of customary international law for the minimum protection to be afforded to aliens, it is now mainly a procedural standard based on the principles of due process. Besides the five main concepts, UNCTAD states that tribunals also take the investor's own conduct into account. If the investor has failed to assess the risks properly or has committed fraud, a state may be justified in taking measures.²⁴

International law, including the general principles of international law and customary international law, influence the application and interpretation of an IPA since such an agreement is part of international law. Most IPAs provide that tribunals must assess disputes in accordance with the IPA and applicable rules and principles of international law. If an IPA specifically refers to another agreement, that agreement is then deemed to be incorporated into the IPA.

Arbitrators and judges are required to interpret IPAs in accordance with the rules of the Vienna Convention on the Law of Treaties, which codifies the customary international rules on treaty interpretation. Article 31 of that Convention provides that a treaty must be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose. Article 31 also provides that account must be taken of any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions. After a treaty has been ratified, the parties to it may clarify in subsequent statements what they consider to be the correct interpretation. Where these methods of interpretation produce ambiguous results, supplementary means of interpretation may be used in accordance with article 32. Judges or arbitrators may then take into account the preparatory work of the treaty and the circumstances of its conclusion when determining the meaning.

Precedent is not binding under international law. However, as arbitrators frequently refer to awards made by other tribunals in earlier cases precedent does have some effect in practice.²⁵

Customary international law is also a source of substantive arbitration law. The minimum protection which must be afforded to aliens under customary international law is not clearly defined. Other principles of public international law are also relevant, for example the attribution of conduct to a state, denial of justice and the minimum standard of treatment of aliens.²⁶

24 UNCTAD Series on Issues in International Investment Agreements II, *Fair and Equitable Treatment* (UNCTAD/DIAE/IA/2011/5), New York and Geneva, 2012. See: <http://unctad.org/en/Docs/unctaddiaeia2011d5_en.pdf>.

25 J.P. Commission, *Precedent in Investment Treaty Arbitration: a Citation Analysis of a Developing Jurisprudence*, *Journal of International Arbitration* 24(2), 2007, pp. 149-151.

26 UNCTAD Series on Issues in International Investment Agreements II, *Investor-State Dispute Settlement, A Sequel*, New York and Geneva, 2014, p. 132.

Other sources of substantive law may also play a role: the domestic law of the country where the investment has been made (the host country), an agreement between investor and state concerning the investment about which a dispute exists, and a joint interpretation of the agreement by the parties to it.

An OECD study of 1,660 IPAs shows that only 32% of these agreements contain a provision on the applicable law. These IPAs mention various combinations of legal sources: the IPA itself, principles of international law, the law of the country where the investment is made, agreements between state and investor, interpretations of the agreement by the parties to it, and other relevant agreements. Other IPAs delegate the choice of applicable law to the parties to the dispute. If the IPA does not stipulate what law is applicable, the choice of a forum or procedural rules may be decisive.

II.2 Procedural law

IPAs usually offer the investor a choice of different proceedings, including resolution of disputes by a domestic court or ISDS. Other rules of international law are also applicable. An example of a relevant rule of customary international law is the principle that a court will not be able to hear a case which is already pending before another court (*litis pendens*). This is intended to prevent forum shopping and is dealt with in section II.3.

The three fora and proceedings most commonly used for ISDS are discussed below. These are arbitration by the International Centre for Settlement of Investment Disputes (ICSID), arbitration in accordance with the rules of UNCITRAL and arbitration by the Permanent Court of Arbitration (PCA). ICSID proceedings are used in over half of the cases in which disputes are settled by means of ISDS. UNCITRAL proceedings are also fairly common. ICSID provides a forum and procedural rules, whereas UNCITRAL provides procedural rules only. The PCA is used mainly as a forum.

Various other institutions, often linked to a Chamber of Commerce, offer facilities for dispute settlement. Since they are used only occasionally for ISDS, they will not be discussed further in this letter. As ISDS may be conducted in secret, it is not possible to establish whether such institutions are used and, if so, how often. Nonetheless, experts believe that the majority of disputes are settled in accordance with the rules of ICSID and UNCITRAL.

A feature of ISDS, which it shares with other forms of arbitration, is that the parties to a dispute may themselves to some extent determine what procedural rules will apply. The states that are party to the treaty provide a framework for the arbitration (in the form of international treaties, domestic arbitration law, arbitration rules and the arbitration agreement), but within this framework the parties to the dispute are free to make further arrangements. As a corollary, arbitrators too have a certain freedom to organise arbitral proceedings as they see fit.

ISDS may involve substantial power imbalances between the parties to a dispute. ISDS was originally introduced to protect investors from the arbitrary actions of governments or non-independent courts. In practice, however, situations also occur in which investors are in a position of great power and the host country in a position of relative weakness. Both situations must be taken into account in developing a good ISDS system.

International Centre for Settlement of Investment Disputes (ICSID)

The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Washington Convention) entered into force on 14 October 1966. This convention established ICSID as an autonomous part of the World Bank Group, with its own constitution, capital, management and staff. By 11 April 2014, 159 states had signed the convention, of which 150 had also ratified it. Poland is the sole EU member state which has not ratified the convention. As noted above, the convention has already been denounced by three South American countries: Bolivia in 2007, Ecuador in 2009 and Venezuela in 2012.

The rules of the Washington Convention form a self-contained system, independent of domestic courts. The convention lays down procedures, not substantive law. The role of the ICSID secretariat is to assist the tribunals. The parties to a dispute determine how arbitrators are appointed and how many there should be. If the parties to the dispute are unable to reach agreement on the composition of the tribunal, the chairman of the Administrative Council of ICSID (who is also President of the World Bank) may appoint the missing arbitrators at the request of either party. ICSID therefore has a central logistical role.

The tribunal itself determines whether it is competent to act. It decides a dispute in accordance with such rules of law as may be agreed by the parties to the dispute. In the absence of such agreement, the tribunal applies the law of the contracting state party to the dispute and any other rules of international law that are applicable. The tribunal decides questions by a majority of the votes of all its members and records the award in writing. The award will not be published without the consent of both parties to the dispute.

Revision of a tribunal's award is possible on the grounds of new facts and by a tribunal of the same composition. Either party may request annulment of an award on the grounds that there was corruption on the part of a member of the tribunal. In such a case an application for annulment must be made within 120 days of discovery of the corruption. Annulment may also be requested within 120 days of the date on which the award was rendered if either party considers that the tribunal was not properly constituted or has manifestly exceeded its powers, that there has been a serious departure from a fundamental rule of procedure or that the award has failed to state the reasons on which it is based. If annulment is requested, the chairman of the Administrative Council appoints an ad hoc committee of three persons from the panel of arbitrators, to which each contracting state may designate four persons. If an award is annulled, a new tribunal will be constituted to render a new award.

The award of a tribunal is final and binding. All parties to the Washington Convention are obliged to enforce the pecuniary obligations resulting from an award; awards are treated as if they were a final judgment of a domestic court. Domestic courts are not competent to revise or annul awards of an ICSID tribunal.

The rules of the Washington Convention are binding, as are some of the administrative and financial regulations. In practice, even the rules which are not binding are applied, since the parties to the dispute usually do not reach agreement about alternative rules.

The rules of the Washington Convention are applicable only to disputes in which both states involved (i.e. the investor's home country and the host state) are parties to the convention. ICSID may also provide facilities for arbitration if one of the two states

involved is not a party to the convention. In such a case the Additional Facility Rules apply and not the Washington Convention. As these rules are not recorded in a treaty, they are not binding. The fact that the Washington Convention is not applicable has two important consequences. First, an award made by a tribunal does not have the same force as a judgment of a domestic court in each country that is a party to the Washington Convention. That makes it more difficult to enforce awards. Second, it is not possible to apply for the award to be annulled by an ad hoc tribunal under the Washington Convention. However, the award may be quashed by the domestic courts in the place of arbitration under domestic law. If dispute settlement takes place under the Additional Facility Rules, there is a connection with domestic law and the domestic courts. This is of great importance because a few members of the G-20 are not party to the Washington Convention, namely Brazil, India, Mexico and South Africa (position on 11 April 2014).

Only states can be party to the Washington Convention; if the EU and the United States wish to choose ICSID as one of the fora for ISDS in TTIP, the Additional Facility Rules would apply in cases where the EU is the respondent in a dispute. The free trade agreement between the EU and Canada (CETA) mentions ICSID as one of the fora for ISDS.

United Nations Commission on International Trade Law (UNCITRAL)

The General Assembly of the United Nations established UNCITRAL in 1966. Among the subjects on which UNCITRAL focuses are dispute resolution, international trade contracts, transport, insolvency, electronic commerce, international payments and procurement. The Commission comprises 60 members representing the world's various geographic regions and its principal economic and legal systems. The members are not individuals but states, each elected by the United Nations General Assembly for a term of six years.

UNCITRAL has drawn up procedural rules for arbitration. These rules are not laid down in a Convention. The rules have been drafted for disputes between commercial parties, but are also used for disputes between states and investors. IPAs may provide that disputes between states and investors will be resolved in accordance with these rules. Approximately a third of known disputes are resolved in accordance with the UNCITRAL rules. UNCITRAL does not provide administrative support for the tribunals handling these proceedings; usually this is done by the PCA.

If an investor and a state settle a dispute under the UNCITRAL Arbitration Rules, they must choose a place of arbitration. This determines what national law is applicable not only to the substance of the dispute but also procedurally.

The tribunal's award is enforced in the country of the place of arbitration according to national law and in other countries pursuant to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention). 154 states are party to this convention. Almost all of the countries which are not party to it are African.

Whether the court in the country of the place of arbitration permits or prohibits enforcement of the award has no legal consequences for its possible enforcement in other countries. Courts in other countries may come to a different conclusion. Article V of the Convention lists the (very limited) cases in which recognition of an award of a tribunal may be refused, for example where there is no valid arbitration agreement. The authorities may also refuse recognition and enforcement if the dispute is not capable of settlement by arbitration under domestic law or recognition and enforcement would be contrary to the public policy of the country concerned.

The courts in the country of the place of arbitration have exclusive power to set aside the tribunal's award. The domestic law of the place of arbitration determines on what grounds an award may be set aside. Courts in other countries do not have this competence. If a tribunal's award is set aside, it no longer has legal force in other countries. National courts therefore play a major role in the UNCITRAL system, unlike under the Washington Convention.

UNCITRAL confers a fairly large degree of freedom on the parties to arrange the proceedings as they see fit. The arbitration law of the place of arbitration determines the extent to which the parties to the dispute have this freedom.

The Permanent Court of Arbitration

The PCA was established during the Hague Peace Conferences by the 1899 Convention for the Pacific Settlement of International Disputes to facilitate arbitration between states. 117 states have now acceded to the PCA's founding convention. A new and more detailed version of the convention was adopted in 1907. Article 15 of the 1907 Convention defines international arbitration as follows: 'International arbitration has for its object the settlement of differences between States by judges of their own choice and on the basis of respect for law.' Nowadays, the PCA provides services for arbitration between parties of different types: states, international organisations and private parties such as investors. The EU also therefore comes within this definition.

The PCA is not a court in the usual sense of the word. It is an institution which provides all kinds of services to parties, including registry services, the provision of hearing facilities and assistance with the composition of the tribunal. The great majority of the arbitration which takes place under the auspices of the PCA concerns investor-state disputes.

