

April 7, 2015

Dear Majority Leader McConnell, Minority Leader Reid, Speaker Boehner, Minority Leader Pelosi, and Ambassador Froman:

We the undersigned—professors and scholars of international law, arbitration, and dispute settlement—strongly support a robust, even-handed, and careful discussion about investment treaty arbitration (ITA), which is sometimes referred to as investor-state dispute settlement (ISDS). We believe, however, that the discussion should be based on facts and balanced representations, rather than on errors or skewed information.

To that end, we offer the following responses to the letter circulated by the Alliance for Justice.<sup>1</sup>

### **Sovereignty and the Rule of Law**

Far from an abdication of sovereign responsibility, entering into international treaties of any kind—including trade and investment agreements—is a core exercise of that sovereignty. States decide which obligations they wish to include in a treaty. They can and do carefully delineate the scope of those obligations to achieve greater stability and predictability for foreign investors and host states alike. Negotiating those trade-offs is not just a nation's sovereign right, but its sovereign duty.

It is a hallmark of the rule of law that states must justify their acts and take responsibility for improper conduct. Far from undermining the rule of law, investment treaty arbitration ensures that states honor their obligations, thereby reinforcing the rule of law. Of course, by opening themselves to arbitration, states open themselves to the risk of losing some cases. But creating such a risk is our sovereign right, and it is an incentive to gain international cooperation that benefits not just foreign states but our nation as well. In addition, there is a difference between actual risk and realized risk. Simply proclaiming that states *might* lose a case is not a reason for dismantling a rule of law adjudicative mechanism. Indeed, holding states responsible for violating fundamental norms is part of any regime based on the rule of law, whether the protections in questions are based in a constitution, in national law, or in an international treaty. Likewise, affirming when state conduct is a proper exercise of sovereignty is also a fundamental value of any rule of law regime.

Investment treaty arbitration permits foreign investors—whether they are small, medium or large entities, and whether they are human beings or corporations—to challenge government measures that violate the treaty obligations negotiated for their protection. Many of these rights are similar to those guaranteed by the U.S. Constitution, but they might not be guaranteed in foreign countries.

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<sup>1</sup> The letter is available at: <http://www.afj.org/wp-content/uploads/2015/03/ISDS-Letter-3.11.pdf>

Common bases for complaints are that a host state has discriminated on the basis of nationality, has failed to accord a foreign investor due process, or has expropriated the property of a foreign investor without payment of prompt, adequate, and effective compensation. Investment treaties also generally require that a government permit a foreign investor to repatriate its profits.

It is not correct that investment treaty arbitration permits corporations to initiate dispute settlement against governments “for actions that allegedly cause a loss of profit for the corporation.” “Lost profits” is merely a measure of damages, not a cause of action, which must be predicated on allegedly wrongful government acts, such as discriminating against foreigners or failing to provide them with due process, that violate the express terms of a treaty.

While some challenges involve environmental, health, and safety regulations, fears that such claims threaten legitimate state regulatory conduct must be tempered by recognizing that a state can be penalized for those regulations only if their acts are arbitrary, discriminatory, or otherwise violate the investment guarantees to which states have previously agreed. In *S.D. Myers v. Canada*, for example, Canada imposed a ban on the export of PCB waste for remediation in the United States by a U.S. company. Canada’s goal in imposing the ban was not to protect the environment, but to protect Canada’s PCB waste disposal industry, as acknowledged by Canada’s Minister for the Environment in a speech that she gave to the House of Commons.

By contrast, *bona fide* government acts will pass muster. Several years ago, the United States was challenged in the *Methanex* case, which involved California’s ban on the gasoline additive methyl tertiary-butyl ether. The United States won that case because the ban addressed a legitimate environmental concern and did not violate the underlying investment treaty—namely NAFTA—notwithstanding the fact that the ban negatively affected the company’s profits. In fact, the United States was awarded attorneys’ fees in that case – something that rarely occurs in U.S. domestic litigation.

Similarly, Canada prevailed in another NAFTA case involving pesticide products containing the active ingredient lindane, which the Pest Management Regulatory Agency of Canada (PMRA) decided to phase out after an agency study revealed environmental concerns. Chemtura, a manufacturer of lindane-based pesticides, submitted a claim under Chapter 11 of NAFTA, claiming that the PMRA’s prohibition constituted expropriation of its investment in Canada. The arbitral tribunal decided unanimously in favor of Canada, concluding that “the PMRA took measures within its mandate, in a non-discriminatory manner, [and] motivated by the increasing awareness of the dangers presented by lindane for human health and the environment. A measure adopted under such circumstances is a valid exercise of the State’s powers and, as a result, does not constitute an expropriation.”