Each state party to the 1899 and 1907 conventions may nominate four persons at most for a list of arbitrators. These persons must be of known competency in questions of international law and be of the highest moral reputation. If parties to a dispute decide to have it heard under the auspices of the PCA, they may select their arbitrators from this list. However, the parties are also free to choose arbitrators who are not on the list. Commercial companies, in particular, prefer to appoint lawyers from their own circle or attorneys connected with the major law firms who are specialised in investment arbitration. Tribunals may consist of one or more members, provided that it is an odd number. An arbitrator is therefore appointed for the duration of one case. Whether the documents and sessions are public depends on the underlying treaty and the arrangements between the parties. A feature of arbitration practice hitherto has been that in most cases the parties to the proceedings can derogate from the procedural rules and even draw up ad hoc rules themselves. For example, as there is no rule governing whether awards are made public, this is determined from case to case by the treaty and by the parties. Moreover, the PCA may also arrange for arbitration under other rules, for example those of UNCITRAL or ICSID. The Washington Convention explicitly mentions the PCA as a possible place of arbitration.

No appeal lies against an award. However, revision is possible if new facts have been discovered and if the parties to the dispute have agreed in advance to permit revision. In such circumstances, the case will once again be decided by a tribunal of the same composition. The award is binding only on the parties to the dispute. The PCA's International Bureau is funded from subscriptions: all parties to the 1899 and 1907 Conventions pay a fixed amount annually. The parties to a dispute bear their own

costs and part of the costs of the proceedings. Part III of the 1907 Convention contains optional procedural rules.

II.3 ISDS and domestic law

Domestic law plays a role in ISDS because it is one of the sources of arbitration law. A claim based on an IPA may be brought before a domestic court only if the treaty concerned has direct effect in the domestic law of the host country. In some countries such as the United States, treaties do not have direct effect, and a domestic court may apply rules of international law only if they have been incorporated in a domestic law. In such cases an IPA cannot be invoked directly.

The majority of Western countries' IPAs give investors the choice of submitting a dispute with a state to the domestic courts of the host country or to an international arbitral tribunal. Modern IPAs almost always contain a provision offering the investor the choice between these two forms of dispute resolution.²⁷

If an IPA enables investors to submit disputes to a domestic court and to an arbitral tribunal, provisions must be included in order to prevent simultaneous or successive forum shopping. Well-known examples are the 'fork-in-the-road' and 'no-U-turn' clauses. The fork-in-the-road provision obliges the investor to make a definite choice between national and international proceedings at the outset. The no-U-turn provision enables an investor to initiate ISDS after the case has been submitted to the domestic courts, provided that the investor discontinues the domestic proceedings.

Forum shopping is hard to prevent in practice. According to the principle of *litis pendens*, a dispute cannot be said to be the same dispute unless the parties, subject matter and grounds of dispute are identical. Companies with a local branch can institute proceedings before the domestic courts while ISDS is under way, can sue a lower tier government entity rather than the state, or simultaneously initiate ISDS under the IPA and domestic proceedings on the basis of national legislation. There are therefore ways of circumventing the principle of *litis pendens*. Efforts to counter this have been made in some IPAs. The fork-in-the-road provision discourages recourse to the domestic courts, which states often regard as undesirable.

The OECD states that a common provision of IPAs concluded in the 1970s and 1980s was an obligation to exhaust local remedies before accessing international arbitration, but this obligation is no longer found in IPAs concluded since 2004.²⁸ The requirement of exhaustion of local remedies does not appear in Dutch IPAs. A few years ago, the European Parliament stated that it was in favour of such a requirement. According to a resolution of 6 April 2011 on the future European investment policy, the European Parliament stated that it '[b]elieves that changes must be made to the present dispute

27 Pohl, J., K. Mashigo and A. Nohen (2012), *Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*, OECD Working Papers on International Investment, 2012/02, OECD Publishing, pp. 10-11. This is a survey of the bilateral investment treaties (BITs) concluded by 54 countries that participate in the 'Freedom of Investment' (FOI) Roundtables.

28 Pohl, J., K. Mashigo and A. Nohen (2012), *Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey*, OECD Working Papers on International Investment, 2012/02, OECD Publishing, pp. 13-14.

settlement regime, in order to include the obligation to exhaust local judicial remedies where they are reliable enough to guarantee due process.’ The European Commission has not acceded to this request. CETA does not require exhaustion of local remedies. The requirement that local remedies be exhausted before starting ISDS makes proceedings longer and more expensive.

ISDS or domestic courts in TTIP?

As argued above, an IPA often affords better protection for foreign investors than they would have under domestic law in countries where discrimination against foreigners in the economic field is not prohibited. In the United States, discrimination against foreign companies is not explicitly prohibited under domestic law. Within the EU no discrimination may take place between companies from EU member states, but EU legislation does not prohibit discrimination against investors from countries outside the EU. Although the conventions of the World Trade Organisation (WTO) prohibit discrimination, they relate mainly to trade and concern only a few aspects of foreign investment. As an IPA prohibits discrimination between foreign and domestic investors, it often has added value, regardless of whether or not it provides access to ISDS.

Originally, ISDS was introduced for states with a weak legal system. The possibility of accessing ISDS meant that an investor was no longer reliant on domestic courts. The functioning of the rule of law in some EU member states gives rise to doubts, for example among the organs and other member states of the EU.²⁹ In many cases this will prompt states that conclude an IPA with the EU to press for the inclusion of ISDS in the agreement. Most IPAs concluded by the EU with third states in the near future can therefore be expected to contain ISDS provisions, in any event in so far as no other alternatives are available for dispute resolution by domestic courts. If the rule of law were to function effectively in all states, this would eliminate one of the main reasons for having ISDS. Investors would then have more confidence in the domestic courts. This is one reason why it is important for international cooperation to focus on strengthening the rule of law in countries where this is necessary.

Even in a country where the rule of law functions effectively, ISDS can still serve as a useful addition if international law does not have direct effect in that country. If the courts are not obliged to apply the substantive rules of international law, foreign investors still run the risk of being discriminated against, even if this is prohibited by an IPA that is in force. For example, international law does not have direct effect in the United States. The European Commission has stated that in a few cases American courts have provided insufficient protection for foreign investors, despite the existence of an IPA. In these cases the Commission has gone as far as calling this a denial of justice.³⁰ Although treaties have direct effect in the Netherlands, this is not the case in most EU member states. This is another reason why most IPAs concluded by the EU with third states can be expected to contain ISDS provisions.

29 AIV, *The Rule of Law: Safeguard for European Citizens and Foundation for European Cooperation*, advisory report no. 87, The Hague, January 2014.

30 Parliamentary questions, 27 January 2014, E-013215/2013.

II.4 ISDS and investments: some data

Disputes between states and investors about investments

This advisory letter contains various data about ISDS. As not all cases are made public, however, the data presented below cover only a proportion of the disputes submitted to international arbitral tribunals. This should be borne in mind when reading this section.

608 disputes are known to have been submitted to international arbitral tribunals worldwide between 1966 and the end of 2014.³¹ Claims have been submitted against 101 states in total. Argentina is the most frequent respondent state (54 claims), followed by Venezuela (38 claims). Other countries ranked in the top 10 are the Czech Republic, Egypt, Canada, Mexico, Ecuador, India, Ukraine, Poland and the United States. It is noteworthy that the respondent states include rich countries as well as developing countries. Rich countries therefore have an ever greater interest in concluding IPAs that strike a balance between investment protection and their right to regulate.

To some extent these data reflect particular events. The majority of the disputes between investors and Argentina are connected with the economic crisis in 2001-2002, as a result of which Argentina received some 40 claims. In 2013 the Czech Republic received seven claims following changes to energy sector regulation and Spain six claims following changes to solar energy regulation. In view of the generally low number of claims per country, such events can significantly skew the statistics.

The most frequent home states of investors who submitted claims (as at end-2013)³² were the United States (127 claims), the Netherlands (61), the United Kingdom (43), Germany (39), France (31), Italy (26) and Spain (25). The total for all EU member states is 229, which is 53% of all known cases.

356 of the 608 known cases have been concluded. The arbitral award was in favour of the state in 37% of the cases and in favour of the investor in 25% of the cases. The dispute was settled before the tribunal made an award in 28% of the cases. The outcome remained undisclosed in the cases that were settled. 8% of the cases were discontinued for unknown reasons and in 2% of the cases the agreement was found to have been breached but no monetary compensation was awarded to the investor.

The majority (but by no means all) of the claimants are large corporations from Western countries. The OECD³³ concludes from a survey of 50 ICSID cases and 45 UNCITRAL cases that 22% of the claimants are either individuals or very small corporations with limited foreign operations. As little or no public information is available about one third of the claimants, they cannot be classified. Around half of the other claimants are medium and large multinationals. The nationality of the investor claimants is not always easy to determine as some are multinationals and little information is available in around one third of the cases. At least 14 of the 95 cases were brought by investors from low income or middle income countries.

31 UNCTAD, *Recent Trends in IIAs and ISDS*, IIA Issues Note, no. 1, February 2015.

32 UNCTAD, *Recent Developments in Investor-State Dispute Settlement (ISDS)*, IIA Issues Note, no. 1, April, 2014.

33 OECD, *Investor-State Dispute Settlement, Public Consultation*: 16 May - 9 July 2012.

Most arbitral awards are complied with. The OECD reports, however, that a number of countries, including Argentina and Russia, have failed to comply with recent arbitral awards. The OECD notes in this connection that as states sometimes pay compensation late or only in part, it is not clear whether non-compliance is on the increase.³⁴

Research into the size of claims and the damages awarded is hampered by the lack of transparency. In many cases the amount claimed is not known and some awards remain secret, even if the existence of the dispute has been disclosed. A study by Susan Franck³⁵ of 52 final arbitral awards showed that no damages were awarded in 31 of these cases. Damages of between USD 1 million and USD 5 million were awarded in 13 cases, between USD 5 million and USD 10 million in four cases, and more (or much more) than USD 10 million in four other cases. The average damages awarded were USD 10.4 million.

Frank's study also included cases that had not yet been concluded. She noted that of the 82 cases studied only 44 quantified the investor's claimed damages either fully or partially. The claimed damages averaged USD 343 million. Although these 44 cases overlapped only partially with the 52 cases in which a final award was made, she concluded that there was a very large gap between the damages claimed (USD 343 million) and the average damages awarded (USD 10.4 million).

As little information is therefore available about the damages claimed and awarded, there is no way of knowing whether empirical research provides a representative picture. For example, it is impossible to establish whether the awards that are not disclosed are precisely those in which substantially higher damages are granted.

*Investments and ISDS: the United States and the EU*³⁶

The Netherlands is one of the main sources of foreign direct investment in the United States and, conversely, the United States is one of the largest investors in the Netherlands, although there is no bilateral IPA. According to UNCTAD, the Netherlands is the main recipient of American direct investment, receiving 14.5% of the total. The Netherlands is the third largest investor in the United States (10.4% of total direct foreign investment), after the United Kingdom (18.4%) and Japan (11.6%).³⁷

Multinational corporations frequently make use of special purpose entities to channel their investments. The same investments are then treated simultaneously as inward and outward flows of capital. To avoid double-counting of this kind, UNCTAD has corrected the data on direct foreign investment for the Netherlands and some other countries.³⁸ UNCTAD's corrected data are used in this advisory letter.

34 OECD, *Investor-State Dispute Settlement, Public Consultation*: 16 May - 9 July 2012, pp. 29-30.

35 S.D. Franck, *Empirically Evaluating Claims about Investment Treaty Arbitration*, North Carolina Law Review, volume 86, 2007, pp. 57-62. See: <<http://ssrn.com/abstract=969257>>.

36 UNCTAD, IIA Issues Note June 2014, no. 2, *Investor-State Dispute Settlement: an Information Note on the United States and the European Union*.

37 World Investment Report 2014, *Investing in the SDGs: an Action Plan*, pp. 79-80.

38 World Investment Report 2014, *Investing in the SDGs: an Action Plan*, p. 3.

62% of total direct foreign investment in the United States comes from EU member states. The converse figure is 50%.³⁹ These are relatively high shares given the volume of bilateral trade and the share of the EU and the United States in global production.

Although the United States does not have IPAs with the majority of EU member states, the exceptions are Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania and Slovakia. These countries account for just 1% of US foreign direct investment and only 0.1% of foreign direct investment in the United States.

Investors have filed 16 ISDS claims against the United States. None of them has been brought by a company from an EU member state. All but one are claims by Canadian investors, the exception being a Mexican company. All 16 ISDS claims have been brought under NAFTA. An award has been made in nine of the 16 cases against the United States, in each case in favour of the United States.

117 claims worldwide have been brought against EU member states, of which a quarter concern the Czech Republic. The great majority (88 cases) concern disputes between an EU member state and an investor from another member state. American investors have referred nine cases against an EU member state to international arbitration. These concern member states which acceded to the EU relatively recently. EU member states win around half of these cases, and a quarter of the claims are settled. The amount of damages awarded when an investor wins varies greatly.

Some European countries have not yet found themselves in the position of respondent in investment disputes, but the situation can quickly change. More and more Western countries are being sued for breaches of an IPA. This is evident from the recent claims against the United States, Spain and the Czech Republic. As regards the negotiations on TTIP, this means that both Europe and the United States have an interest in establishing an agreement which combines effective investor protection with effective provisions enabling states to defend themselves against claims brought by investors. It should be noted that even if an IPA is not in force, states can still be compelled to defend themselves against a claim brought by an investor through domestic proceedings.

39 World Investment Report 2014, *Investing in the SDGs: an Action Plan*, p. xxii.

III Overview of concerns about and criticism of ISDS

This chapter discusses concerns about and criticism of ISDS from the rule-of-law perspective. A matter of concern raised in the public debate is that ISDS can produce results that are at odds with democratic decision-making and are a severe drain on the public purse.⁴⁰ A criticism from the rule-of-law perspective is that although ISDS often concerns matters in the public interest the arbitral proceedings take place in private and have sometimes resulted in conflicting awards. In addition, there are doubts about the independence and impartiality of arbitrators. The legitimacy of ISDS depends in part on finding solutions to these issues. This chapter also discusses possible solutions, including the establishment of a permanent court for investor-state disputes. The AIV would note at the outset that the criticism often fails to distinguish between provisions from the first generation of IPAs and those from more recent treaty texts such as the US model bilateral investment treaty and CETA, in which many of the criticisms have already been addressed.

This overview is based mainly on publications of UNCTAD⁴¹ and the OECD,⁴² supplemented by other literature and information from interviews with experts.

III.1 The right to regulate and regulatory chill

The right to regulate (i.e. the right to determine policy) must be distinguished from 'regulatory chill'. States have the right to regulate, even if this is to the detriment of investments. If a state expropriates property, an investor has a right to damages. In the case of the right to regulate, the key question is whether the state has a duty to pay compensation for the damage suffered by an investor. The term regulatory chill is used to describe a situation where a state refrains from taking regulatory measures or retracts existing rules for fear of claims from foreign investors, even if the purpose of the measures is to provide necessary or desirable protection of public interests such as the environment, health and so forth.

The right to regulate

States have the right to regulate. This is a consequence of state sovereignty. In exercising this right they must not breach their international obligations. ISDS may not – and does not – undermine the right to regulate. States must always be able to take measures to protect the environment, regulate the quality of work, supervise the banking sector, promote health and so forth. On the other hand, an investor's ownership of property also deserves protection. If states exercise their right to regulate, situations may arise in which investors are entitled to damages. This involves striking a balance

40 See, for example, Platform Authentieke Journalistiek, TNI and SOMO, *Feiten of fabels, 7 claims over TTIP* (Fact or fable: 7 claims about TTIP), June 2014, <http://somo.nl/publications-nl/Publication_4085-nl>.

41 UNCTAD Series on Issues in International Investment Agreements II, *Investor-State Dispute Settlement, A Sequel*, New York and Geneva, 2014 and UNCTAD 2013: *Reform of Investor-State Dispute Settlement: In Search of a Roadmap*. IIA Issues Note No. 2, June 2013.

42 OECD, *Indirect Expropriation and the Right to Regulate in International Investment Law*, OECD Working Papers on International Investment, 2004/04.

between the state's right to regulate and the investor's right to protection of ownership. Both are legitimate interests.

International law on the right to compensation in the event of direct expropriation is clear.⁴³ According to international law, a state may expropriate foreign property provided that this is in the public interest, is carried out in a non-discriminatory manner, under due process of law and against the payment of compensation to the investor for the loss or damage suffered. Indirect expropriation may occur where a state takes measures to prevent an owner from managing or using his investment in such a way that its economic value is permanently almost completely destroyed.⁴⁴ To determine whether there is indirect expropriation (and hence a right to compensation), a tribunal must examine each individual case in the light of the facts, the precise wording of the IPA and other relevant law. Three criteria are relevant: the extent of the interference with the property right, the object and context of the government measure and the degree to which the government measure interferes with legitimate expectations.⁴⁵ Some tribunals take into account only the effect of the measure on the value of the investment (known as the 'sole effect'), while others also consider the object and proportionality of the measure when determining whether there is a right to compensation. In practice, claims in respect of indirect expropriation are seldom successful; they tend to succeed only where little, if anything, is left of the property.⁴⁶ The provisions of most IPAs give arbitrators insufficient criteria to decide whether or not there is a right to compensation in a particular case. Greater clarity could be created if IPAs used more precise wording.

A state may also find itself obliged to take certain measures out of necessity. In such a case greater importance is attached to the right to regulate than in normal circumstances. Measures that would normally result in an obligation to pay compensation need not necessarily do so where a state can invoke necessity. Under customary international law a state may invoke necessity as a ground for suspending performance of its international obligations if there is a grave and imminent peril (article 25 of the International Law Commission's Articles on State Responsibility). Originally, necessity was interpreted as military necessity, but the modern view is that necessity can also be of an economic nature. Argentina advanced this argument as a defence to claims submitted in respect of measures taken to combat the economic crisis in 2001-2002 (see III.4). The concept may have to be interpreted more broadly in the future, for example to include ecological necessity.

43 UNCTAD Series on Issues in International Investment Agreements II, *Expropriation*, United Nations, New York and Geneva, 2012.

44 UNCTAD Series on Issues in International Investment Agreements II, *Expropriation*, United Nations, New York and Geneva, 2012, p. xi.

45 See, for example, OECD, *Indirect Expropriation and the Right to Regulate in International Investment Law*, OECD Working Papers on International Investment, 2004/04, and Professor C. Tietje and Professor F. Baetens, *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*, annexe to letter to the House of Representatives of the States General 21501-02 no. 1397, pp. 51-56.

46 UNCTAD Series on Issues in International Investment Agreements II, *Expropriation*, United Nations, New York and Geneva, 2012, p. xii.

The right to regulate is in fact subject to limitations where states have voluntarily become party to treaties that limit their freedom to exercise it. For example, member states of the WTO cannot take measures that hamper trade or result in protectionism. The freedom of EU member states to regulate has been circumscribed by EU legislation in various fields such as the internal market and police and judicial cooperation.

The World Investment Report 2014 shows that regulatory action sometimes results in claims by investors.⁴⁷ Around a quarter of the 56 cases instituted in 2013 were brought against the Czech Republic and Spain on account of regulatory action affecting the renewable energy sector. In the case of the Czech Republic this concerned a levy (introduced in 2011) on electricity generated from solar power plants. Investors argued that the amendments at issue undercut the viability of the investments and changed the incentives originally put in place to stimulate the use of renewable energy. The claims against Spain concerned a 7% tax on the revenues of power generators and a reduction of subsidies for renewable energy producers.

Major steps have been taken in CETA to prevent claims by foreign investors where a state exercises its right to regulate. One example of these efforts is the inclusion of a more precise definition of indirect expropriation. The definition (in Annex X.11 to CETA) rejects the 'sole effect' doctrine and explicitly mentions various criteria for determining indirect expropriation, namely the duration of the measure, the extent to which the measure interferes with reasonable expectations and the object, context and intent of the measure. Article X.11 to CETA provides, among other things, that the article must be interpreted in the light of the clarification of the concept of expropriation in Annex X.11. It follows that the provisions of Annex X.11 are binding on arbitrators. Relevant passages from CETA have been included in Annexe II below.

In addition, IPAs may include definitions of exceptions to investment protection, for example measures to promote public health or the environment. Annex X.11 to CETA provides that non-discriminatory measures designed and applied to protect legitimate public welfare objectives do not constitute indirect expropriation, with the exception of rare circumstances where the impact of the measure is so severe in the light of its purpose that it appears manifestly excessive. This exception has been worded in such a way as to provide very little basis for claims. It is seen as a 'reasonableness clause'.

Finally, the IPA's preamble and provisions may explicitly mention the right to regulate or (specific) matters in the public interest. Arbitrators must interpret a treaty partly in the light of the preamble. Although the preamble to a treaty may mention the right to regulate, it is not the place to define the concept in detail. Only the inclusion of specific provisions in the treaty on the right to regulate can offer adequate protection.

Protection of the right to regulate should also take account of future developments. If a treaty on climate change is concluded, this will prompt many countries to introduce national measures that adversely affect the rights of foreign investors in the fossil fuel sector. Foreign investors could then claim substantial damages.

Regulatory chill

One of the criticisms of ISDS concerns the risk of substantial investor claims against states, which compromise their right to regulate. Governments might refrain from

47 UNCTAD, World Investment Report 2014, p. 125.

acting in the public interest for fear that private investors might submit large claims for damages. It should be noted in this connection that arbitral tribunals cannot force states to repeal or retract legislation. However, if a tribunal finds that an IPA has been breached, it may award damages to the foreign investor.

It would not be acceptable if states failed to regulate on matters of major public interest for fear of claims for damages from foreign investors. However, as regulation can affect rights of ownership an award of damages may be appropriate. In such cases foreign investors should not be able to claim greater protection than local investors.

Tietje and Baetens define 'regulatory chill' as a situation in which governments forgo the adoption of legitimate regulatory changes because of the perceived or actual threat of arbitration by an investor.⁴⁸ The addition of the word 'legitimate' is essential because measures intended to adversely affect the interests of foreign investors or motivated by protectionism are not legitimate and constitute a breach of the IPA. The authors distinguish between three categories of regulatory chill. 'Anticipatory chill' occurs where policymakers refrain from drafting legislation for fear of potential disputes with investors. In this variant governments are passive. Since it is difficult, if not impossible, to demonstrate this form of regulatory chill it is disregarded here. The second category is 'specific response chill', where state actors refrain from introducing a specific regulatory measure once they become aware of the risk of an investor-state dispute. In other words, they change their policy in response to an actual or perceived risk. The third category is 'precedential chill', which occurs where a state actor modifies a regulation in response to an award made by an arbitral tribunal. In such a case, a host country which has unsuccessfully invoked the right to regulate and has to pay damages to an investor decides to freeze the measure. Another country may also draw the same conclusion.