Corporations cannot and will not gain victory simply by arguing reduced investment value. Rather, legitimate government conduct will be upheld as a proper exercise of sovereignty.

Moreover, nothing in investment treaties requires states to change their domestic regulations. The only remedy available in most cases is the payment of damages. The United States, for example, has forbidden arbitral tribunals from ordering the removal of any offending state measure; rather, tribunals can only order property restitution in the event of expropriation, but even in those cases must in the alternative permit the payment of money damages.

One of the most contested issues currently is a challenge to Australia's plain-packaging legislation, which imposes certain limits on the use of trademarks and identifying features on cigarette packages. This is not necessarily a representative case and, more importantly, the outcome has not yet been decided. It is quite possible that Australia will win and its plain packaging regulation will be vindicated as an appropriate health and safety measure both by national and international tribunals.

It is wrong to condemn a system on the basis of dire predictions rather than facts. Overall data reflect that states win more than investors. At current rates, states have won roughly three cases for every two cases won by investors.<sup>2</sup> Research by the United Nations Conference on Trade and Development similarly reflects that the proportion of state wins has been larger than the proportion of investor wins.<sup>3</sup> There can be real value—both in terms of symbolic justice and in clarifying international law obligations—in permitting these cases to proceed and in identifying where investors will lose.

### **Procedural Protections**

International arbitration includes a number of procedural protections that resemble protections often found in national court systems.

Even after a case has commenced it is possible to challenge arbitrators if a party is concerned that their independence or impartiality has been compromised. Both parties are represented by counsel, and both parties submit evidence, including expert testimony, to arbitral tribunals who exercise adjudicatory functions. The arguments and the decisions are based on law. Both parties are able to make opening and closing arguments, and in addition to at least one, and often two, rounds of pre-hearing briefs, the parties often submit post-hearing briefs as well. In short, these are precisely the sort of procedures that are followed in U.S. courts.

Investment treaty arbitration is supported by both national and international laws, including the New York Convention on Recognition and Enforcement of Foreign Arbitral

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<sup>2</sup> See, e.g., Susan D. Franck, *Conflating Politics and Development? Examining Investment Treaty Arbitration Outcomes*, forthcoming 55 VIRGINIA JOURNAL OF INTERNATIONAL LAW 13 (2014), available at <http://ssrn.com/abstract=2574299>.

<sup>3</sup> See UNCTAD, WORLD INVESTMENT REPORT 2014: INVESTING IN THE SDGs: AN ACTION PLAN TOWARDS A NEW GENERATION OF INVESTMENT POLICIES, 126, U.N. Doc. UNCTAD/WIR/2014 (observing that of 274 known completed cases “approximately 43 per cent were decided in favour of the State and 31 per cent in favour of the investor. Approximately 26 per cent of cases were settled.”).

Awards, which was finalized in 1959 and requires that states that are party to the Convention (154 countries, including the United States) enforce awards rendered in states that are party to it.

Investment treaty arbitrations unfold under two different regulatory regimes. Either they take place under the auspices of the Convention on Settlement of International Investment Disputes (the ICSID Convention), or they take place under another set of arbitral rules, such as the UNCITRAL Rules, where the New York Convention provides an enforcement mechanism. In each case, there are multiple control mechanisms to police the procedural fairness of the award rendered, including concerns about the potential bias of arbitrators.

Awards rendered under the ICSID Convention are subject to annulment, with the annulment committee (comprised of arbitrators drawn from a roster appointed by states) reviewing awards to ensure that arbitrators have not manifestly exceeded their authority or departed from a fundamental rule of procedure, to name just two of the grounds. Awards may be annulled – in full or in part – for procedural irregularities and other problems that generate doubts as to the integrity of the quality of an arbitral tribunal’s adjudicative decision.

The fact that ICSID Convention *ad hoc* annulment committees have recently annulled awards rendered against states, both in whole and in part, indicates that they take their obligations seriously and are willing to provide a critical procedural check on initial awards rendered by arbitral tribunals. This practice reflects, rather than detracts from, the rule of law capacity of these tribunals. It also provides oversight of arbitral practice.