Tietje and Baetens confine themselves to discussing possible examples of the last two categories of regulatory chill and to disputes under NAFTA and the Central America Free Trade Agreement. They believe that ISDS may be just one of a number of factors in the political process leading to regulatory chill. Usually, various considerations play a role in decisions to retract legislation, including the fact that it is controversial in the country itself. In such situations it is hard to establish that ISDS is the reason why an authority has modified or retracted legislation. The authors also point out that investors can claim compensation under domestic law too for government measures. This could also cause regulatory chill.

Tietje and Baetens⁴⁹ discuss three cases which in their view demonstrate credible prima facie evidence of regulatory chill, but acknowledge that, in legal and factual terms, proving that ISDS was indeed the source of the chill is complex and difficult. They conclude that there is insufficient empirical evidence to demonstrate regulatory chill. The AIV would point out here that there is also no empirical evidence that regulatory chill does not occur. The conclusions of Tietje and Baetens about regulatory chill and the possible 'threat to policy

48 Professor C. Tietje and Professor F. Baetens, *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*, annexe to letter to the House of Representatives of the States General 21501-02 no. 1397, sections 67-73.

49 Professor C. Tietje and Professor F. Baetens, *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*, annexe to the letter to the House of Representatives of the States General 21501-02 no. 1397, sections 74-79.

space' as a consequence of ISDS tend to underestimate the risks, which is something that is attributable to self-imposed limitations on their research. The AIV's view is that it is not clear to what extent regulatory chill occurs.

An example of regulatory chill often cited in the literature is the case of tobacco company *Philip Morris v. Australia*. Philip Morris has brought a claim against Australia before an international arbitral tribunal under the IPA between Hong Kong and Australia. Since 1 December 2012 cigarettes may be sold in Australia only in plain packaging that carries a health warning. Philip Morris is claiming substantial damages on the grounds that it is now unable to differentiate its products from those of its competitors and is thus suffering damage and that there is also no proof that this type of packaging discourages smoking. As the tribunal has not yet given its ruling, it is still too early to decide whether or not this is a case of regulatory chill.

In December 2013 the government of New Zealand submitted the Smoke-free Environments (Tobacco Plain Packaging) Amendment Bill to parliament. This bill is now under consideration in the New Zealand parliament. The government had previously announced that the introduction of a plain packaging regulation could be postponed pending the outcome of the settlement of the dispute between Philip Morris and Australia.⁵⁰ If the New Zealand government actually refrains from promulgating the plain packaging legislation in this way, it would qualify as an example of anticipatory chill.

Ukraine, Honduras, the Dominican Republic, Cuba and Indonesia have now each submitted a complaint to the WTO alleging that Australia's plain packaging legislation breaches the Agreement on Trade-Related Aspects of Intellectual Property Rights and the Agreement on Technical Barriers to Trade.⁵¹ The findings of the panel dealing with the five cases are expected to be published in the first half of 2016 at the earliest. Although the findings of WTO panels cannot result in an award of damages, they can lead to an obligation to modify or repeal legislation. Australia could in this way be forced to repeal its plain packaging legislation. This shows that Australia's right to regulate is limited by the treaties to which it has become party in the context of the WTO. However, as these cases do not involve a claim by a foreign investor, they do not constitute examples of regulatory chill as defined above.

Various ways of reducing or preventing regulatory chill are discussed in the literature. Basically, they are the same measures that can be taken to protect the right to regulate from claims of foreign investors, i.e. clearly define what is meant by indirect expropriation, reject the 'sole effect' doctrine, define exceptions to the protection of investments under the IPA and include the right to regulate in the IPA's provisions.

III.2 Impartiality and independence of arbitrators

Daly mentions that academics and legal practitioners have criticised the fact that all too often party-appointed arbitrators obtain their position because they are willing to neglect their duty to settle disputes independently and impartially and instead act as advocates

50 Turia, T., *Government moves forward with plain packaging of tobacco products*, Beehive.govt.nz: The Official Website of the New Zealand Government, 19 February 2013, available at <<http://www.beehive.govt.nz/release/government-moves-forward-plain-packaging-tobacco-products>>. Consulted on 16 February 2015.

51 These cases are numbered DSB-434, DSB-435, DSB-441, DSB-458 and DSB-467.

for the party who has appointed them. This concern about the neutrality of arbitrators appointed by parties is long-standing.⁵²

The Venice Commission⁵³ and the Consultative Council of European Judges⁵⁴ have framed criteria for the independence and impartiality of the judicial system. One of the characteristics of the rule of law is that those seeking justice should have access to independent and impartial judges. This applies all the more in cases in which a state is one of the parties to the dispute. Judges must therefore be protected from undue pressure and intimidation. This has implications for the procedure for the appointment, training and professional career of judges and the rules for their promotion, transfer, suspension and removal from office. Judicial appointments should be made on the basis of objective criteria such as integrity and merit. Judges should also have the right qualifications, such as a sound education. Security of tenure lasting until retirement age or for a fixed term strengthens their independence.

Judges should be independent not only of the executive and the legislature but also of lobby groups. They should themselves avoid conflicts of interest and be cautious about accepting (remunerated) second jobs. They must avoid even the semblance of bias. The impartiality of judges means that they may not have any preconceived views on the case they are hearing. If there are indications that they are biased, they must be taken off the case or recuse themselves. Failing that, parties to the dispute may request the replacement of a judge. In practice, compliance with these requirements of independence leaves something to be desired in some countries. The AIV would note here that the position of arbitrators differs from that of judges. Arbitrators are appointed by the parties to the dispute and do not have security of tenure by law or under an international agreement. As an arbitrator does not have this security he has an interest in obtaining a further engagement later. Needless to say, parties nominate an arbitrator who is expected to defend their interests, even if the role of arbitrator is to administer justice. In this connection, the changing professional roles of many arbitrators is a problem. Sometimes they act as arbitrator and sometimes as counsel for a state or investor: as arbitrator they must give an objective ruling although they have defended a specific interest in the past or may do so in the future. Such circumstances can create the impression that arbitrators are not independent and impartial.

The Washington Convention and the UNCITRAL Rules merely contain general requirements to be fulfilled by an arbitrator. Article 14 of the Washington Convention provides that persons designated to serve on the panels must be of high moral character and recognised competence in the fields of law, commerce, industry or finance, who may be relied upon to exercise independent judgement. Article 57 provides that a party may propose the

52 B.W. Daly, *The Abyei Arbitration: Procedural Aspects of an Intra-state Border Arbitration*, *Leiden Journal of International Law*, 23, (2010), p. 811.

53 Also known as the European Commission for Democracy through Law, *Report on the Rule of Law*, Strasbourg, CDL-AD(2011)003rev., 4 April 2011.

54 Opinion no 1 (2001) of the Consultative Council of European Judges (CCJE) for the attention of the Committee of Ministers of the Council of Europe on standards concerning the independence of the judiciary and the irremovability of judges (Recommendation No. R (94) 12 on the independence, efficiency and role of judges and the relevance of its standards and any other international standards to current problems in these fields).

disqualification of an arbitrator on account of any facts indicating a manifest lack of these qualities. Article 12 of the UNCITRAL Rules lays down that arbitrators may be challenged if they are not impartial or independent. Article X.25 of CETA provides that arbitrators must be independent and not have accepted instructions from others. They must comply with the code of conduct of the International Bar Association.

There are different ways of enhancing the independence and impartiality of arbitrators. For example, ICSID uses lists of conciliators and arbitrators (panels) to which the parties to the agreement can designate four candidates. In practice, states also designate people who probably do not have the necessary qualifications to act as arbitrator. However, there is no selection committee to assess designations and reject designees. Such a committee is necessary in order to ensure that all panel members possess the desired qualities. If the quality of the panels is assured, an obligation could also be introduced to designate panel members as arbitrators, to the exclusion of others.

Codes of conduct for arbitrators could also play a role, although they are usually difficult to enforce in practice. There are already a number of codes of conduct, such as the International Bar Association Guidelines on Conflicts of Interest in International Arbitration. In general, these are designed to limit changes in professional roles and lay down rules for incompatible second jobs.

The subject of challenge deserves special mention. The number of challenges made in international arbitration proceedings has risen in recent years. This is due in part to an increase in the number of cases in absolute terms, but also and above all to the fact that there has been no corresponding increase in the pool of qualified arbitrators, which increases the potential for real or perceived conflicts of interest. Although the problem of the lack of impartiality of arbitrators is generally acknowledged, there is as yet no stable case law on the grounds for challenge. An attempt has been made in a number of important arbitrations to declare that a semblance of bias or dependence is a ground for a challenge.⁵⁵ This criterion has been recorded in the International Bar Association Guidelines on Conflicts of Interest in International Arbitration of October 2014, but is still a long way from gaining acceptance as a general legal principle by all tribunals. The test of whether there is a semblance of bias or dependence is based on UNCITRAL. This criterion goes much further than the one preferred by many parties, namely that there is a conflict of interest consisting of previous involvement in the subject matter of the case in question. Under the PCA's Optional Rules for Arbitrating Disputes between two States, an arbitrator can be challenged if there are circumstances warranting justifiable doubts as to his or her impartiality or independence. This criterion of justifiable doubts seems to be gaining some acceptance. In general, however, it must be noted that requests to challenge are successful in only a small number of international arbitrations. In practice, challenges lead to suspension of the proceedings and hence not only loss of time but above all higher costs.

III.3 Transparency

As already noted above, ISDS can take place in secrecy. This is at odds with the duty of accountability of democratically elected governments. The secrecy of such proceedings could make it impossible for governments to render account for matters in the public

⁵⁵ American Society of International Law Insights, volume 16, issue 20, 6 June 2012. See: <<http://www.asil.org/sites/default/files/insight120606.pdf>>. Consulted on 1 April 2015.

interest such as health or the environment, on which democratic decisions have been taken. This is unacceptable. Enhancing transparency is an important way of increasing the legitimacy of ISDS.

Transparency could be achieved by disclosing all disputes, granting access to documents (including the judgments) and public access to the hearings, and permitting third-party interventions (*amicus curiae*). The existence of some disputes and proceedings is never disclosed. In practice, access to documents and hearings is usually dependent on the consent of the parties to the dispute. The public nature of proceedings is one aspect of a fair trial. Only in special circumstances are proceedings not public, for instance in cases where state security is at issue. In addition, the need to protect corporate secrets can and should be a reason for conducting proceedings (or parts of proceedings) in private. Greater transparency enables third parties to determine whether their interests are at issue in a dispute. They could then make this known by means of an *amicus curiae* letter to the tribunal dealing with the case, thereby enabling the arbitrators to take account of their interests. Various tribunals have permitted third-party interventions.

ICSID has the highest level of transparency of all institutions. ICSID reports all registered cases on its website and indicates the parties involved. However, the arbitral awards are published only with the consent of all parties.

Recently, UNCITRAL has adopted rules to enhance the transparency of arbitral proceedings. These rules apply to disputes in relation to IPAs that have entered into force since 1 April 2014, unless the states that are party to the IPA decide otherwise. Where a dispute falls under a treaty which entered into force before 1 April 2014, the transparency rules apply only if both the state and the investor concerned agree. In certain cases an arbitral tribunal may derogate from the transparency rules, particularly in order to protect confidential information or the integrity of the arbitral process.

The General Assembly of the United Nations adopted the Convention on Transparency in Treaty-based Investor-State Arbitration at the end of 2014. When states accede to this convention, the UNCITRAL Rules on Transparency automatically become applicable, subject to certain conditions. First, the ISDS must be under an IPA between states which have all acceded to the UN Convention and, second, the IPA must have entered into force before 1 April 2014. The transparency rules also apply if the respondent state has acceded to the convention and the investor agrees to their application.

III.4 Coherence, consistency and legal certainty

Legal certainty is one of the characteristics of the rule of law. Awards of arbitral tribunals must be consistent (i.e. comparable rulings in comparable cases). However, tribunals have sometimes given conflicting rulings in comparable cases. Examples cited in the literature are the awards made by tribunals established following the economic crisis in Argentina in 2001-2002. In response to the economic crisis, rising unemployment and political unrest, the government had taken measures which led to around 40 arbitration proceedings. A number of claims related to the regulation of the tariffs of utility companies, which had been privatised a few years earlier. These claims were based on the IPA between Argentina and the United States. In most cases, Argentina put forward the same defence, namely economic necessity.⁵⁶ Although these cases were therefore

⁵⁶ For a detailed consideration see J.E. Alvarez, *The Public International Law Regime Governing International Investment*, The Hague Academy of International Law, 2011, pp. 247-339.

governed by the same substantive rules and dealt with identical circumstances, the tribunals and annulment tribunals came to differing conclusions. Alvarez states that in ten of these cases the rulings display worrying inconsistencies in terms of findings of fact and the application of logic and law.⁵⁷ Franck discusses various inconsistencies under NAFTA.⁵⁸ As this gives the impression that the law produces unpredictable results, it undermines the legitimacy of ISDS.

Some of the inconsistencies arise because the law is unclear. Concepts such as MFN or FET are usually not clearly defined in an IPA and there is no agreement among arbitrators about their meaning. This has been explained in chapter II.1 about MFN and FET. Some tribunals adopt not only the substantive standards of other IPAs on the MFN provision but also procedural provisions. This opens the door to ISDS shopping: i.e. situations in which procedural rules not mentioned in the IPA are nonetheless declared applicable. Article X.7 (4) of CETA excludes ISDS provisions from the application of MFN. Views on the scope of a state's right to regulate also differ. Arbitral tribunals have considerable discretion in interpreting treaties and have to guess at the intentions of the states which concluded the IPA.⁵⁹

It should be noted there are over 3,000 IPAs, which are not identical to one another. Differences in wording imply differences in the applicable law. And as states' other international obligations are also relevant, the applicable law differs from case to case in this respect. Moreover, the facts also differ from case to case. In short, disputes hardly ever qualify as comparable. The claims against Argentina referred to above are an exception: these cases were clearly very comparable. Although the inconsistency and unpredictability can therefore appear greater than is actually the case, a problem does exist in respect of the predictability of international arbitration law.

A possible solution would be to define terms more clearly in IPAs. There is indeed a trend to provide more detailed definitions in new IPAs. Tietje and Baetens give a few examples of how FET has been better defined in recent IPAs.⁶⁰ MFN too can be defined in such a way as to relate exclusively to substantive standards for the protection of investments and not to the procedures mentioned in other IPAs with third countries.⁶¹

A second possible solution would be to clarify the correct interpretation of an IPA. States determine the content of international law and can explicitly define the intentions

57 *Idem*, p. 263.

58 S.D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 *Fordham Law Review*, 1521 (2004-2005), pp. 1558-1581.

59 UNCTAD, *International Investment Agreements Issues Note*, no. 3, December 2011, *Interpretation of IIAs: What States Can Do*, pp. 3-4. See: <http://unctad.org/en/Docs/webdiaeia2011d10_en.pdf>.

60 Professor C. Tietje and Professor Baetens, *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*, annexe to the letter to the House of Representatives of the States General, 21501-02, no. 1397, sections 121-124.

61 International Institute for Sustainable Development 2014: *A Response to the European Commission's December 2013 Document 'Investment Provisions in the EU-Canada Free Trade Agreement (CETA)'*, N. Bernasconi-Osterwalder and H. Mann, February 2014. See: <<http://www.iisd.org/>>.

of the contracting parties.⁶² As noted in section II.1 above, in interpreting a treaty tribunals must take account, for example, of any subsequent agreement reached by the contracting parties concerning the interpretation of the treaty or the application of its provisions. The contracting parties may arrange in the treaty for the establishment of a commission charged with the task of issuing binding decisions on the interpretation of the treaty. The commission established in NAFTA has to date issued one interpretation concerning the concept of FET. This was prompted by the fact that tribunals had interpreted FET more broadly than the contracting parties considered desirable.⁶³ Another example mentioned in the literature is that of the Netherlands and the Czech Republic, which issued a joint declaration in response to the case of *CME v. the Czech Republic*.⁶⁴

Precedent is sometimes seen as a way of enhancing predictability in arbitration. In international law judges or arbitrators are under no obligation to follow previous rulings. Nonetheless, tribunals regularly cite one another's rulings. A survey of 98 awards of ICSID tribunals revealed that 92 of them contained one or more references to rulings by previous ICSID tribunals.⁶⁵ Ten Cate challenges the view that arbitrators should strive for greater consistency in ISDS disputes. She believes that the applicable law is too fragmented (there are over 3,000 IPAs) and that arbitration is flawed as a vehicle for harmonising the law. She states that arbitrators should resist any norm of precedent in the sense of deference to earlier awards, and focus instead on developing the law. Tribunals should explain why their interpretation of the law is the correct one and how it differs from other tribunals' interpretations. Precedent should therefore not be decisive in the international arbitration of disputes between states and investors.⁶⁶

A fourth way of promoting the consistency of arbitral awards would be to establish an appellate body. The revision of arbitral awards through an appeal procedure is regarded as a solution to the problem of occasionally inconsistent or even incorrect decisions of tribunals. No possibility of appeal exists under the rules of the Washington Convention and UNCITRAL. However, the Washington Convention does permit revision of an award upon discovery of new facts. Revision is then carried out by the same tribunal which rendered the award. Either party may also request annulment of an award on the grounds that there was corruption on the part of a member of the tribunal, that the

62 UNCTAD, International Investment Agreements Issues Note, no. 3, December 2011, *Interpretation of IIAs: What States Can Do*. See: <http://unctad.org/en/Docs/webdiaeia2011d10_en.pdf>.

63 S. Hindelang, *Study on Investor-State Dispute Settlement (ISDS) and Alternatives of Dispute Resolution in International Investment Law*. In: *Investor-State Dispute Settlement (ISDS), Provisions in the EU's International Investment Agreements*, Volume 2, Policy Department DG External Policies, September 2014, p. 62.

64 UNCTAD, IIA Issues Note, no. 3, December 2011, p. 11.

65 O.K. Fauchald, *The Legal Reasoning of ICSID Tribunals – An Empirical Analysis*, *The European Journal of International Law*, volume 19, no. 2, p. 335. See also J.P. Commission, *Precedent in Investment Treaty Arbitration, a Citation Analysis of Developing Jurisprudence*, *Journal of International Arbitration* 24 (2), 2007, pp. 129-158.

66 I.M. Ten Cate, *The Costs of Consistency: Precedent in Investment Treaty Arbitration*, 51 *Columbia Law Review* (2013), pp. 418-478. See: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2149245>.

tribunal was not properly constituted, that the tribunal has manifestly exceeded its powers, that there has been a serious departure from a fundamental rule of procedure or that the award has failed to state the reasons on which it is based. Awards made under rules other than those of the ICSID may be annulled on grounds specified in the domestic law of the place of arbitration.

Since 2004 the US model bilateral investment treaty contains a provision that expresses the intention to consider whether a future multilateral agreement on an appellate mechanism for reviewing ISDS awards should be declared applicable to the treaty. In addition, the model treaty contains a provision that the parties will strive to establish a bilateral appellate mechanism. ICSID subsequently made a proposal, but informal soundings revealed that there was insufficient support among the state parties to the Washington Convention for the establishment of an appellate mechanism.⁶⁷ Article X.42 of CETA establishes the Committee on Services and Investment, one of whose functions is to examine whether an appellate mechanism could be created and, if so, on what conditions.

Obstacles to the creation of an appellate mechanism

An appellate mechanism could be created at one of the existing institutions such as ICSID or the PCA, depending on its features. Such a mechanism can only be established by treaty. The creation of an appellate mechanism at ICSID would not be a logical solution from the perspective of the EU. A complication is that the EU cannot become a party to the Washington Convention. Moreover, Poland is not a party to the Washington Convention.

Inserting the possibility of appeal into a bilateral convention would produce consistency only in that bilateral relationship. That is not sufficient, because the impact would then be confined to a limited number of cases. Introducing a new multilateral investment convention would be extremely time-consuming and for the time being the idea does not have sufficient support, bearing in mind the unsuccessful attempts of ICSID in 2004 to establish an appeal mechanism through an addition to the Washington Convention. It is therefore questionable whether there is sufficient political support for a multilateral appellate body.

A WTO appellate body could play a role only in relation to WTO treaties. They do not include the subject of investment protection and, furthermore, dispute settlement within the WTO is limited to disputes between states. All other parties to the WTO convention would have to agree to use the WTO's appeal procedure for TTIP (or other IPAs). It is an advantage that both the EU and its member states are members of the WTO.

An appellate mechanism could also be included in the agreement on TTIP. Naturally, this would then only apply in relations between the contracting parties. However, it would be possible to go a step further, for example by issuing a declaration providing the basis for an international appellate body. ICSID would be best suited for this purpose, for example by extension of the existing grounds for annulment. This would require a treaty change to which the EU as such would have to be a party. Perhaps this could be achieved in the longer term. An alternative would be a protocol creating an appellate body to which non-treaty parties could accede.

⁶⁷ C.J. Tams, *An Appealing Option? The Debate about an ICSID Appellate Structure*, Essays in Transnational Economic Law, no. 56, June 2006, pp. 5-6.

III.5 Towards an International Investment Court

Van Harten⁶⁸ contends that arbitration is not a suitable way of settling disputes between states and investors. He bases this on the following arguments. First, there is no relationship of mutual rights and obligations of the kind that exists in disputes between private parties or disputes between states. Instead there is a dispute – between a state and an entity subordinate to it – about the manner in which that state exercises its sovereign right to regulate. Moreover, only investors can file claims. Usually, however, the interests of consumers, taxpayers and other third parties are also at issue. The equivalent of such disputes in domestic law is judicial review under administrative law.

Van Harten notes that the settlement of disputes between states and their citizens is usually left to judges, who are required to be impartial and independent. To safeguard their independence, judges have security of tenure and a fixed salary and cannot easily be removed from office. Arbitrators, on the other hand, are appointed on an ad hoc basis. He emphasises that the issue is not whether or not arbitrators are impartial or independent but the absence of safeguards to guarantee their impartiality and independence. He points out that in the case of a challenge it is not usually necessary to prove that an arbitrator or judge is biased or insufficiently independent. Even the semblance of bias or lack of independence is sufficient to get an arbitrator or judge taken off a case. Arbitration lacks the safeguards for impartiality and independence that are an intrinsic part of judicial decision-making. Van Harten draws a number of conclusions from this. He submits that dispute resolution between states and investors takes place in the context of public international law and that ISDS does not comply with the standards for independence and impartiality. He argues that the establishment of an international court for the settlement of disputes between states and investors would rectify these failings.