Other investment treaty arbitration awards are subject to review in the place of arbitration *and* in any place where enforcement is sought. These New York Convention awards are policed in the first instance by the court in the legal seat of the arbitration, which reviews the award on the grounds that the local government has chosen to include in their national laws. Frequent grounds are that the arbitral agreement was invalid, or that the losing party was given inadequate time to present its case. Local courts—including courts in the United States—can, and do, “set aside” arbitral awards. Last term, the United States Supreme Court had an opportunity to consider the validity of an award rendered under an investment treaty. In *BG Group v. Argentina*, the Supreme Court chose to defer to the interpretation of international arbitrators. This mechanism, again, provides oversight and review.

If a judgment creditor tries to enforce the award outside the place of arbitration under the regime established by the New York Convention, it must seek a court’s assistance to enforce the award. The losing party is able to argue against enforcement on multiple bases, including that enforcement would violate the public policy of the forum.

## **Transparency and public participation**

The United States and Canada have been champions of transparency in investment treaty arbitration. Each has, since 2001, maintained a website where they post the awards rendered in the cases they defend. They also post pleadings, memorials, and procedural decisions. Mexico has followed the same practice in NAFTA Chapter 11 proceedings. These materials are available for free. In that respect they are more easily and widely available than documents in most U.S. courts. The U.S. federal government maintains an electronic records system for domestic litigation, but users must pay for access (\$.10 per page).

The United States, Canada, and Mexico have also welcomed the participation of non-disputing parties, including non-governmental organizations. They can seek permission to file *amicus curiae*-like briefs. NGOs such as the International Institute for Sustainable Development, the Center for International Environmental Law, and the International Commission of Jurists, to name just some, have participated in cases around the globe. In addition, states that are party to the treaty but are not party to the dispute also frequently file submissions on matters of treaty interpretation.

Both Canada and the United States have agreed to make hearings public. The International Centre for Settlement of Investment Disputes (ICSID) has helped to facilitate those hearings. ICSID also revised its rules in 2006 to encourage more transparency: ICSID publishes all awards if the parties to the case agrees, but they publish excerpts of the legal reasoning even if the parties do not want the full award to be made public. The ICSID Arbitral Rules also permit participation by *amici curiae*. Several ICSID-administered proceedings have also been streamed live to make them fully accessible to the public.

Other states have been slower to promote the same standards of access to documents and awards, but that trend is changing. UNCITRAL has recently promulgated new rules for transparency in investor-state disputes. A United Nations treaty (the Mauritius Convention) opened for signature on March 17, 2015; when it enters into force, for those states signing the treaty, the transparency rules will apply retroactively to existing investment treaties.<sup>4</sup> Thus, a more balanced perspective demonstrates that investment treaty arbitration proceedings need not be, and are more often not, opaque, closed-door proceedings. The way to ensure even greater transparency in these proceedings, for those states that have not yet agreed to transparency norms in international dispute settlement, is to mandate it within a treaty.

## Conclusion

Contrary to the assertions contained in the Alliance for Justice letter, investment treaty arbitration does not undermine the rule of law. It ensures that, where a right is given, a remedy is also provided. It permits foreign investors to hold host states to the obligations they have undertaken in their treaties by means of a quasi-judicial process; and it also offers a forum for states to vindicate their policy choices. Indeed, it is useful to recall one

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<sup>4</sup> Canada, Finland, France, Germany, Mauritius, Sweden, the United Kingdom and the United States have already signed the Mauritius Convention.

of the alternatives: gunboat diplomacy, whereby investment disputes were resolved by the use of force, was not unknown even in the twentieth century.

The obligations commonly found in investment agreements—including non-discrimination on the basis of nationality; due process; expropriation of property only for a public purpose and on payment of prompt, adequate, and effective compensation; and repatriation of profits—are the hallmarks of a society that is governed by law. Procedural protections pervade the investment treaty arbitration process. Cases involving the United States are extraordinarily transparent due to the publication requirements that the United States rightly insists should be included in its agreements.

We respectfully submit that there are legitimate areas for meaningful debate about the substantive rights provided in investment treaties. Having provided those rights, however, it is critical to offer a rule of law adjudicative mechanism—one that is perceived to be fair and creates enforceable outcomes—to provide a remedy that identifies when rights are breached and clarifies when state conduct is legitimate. All systems of justice, whether national courts or international courts and tribunals, are capable of improvement. It is essential, however, that the current debate be based on accurate information and not focus on perceived, isolated shortcomings that are present in some form in any and every adjudicative body.

Thank you for your consideration.

Sincerely,

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