The AIV notes that a treaty would be necessary to provide a legal basis for such a court and adequately regulate the legal status of the judges. This cannot be achieved in the short term, but could be a long-term objective. The failed attempts by the OECD and ICSID to establish a multilateral investment treaty show that it will be no simple matter to reach agreement at international level.

Such a court would meet many of the objections to the existing system of ISDS. A permanent court could differ in four respects from ISDS: the institution of a permanent registry, the appointment of tenured judges rather than arbitrators appointed ad hoc, uniform substantive law and uniform procedural law. ICSID and the PCA already provide a permanent registry, and there would be no merit in creating a new permanent court merely to provide registry services.

The first step would be to appoint tenured judges. The appointment of judges with a permanent and full-time position would provide more safeguards of independence and impartiality than the ad hoc appointment of (commercial) arbitrators. Arbitrators are accustomed to switching between the roles of arbitrator, state counsel and counsel for investors and may also hold other positions that could give rise to a conflict of interest. A permanent international investment court would need to have a sufficient workload to

68 G. Van Harten, *A Case for an International Investment Court*, Inaugural Conference for International Economic Law, Geneva, 16 July 2008. See: <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1153424>.

justify the appointment of full-time judges. In this way, better safeguards can be created for the independence and impartiality of judges.

As there are dozens of new cases each year, the total volume of known arbitration cases is sufficient to justify the existence of a permanent court (in economic terms), but this presupposes that almost all states and investors would submit their disputes to the court. However, this is unlikely to happen. Indeed, the volume of cases might remain so low that an investment court would have insufficient work for judges appointed full-time. A solution could be to appoint judges who hold judicial office in their own country. In this way, the court would consist of tenured judges who would not need to accept non-judicial second jobs that could give rise to conflicts of interest. The European Court of Human Rights also functioned in this way when it was first set up. Another possibility is that all member countries nominate a number of judges (or other qualified persons) to be entered on a list from which the investment court could compile a chamber to hear a specific dispute.

Another advantage is that a court staffed by tenured judges would be better placed to monitor the consistency of the law, although there is as yet no uniformity in international investment law. In view of experiences in the recent past, it will not be possible to achieve uniform substantive and procedural law in the short term.

The EU has obtained competences in the area of direct foreign investment under the Treaty of Lisbon and therefore negotiates with many countries about the conclusion of IPAs. This provides opportunities for the establishment of a permanent investment court, if necessary on a bilateral basis. The court could be established initially in the context of TTIP, but in the longer term it could function as a dispute resolution body for all IPAs. There should therefore be an opt-in possibility for other states. The provisions of IPAs are sufficiently uniform to make this a realistic option.

An international investment court (with tenured judges) could be established in The Hague under the auspices of the PCA. The staff of the PCA have a wealth of experience in the settlement of disputes between states and investors and would be ideally placed to play a supporting role, in any event in the initial stage. Another option would be to set up the court under ICSID.

IV Summary, conclusions and recommendations

ISDS: history and debate

Since 1959 states have concluded between them more than 3,000 agreements containing provisions on the mutual protection of investments (referred to below as IPAs). The settlement of disputes between states and investors through international arbitration (investor-state dispute settlement or ISDS) gives investors the opportunity to invoke these agreements directly. ISDS is an instrument which protects investors in two situations: first, where an investor's own government is unable or unwilling to provide effective assistance through diplomatic channels and, second, where the national legal system of the host country, for any reason whatever, provides insufficient protection for foreign investors. ISDS also has the advantage of being a fast and flexible procedure. As a result, ISDS is increasingly being used alongside domestic court proceedings and protection through diplomatic channels.

After leading an inconspicuous existence for many years, ISDS has evolved rapidly in recent decades. The provisions on ISDS in modern treaties, such as the free trade agreement between Canada and the EU (CETA) and also in the model bilateral investment treaty of the United States differ greatly from the provisions in the IPAs dating from the 1960s. The number of cases brought under these agreements has also increased greatly (at present a few dozen a year), as has the total volume of direct foreign investment worldwide.

The cumulative number of known ISDS disputes (including pending cases) by end-2014 was 608, of which 356 had been concluded. The arbitral award was in favour of the state in 37% of the cases and in favour of the investor in 25% of the cases. The dispute was settled before the tribunal made an award in 28% of the cases. The outcome remained undisclosed in the cases that were settled.

The majority (but by no means all) of the claimants are large corporations from Western countries. The OECD concludes from a survey of 95 cases that 22% of the claimants are either individuals or very small corporations with limited foreign operations.

Research into the size of claims and damages awarded is hampered by the lack of transparency. In many cases the amount claimed is not known and some awards remain secret, even if the existence of the dispute has been disclosed. Examination of the scarce data (see section II.4) shows that the claimed damages averaged USD 343 million and the average damages awarded were USD 10.4 million, but it is uncertain whether this picture is representative of all concluded disputes.

The total volume of foreign investment in the world amounted to over USD 25,000 billion in 2014. The United States and the EU were major investors in each other's economies. Over half of direct foreign investment in the United States comes from the EU, and the reverse is also true.

IPAs provide benefits for both the contracting states and investors. Investors can thus rely on protection of their investments, even if the host country's legal system is weak. For states, an IPA is an aspect of a favourable investment climate which enables them to attract foreign investment. This boosts economic growth, innovation and employment.

The existence of sufficient protection for foreign investment is of major importance to the Netherlands. This is because the Netherlands is among the world's largest sources and recipients of foreign direct investment. Dutch companies make relatively frequent use of ISDS.

The EU has recently (since 1 December 2009 when the Treaty of Lisbon entered into force) obtained exclusive competence in the area of direct foreign investment, but not other forms of foreign investment. The EU is therefore empowered to conclude IPAs with third countries (a competence which it shares with the member states if the IPA has a broader scope).

Investment protection has recently become a topic of public and political debate, particularly as a result of the negotiations between the EU and the United States on the Transatlantic Trade and Investment Partnership (TTIP). This raises the question of the balance between the interests of free trade and investment on the one hand and the right to regulate of the United States, the EU and the EU member states on the other. This concerns legislation on such fundamental matters as environmental and climate protection, energy generation, health, working conditions, intellectual property rights, telecommunication, e-commerce and data protection. It is advocated in the debate that the right to regulate in such fields be clearly defined and recorded in TTIP, so that the scope for interpretation in the event of dispute settlement through ISDS or the domestic courts is limited.

The debate also focuses on whether ISDS meets the rule-of-law criteria, such as consistency of arbitral awards, the independence and impartiality of arbitrators and the transparency of international arbitration.

The content of investment protection rules

Chapter II describes the international ISDS system. The substantive law provisions of IPAs (the rules governing the substance of investment protection) are very similar in broad outline. Their aim is to ensure fair and equitable treatment, prevent discrimination and lay down conditions for expropriation. Concepts that occur in such agreements are national treatment, most-favoured-nation treatment (MFN) and/or fair and equitable treatment (FET). National treatment means that foreign investors have to be treated the same as national investors. MFN obliges states to treat foreign investors at least as well as an investor from the most favourably treated third country. Although FET has its origins in the standard of customary international law for the minimum protection to be afforded to aliens, it is usually interpreted nowadays as the requirement that a host state provides a fair procedure for the investor.

ISDS has existed for only a few decades and is an area of the law that is still evolving. This is one reason why older IPAs often contain fairly summary ISDS provisions, which leave arbitrators considerable scope for interpretation and the exercise of their discretion. The experience of ISDS in these older IPAs has shown that although ISDS is in itself a good way of settling international disputes, it is necessary to learn from the defects of the older agreements and take the next step in developing ISDS. A logical step would be to introduce more detailed ISDS provisions in the new agreements. In particular, it would be desirable to formulate the intentions of the contracting parties more clearly in the substantive law provisions of the agreement (rather than in the more generally worded preamble). If even concepts such as MFN and FET, which form the core of many IPAs, are not defined more clearly in these agreements, arbitrators will have to continue guessing at the intentions of the contracting parties. In these circumstances, other measures

(such as promoting the independence and impartiality of arbitrators or establishing an appellate mechanism) will not provide the desired legal uniformity. There is also a risk that ISDS may lead to socially undesirable outcomes if more precise definitions are not included in IPAs.

Investment protection procedures

An international investor who is party to a dispute can often choose between different sets of procedural rules for ISDS. The most commonly used rules are those of the Washington Convention (1965). They provide for a procedure which is entirely separate from national judicial decision-making. Under these rules arbitration can be facilitated by the International Centre for Settlement of Investment Disputes (ICSID), which is part of the World Bank Group. Much use is also made of the rules of the United Nations Commission on International Trade Law (UNCITRAL). These provide for a procedure that is heavily reliant on domestic law and the domestic courts, for example in relation to the enforcement of arbitral awards. Usually the Permanent Court of Arbitration (PCA) provides for arbitration proceedings under these rules. The PCA also provides facilities for arbitration under all other procedural rules.

Establishment of a permanent international investment court

Chapter III shows that the ISDS system has failings. There is criticism of ISDS from the rule-of-law perspective (independence and impartiality of arbitrators and the transparency and coherence of arbitral awards), and there are concerns that it may compromise states' right to regulate. This right to regulate is dealt with below.

The AIV believes that from the rule-of-law perspective a permanent international investment court, with tenured judges, would be better equipped than ad hoc arbitration tribunals to rule on disputes involving matters of major public interest. This is therefore the AIV's preferred solution. Ideally, a permanent international investment court would have tenured judges, the substantive law would be the same for all states, all disputes would be dealt with in accordance with the same procedures, and a large number of states would be party to the founding treaty. However, establishing a permanent court for cases at first instance or possibly solely as an appellate body will take time. The AIV does not wish to underestimate its task and therefore makes suggestions below on how to achieve the best possible negotiating result on the ISDS provisions in TTIP and other future agreements containing such provisions. The AIV regards modernisation of the ISDS system as a second best option.

The establishment of a permanent international investment court with tenured judges will meet some of the rule-of-law criticisms of ISDS. The appointment of judges with a permanent and full-time position would provide more safeguards of independence and impartiality than the ad hoc appointment of (commercial) arbitrators. Arbitrators are accustomed to switching between the roles of arbitrator, state counsel and counsel for investors and may also hold other positions which could give rise to a conflict of interest. Unlike arbitration, where the parties to the dispute designate the arbitrators, the court would decide what judges hear a case.

The establishment of a permanent international investment court could also improve the consistency of rulings. Tenured judges would be more likely to consider themselves bound by precedent and, where there is reason to depart from an existing interpretation, to do so only if sufficient reasons can be given for the new interpretation. Coherence and consistency in the manner in which the dispute is concluded are ultimately in the interests of all parties to the dispute.

In practice, ISDS has proved itself a flexible and fast way of resolving disputes. Care should be taken not to lose this advantage if an international investment court is established.

Recommendation 1: the AIV recommends that the government examine whether the establishment of an international investment court would be possible in the context of TTIP. The establishment should preferably be arranged in such a way that other states can accede. The second best option would be to modernise the ISDS system.

The right to regulate and regulatory chill

States have the right to regulate. This is a consequence of state sovereignty. In exercising this right they must not breach their international obligations. ISDS may not – and does not – undermine the right to regulate. However, if states exercise their right to regulate, situations may arise in which investors are entitled to compensation. International law on the right to compensation in the event of direct expropriation is clear: a state may expropriate foreign property provided that this is in the public interest, is carried out in a non-discriminatory manner, under due process of law and against the payment of compensation to the investor for the loss or damage suffered. Indirect expropriation may occur where a state takes measures that permanently destroy the economic value of property almost completely in which an owner has invested, for example because the owner is prevented from freely managing or using the property. To determine whether there is indirect expropriation (and hence a right to compensation), a tribunal must examine each individual case in the light of the facts, the precise wording of the IPA and other relevant law. Sometimes a state may also be able to invoke the right to take such measures out of necessity. Regulatory chill may occur where states forgo the right to regulate or retract legislation for fear that foreign investors will file large claims.

The AIV believes that IPAs must strike a balance between the investor's right to protection of ownership and the state's right to regulate in the public interest. Both are legitimate interests. The right of states to regulate can be protected in various ways, namely by mentioning the right to regulate in the provisions of the IPA, clearly specifying what is meant by indirect expropriation and defining the exceptions to investment protection under the IPA. The AIV therefore advocates inclusion of these elements in the provisions of IPAs. Reference to the right to regulate should be made in the definition of indirect expropriation. It is essential for it to be clear from the provisions of the agreement that in determining whether there is entitlement to compensation a tribunal takes into account not only the impact of the measure on the value of the investment (sole effect) but also the object and proportionality of the measure in relation to the intended objective. These measures can reduce the risk of regulatory chill. These elements can be found in the text of Annex X.11 to CETA, which contains binding provisions. This limits the scope for investors to successfully claim compensation in response to any non-discriminatory government measure designed to protect public welfare objectives. The AIV believes that these elements could greatly reduce the risk of limitation of the right to regulate and the risks of regulatory chill.

At national level the right to regulate is often restricted by the checks and balances that are an integral part of the rule of law in a democracy. And at international level the right to regulate may be limited by the obligations voluntarily entered into by states, for example in the context of the World Trade Organisation (WTO), IPAs or other treaties.

The establishment of a permanent investment court would not provide better protection for states' right to regulate and would not reduce the risk of regulatory chill. These issues must be resolved by better drafting of the substantive provisions of IPAs.

Recommendation 2: the AIV recommends that the following elements be included in the provisions of IPAs: explicit mention of the right to regulate, a precise definition of indirect expropriation, and descriptions of exceptions to the protection of investments under the IPA.

Independence and impartiality of arbitrators

The AIV has expressed a preference above for the establishment of a permanent international investment court. However, it can be expected that such a project will take some considerable time. The AIV has therefore expressly decided to include in this advisory letter consideration of how the existing forms of international dispute settlement through arbitration could be improved. This includes ways of improving procedure and the establishment of an appellate mechanism. An appellate body could be the forerunner of a permanent international investment court, in which case it would make itself redundant in its original capacity.

Arbitrators must avoid any semblance of dependence or bias. This is of crucial importance to the legitimacy of ISDS. The existing ISDS procedures contain few safeguards for the independence and impartiality of arbitrators. The parties to a dispute may choose arbitrators, and the existing rules contain few requirements for arbitrators. Moreover, codes of conduct for arbitrators are not binding. Two improvements would be an obligation for the parties to a dispute to choose arbitrators from a permanent list of qualified candidates and the introduction of a binding code of conduct. The independence and impartiality of arbitrators could also be enhanced if their appointment could be challenged.

The AIV endorses the view of the Minister for Foreign Trade and Development Cooperation on the desirability of introducing an improved code of conduct for arbitrators and preparing a list of independent and qualified arbitrators.

Recommendation 3: the AIV recommends that provisions be included in IPAs to oblige parties to choose arbitrators from a permanent list and to introduce provisions in a code of conduct limiting the scope for arbitrators to take second jobs and swap professional roles. CETA's provisions on this subject are an improvement on earlier IPAs.

Transparency

ISDS can take place in secrecy. This is at odds with the duty of accountability of democratically elected governments. The secrecy of such proceedings could make it impossible for governments to render account for matters in the public interest such as health or the environment, on which democratic decisions have been taken. This is unacceptable. Enhancing transparency is an important way of increasing the legitimacy of ISDS.

Recommendation 4: the AIV recommends that transparency should be the rule. Grounds for limiting transparency are state security and the confidentiality of business information. The AIV also recommends that the subject of transparency be regulated in an IPA, which should specify in what cases the requirement of a public hearing can be waived. The Minister for Foreign Trade and Development Cooperation has already stated her preference for greater transparency.

Coherence, consistency and legal certainty

A few cases are known in which tribunals have given conflicting rulings in comparable cases. The main causes of inconsistency are the defective wording of provisions and inadequate definitions of terms in IPAs, as well as the varying ways in which they are interpreted by arbitrators. The best-known examples of inconsistency are the ISDS cases in response to the measures taken by the Argentine government in combating the economic crisis in 2001 and 2002. Sometimes it is even hard to determine whether inconsistencies have actually occurred, since the applicable substantive standards and facts differ from case to case.

One important way of preventing inconsistency in arbitral awards is to ensure that the text of IPAs is drafted unambiguously. This is already being done more and more in modern IPAs. In addition, the contracting parties can provide clarity about the correct interpretation of the IPA by publishing joint declarations. This responsibility can also be entrusted to a committee established by the IPA and consisting of representatives of the contracting parties.

Recommendation 5: the AIV recommends that the consistency of arbitral awards should be increased by drafting future IPAs better and, where necessary, issuing interpretative declarations about an existing IPA together with the other contracting parties. As regards TTIP, a committee of the contracting parties should be established to issue binding declarations about the interpretation of the agreement.

Recommendation 6: the AIV endorses the view of the Minister for Foreign Trade and Development Cooperation that the concept of MFN should be applied only to substantive standards, not to procedures, and recommends that this be recorded in IPAs (including TTIP). The AIV also recommends that the concept of FET should be defined more precisely in order to limit the scope for interpretation by tribunals.

Arbitral awards must give clear reasons and be accessible. Awards that differ from the commonly held view should be properly reasoned. The establishment of an appellate mechanism would be one way of correcting awards that differ markedly from the consensus view. The Minister for Foreign Trade and Development Cooperation has already stated her support for the establishment of an appellate body.

Recommendation 7: the AIV recommends the establishment of an appellate body to which states and investors could apply on limited grounds for review of an award. This would benefit the consistency of awards. The AIV recommends that the grounds for appeal be limited to cases in which it has been established that the arbitrators concerned were insufficiently independent of the parties, that the decision taken at first instance was manifestly arbitrary, that there was clearly no proper consideration of the relevant facts, that the assessment was demonstrably contrary to what is usual in international arbitration or that procedural standards were flagrantly violated. An appellate body should preferably consist of tenured judges since the risk of inconsistency is greater in the case of a court of fluctuating composition. However, the judges could be available on call on an ad hoc basis.

CETA and TTIP

The AIV considers that it would be desirable to include a form of ISDS in TTIP. It is doubtful whether domestic courts in the United States and the various EU member states are always able (or willing) to provide sufficient legal protection for foreign investors. It appears, for example, that preferential treatment for local investors is not prohibited in

the United States. Similarly, international treaty obligations do not have direct effect in all legal systems of the contracting states. Moreover, there are still significant differences in how the judicial system functions in the different EU countries. ISDS should therefore be in a form which addresses the shortcomings described above.

In the AIV's opinion, the concerns expressed above about states' right to regulate, regulatory chill and the rule-of-law failings of ISDS are already addressed much more effectively in the free trade agreement between the EU and Canada (the Comprehensive Economic and Trade Agreement / CETA) than in the first generation IPAs. For example, CETA contains better definitions of the terms indirect expropriation and FET, thereby protecting states' right to regulate more effectively than in older IPAs. CETA provides an opening for the establishment of an appellate body. It also makes it compulsory for arbitrators to comply with an existing code of conduct. Arbitrators are chosen from a permanent list. On the subject of transparency, CETA follows the UNCITRAL rules. This means that the parties to the dispute determine the desired degree of transparency. The AIV regards CETA as a big step in the right direction and a good model for TTIP, although transparency could still be improved. Transparency should be the rule; confidentiality should be the exception.

Final remarks

Changing the ISDS system will take time. New IPAs can be framed to take account of the latest thinking, but incorporating such thinking into the three thousand-odd existing IPAs is another matter altogether. The Netherlands has concluded some 90 bilateral IPAs, the oldest of which dates from 1966. The IPAs which the EU will conclude with third countries in the next few years will replace some bilateral IPAs between the Netherlands and these third countries. This will make it unnecessary to modernise these existing IPAs. However, the EU will not conclude an IPA within the foreseeable future with all countries with which the Netherlands has a bilateral IPA. In such cases it is necessary to consider amending the IPAs since the concerns about and criticism of ISDS may otherwise continue to exist in relation to them. Sometimes it may be possible to issue a declaration, together with the other contracting party, about the desirable interpretation of the agreement if a dispute arises between an investor and one of the contracting parties. This would enable pressing questions to be resolved quickly.

List of abbreviations

AIV	Advisory Council on International Affairs
CETA	Comprehensive Economic and Trade Agreement
EU	European Union
FET	Fair and equitable treatment
IPA	Investment protection agreement
ICSID	International Centre for Settlement of Investment Disputes
ISDS	Investor-state dispute settlement
MFN	Most-favoured-nation treatment
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Cooperation and Development
PCA	Permanent Court of Arbitration
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organisation

Some CETA provisions on investment protection

Article X.3: definitions

For the purpose of this Chapter:

[.....]

'investment' means:

Every kind of asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, which includes a certain duration and other characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include:

- an enterprise;
- shares, stocks and other forms of equity participation in an enterprise;
- bonds, debentures and other debt instruments of an enterprise;
- a loan to an enterprise;
- any other kinds of interest in an enterprise;
- an interest arising from:
 - a concession conferred pursuant to domestic law or under a contract, including to search for, cultivate, extract or exploit natural resources,
 - a turnkey, construction, production, or revenue-sharing contract, or
 - other similar contracts;
- intellectual property rights;
- any other moveable property, tangible or intangible, or immovable property and related rights;
- claims to money or claims to performance under a contract.

For greater certainty, 'claims to money' does not include claims to money that arise solely from commercial contracts for the sale of goods or services by a natural person or enterprise in the territory of a Party to a natural person or enterprise in the territory of the other Party, domestic financing of such contracts, or any related order, judgment, or arbitral award.

Returns that are invested shall be treated as investments. Any alteration of the form in which assets are invested or reinvested does not affect their qualification as investment.

'Investor' means a Party, a natural person or an enterprise of a Party, other than a branch or a representative office, that seeks to make, is making or has made an investment in the territory of the other Party.

For the purposes of this definition an 'enterprise of a Party' is:

- an enterprise that is constituted or organised under the laws of that Party and has substantial business activities in the territory of that Party; or
- an enterprise that is constituted or organised under the laws of that Party and is directly or indirectly owned or controlled by a natural person of that Party or by an enterprise mentioned under a).

[.....]

Article X.6: National Treatment

1. Each Party shall accord to investors of the other Party and to covered investments, treatment no less favourable than the treatment it accords, in like situations to its own investors and to their investments with respect to the establishment, acquisition, expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.

2. The treatment accorded by a Party under paragraph 1 means, with respect to a government in Canada other than at the federal level, or, with respect to a government of or in a European Member State, treatment no less favourable than the most favourable treatment accorded, in like situations, by that government to investors of that Party in its territory and to investments of such investors.

Article X.7: Most-Favoured-Nation Treatment

1. Each Party shall accord to investors of the other Party and to covered investments, treatment no less favourable than the treatment it accords in like situations, to investors and to their investments of any third country with respect to the establishment, acquisition, expansion, conduct, the operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.

2. For greater certainty, the treatment accorded by a Party under paragraph 1 means, with respect to a government in Canada other than at the federal level, or, with respect to a government of or in a European Member State, treatment accorded, in like situations, by that government to investors in its territory, and to investments of such investors, of any third country.

3. Paragraph 1 shall not apply to treatment accorded by a Party providing for recognition, including through arrangements or agreements with third parties recognising accreditation of testing and analysis services and service suppliers or repair and maintenance services and service suppliers, as well as the certification of the qualifications of or the results or work done by such accredited services and service suppliers.

4. For greater certainty, the “treatment” referred to in Paragraph 1 and 2 does not include investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements. Substantive obligations in other international investment treaties and other trade agreements do not in themselves constitute “treatment”, and thus cannot give rise to a breach of this article, absent measures adopted by a Party pursuant to such obligations.

Article X.9: Treatment of Investors and of Covered Investments

Each Party shall accord in its territory to covered investments of the other Party and to investors with respect to their covered investments fair and equitable treatment and full protection and security in accordance with paragraphs 2 to 6.

A Party breaches the obligation of fair and equitable treatment referenced in paragraph 1 where a measure or series of measures constitutes:

- Denial of justice in criminal, civil or administrative proceedings;
- Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings.

- Manifest arbitrariness;
- Targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;
- Abusive treatment of investors, such as coercion, duress and harassment; or
- A breach of any further elements of the fair and equitable treatment obligation adopted by the Parties in accordance with paragraph 3 of this Article.

The Parties shall regularly, or upon request of a Party, review the content of the obligation to provide fair and equitable treatment. The Committee on Services and Investment may develop recommendations in this regard and submit them to the Trade Committee for decision.

When applying the above fair and equitable treatment obligation, a tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated.

For greater certainty, 'full protection and security' refers to the Party's obligations relating to physical security of investors and covered investments.

For greater certainty, a breach of another provision of this Agreement, or of a separate international Agreement, does not establish that there has been a breach of this Article.

Article X.11: Expropriation

1. Neither Party may nationalize or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation"), except:

- (a) for a public purpose;
- (b) under due process of law;
- (c) in a non-discriminatory manner; and
- (d) against payment of prompt, adequate and effective compensation.

For greater certainty, this paragraph shall be interpreted in accordance with Annex X.11 on the clarification of expropriation.

2. Such compensation shall amount to the fair market value of the investment at the time immediately before the expropriation or the impending expropriation became known, whichever is earlier. Valuation criteria shall include going concern value, asset value including the declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

3. The compensation shall also include interest at a normal commercial rate from the date of expropriation until the date of payment and shall, in order to be effective for the investor, be paid and made transferable, without delay, to the country designated by the investor and in the currency of the country of which the investor is a national or in any freely convertible currency accepted by the investor.

4. The investor affected shall have a right, under the law of the expropriating Party, to prompt review of its claim and of the valuation of its investment, by a judicial or other independent authority of that Party, in accordance with the principles set out in this Article.

5. This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements ('TRIPS Agreement').

6. For greater certainty, the revocation, limitation or creation of intellectual property rights to the extent that these measures are consistent with TRIPS and Chapter X (Intellectual Property) of this Agreement, do not constitute expropriation. Moreover, a determination that these actions are inconsistent with the TRIPS Agreement or Chapter X (Intellectual Property) of this Agreement does not establish that there has been an expropriation.

Article X.15: Denial of Benefits

A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of that Party and to investments of that investor if:

- investors of a non-Party own or control the enterprise; and
- the denying Party adopts or maintains measures with respect to the non-Party that:
- are related to maintenance of international peace and security; and
- prohibit transactions with the enterprise or would be violated or circumvented if the benefits of this Chapter were accorded to the enterprise or to its investments.

Article X.25: Constitution of the Tribunal

Unless the disputing parties have agreed to appoint a sole arbitrator, the Tribunal shall comprise three arbitrators. One arbitrator shall be appointed by each of the disputing parties and the third, who will be the presiding arbitrator, shall be appointed by agreement of the disputing parties. If the disputing parties agree to appoint a sole arbitrator, the disputing parties shall seek to agree on the sole arbitrator.

[.....]

Pursuant to Article X.42(2)(a), the Committee on Services and Investment shall establish, and thereafter maintain, a list of individuals who are willing and able to serve as arbitrators and who meet the qualifications set out in paragraph 5. It shall ensure that the list includes at least 15 individuals but may agree to increase the number of individuals. The list shall be composed of three sub-lists each comprising at least five individuals: one sub-list for each Party, and one sub-list of individuals who are neither nationals of Canada nor the Member States of the European Union to act as presiding arbitrators.

Arbitrators appointed pursuant to this Section shall have expertise or experience in public international law, in particular international investment law. It is desirable that they have expertise or experience in international trade law and the resolution of disputes arising under international investment or international trade agreements.

Arbitrators shall be independent of, and not be affiliated with or take instructions from, a disputing party or the government of a Party with regard to trade and investment matters. Arbitrators shall not take instructions from any organisation, government or disputing party with regard to matters related to the dispute. Arbitrators shall comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration or any supplemental rules adopted pursuant to Article X.42(2)(b) (Committee on Services and Investment). Arbitrators who serve on the list established pursuant to paragraph 3 shall not, for that reason alone, be deemed to be affiliated with the government of a Party.

If a disputing party considers that an arbitrator does not meet the requirements set out in paragraph 6, it shall send a notice of its intent to challenge the arbitrator within 15 days after:

- the appointment of the arbitrator has been notified to the challenging party; or,
- the disputing party became aware of the facts giving rise to the alleged failure to meet such requirements.

[.....]

Article X.27: Applicable Law and Interpretation

A Tribunal established under this Chapter shall render its decision consistent with this Agreement as interpreted in accordance with the Vienna Convention on the Law of Treaties, and other rules and principles of international law applicable between the Parties.

Where serious concerns arise as regards matters of interpretation that may affect investment, the Committee on Services and Investment may, pursuant to Article X.42(3)(a), recommend to the Trade Committee the adoption of interpretations of the Agreement. An interpretation adopted by the Trade Committee shall be binding on a Tribunal established under this Chapter. The Trade Committee may decide that an interpretation shall have binding effect from a specific date.

Article X.29: Claims Manifestly Without Legal Merit

The respondent may, no later than 30 days after the constitution of the tribunal, and in any event before the first session of the Tribunal, file an objection that a claim is manifestly without legal merit.

An objection may not be submitted under paragraph 1 if the respondent has filed an objection pursuant to Article X.30 (Claims Unfounded as a Matter of Law).

The respondent shall specify as precisely as possible the basis for the objection.

On receipt of an objection pursuant to this Article, the Tribunal shall suspend the proceedings on the merits and establish a schedule for considering any objections consistent with its schedule for considering any other preliminary question.

The Tribunal, after giving the disputing parties an opportunity to present their observations, shall at its first session or promptly thereafter, issue a decision or award, stating the grounds therefor. In doing so, the Tribunal shall assume the alleged facts to be true.

This Article shall be without prejudice to the Tribunal's authority to address other objections as a preliminary question or to the right of the respondent to object, in the course of the proceeding, that a claim lacks legal merit.

Article X.33: Transparency of Proceedings

The UNCITRAL Transparency Rules shall apply to the disclosure of information to the public concerning disputes under this Section as modified by this Chapter.

The request for consultations, the notice requesting a determination of the respondent, the notice of determination of the respondent, the agreement to mediate, the notice of intent

to challenge, the decision on an arbitrator challenge and the request for consolidation shall be included in the list of documents referred to in Article 3(1) of the UNCITRAL Transparency Rules.

Exhibits shall be included in the list of documents mentioned in Article 3(2) of the UNCITRAL Transparency Rules.

Notwithstanding Article 2 of the UNCITRAL Transparency Rules, prior to the constitution of the tribunal, Canada or the European Union as the case may be shall make publicly available in a timely manner relevant documents pursuant to paragraph 2, subject to the redaction of confidential or protected information. Such documents may be made publicly available by communication to the repository.

Hearings shall be open to the public. The tribunal shall determine, in consultation with the disputing parties, the appropriate logistical arrangements to facilitate public access to such hearings. Where the tribunal determines that there is a need to protect confidential or protected information, it shall make the appropriate arrangements to hold in private that part of the hearing requiring such protection.

Nothing in this Chapter requires a respondent to withhold from the public information required to be disclosed by its laws. The respondent should endeavour to apply such laws in a manner sensitive to protecting from disclosure information that has been designated as confidential or protected information.

Article X.42: Committee

The Committee on Services and Investment shall provide a forum for the Parties to consult on issues related to this Section, including:

- difficulties which may arise in the implementation of this Chapter;
- possible improvements of this Chapter, in particular in the light of experience and developments in other international fora; and,
- whether, and if so, under what conditions, an appellate mechanism could be created under the Agreement to review, on points of law, awards rendered by a tribunal under this Section, or whether awards rendered under this Section could be subject to such an appellate mechanism developed pursuant to other institutional arrangements. Such consultations shall take into account the following issues, among others:
 - the nature and composition of an appellate mechanism;
 - the applicable scope and standard of review;
 - transparency of proceedings of an appellate mechanism;
 - the effect of decisions by an appellate mechanism;
 - the relationship of review by an appellate mechanism to the arbitration rules that may be selected under Article X.22 (Submission of a Claim to Arbitration); and
 - the relationship of review by an appellate mechanism to domestic laws and international law on the enforcement of arbitral awards.

The Committee shall, on agreement of the Parties, and after completion of the respective legal requirements and procedures of the Parties:

- establish and maintain the list of arbitrators pursuant to Article X.25(3)(Constitution of the Tribunal);
- adopt a code of conduct for arbitrators to be applied in disputes arising out of this Chapter, which may replace or supplement the rules in application, and that may address topics including:

- o disclosure obligations;
- o the independence and impartiality of arbitrators; and
- o confidentiality.

The Parties shall make best efforts to ensure that the list of arbitrators is established and the code of conduct adopted no later than the entry into force of the Agreement, and in any event no later than two years after the entry into force of the Agreement.

The Committee may, on agreement of the Parties, and after completion of the respective legal requirements and procedures of the Parties:

- recommend to the Trade Committee the adoption of interpretations of the agreement pursuant to Article X.27(2) (Applicable Law and Interpretation);
- adopt and amend rules supplementing the applicable arbitration rules, and amend the applicable rules on transparency. Such rules and amendments are binding on the members of a Tribunal established under this Section;
- adopt rules for mediation for use by disputing parties as referred to in Article X.19 (Mediation); and
- recommend to the Trade Committee the adoption of any further elements of the fair and equitable treatment obligation pursuant to Section 5, Article X.9(4) (Treatment of Investors and of Covered Investments).

Annex X.11: Expropriation

The Parties confirm their shared understanding that:

1. Expropriation may be either direct or indirect:

direct expropriation occurs when an investment is nationalised or otherwise directly expropriated through formal transfer of title or outright seizure; and

indirect expropriation occurs where a measure or series of measures of a Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.

2. The determination of whether a measure or series of measures of a Party, in a specific fact situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, among other factors:

- the economic impact of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;
- the duration of the measure or series of measures by a Party;
- the extent to which the measure or series of measures interferes with distinct, reasonable investment-backed expectations; and
- the character of the measure or series of measures, notably their object, context and intent.

3. For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.

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