



# The Netherlands and TTIP:

## Policy space and motives for an Investment Court

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## **Executive summary**

The European Union and the United States are currently negotiating the Transatlantic Trade and Investment Partnership (TTIP) agreement. Both parties intend to include an investor-state dispute settlement (ISDS) clause in TTIP. The European Commission has put forward a proposal to reform the current ISDS system through TTIP; an Investment Court System (ICS) would solve many existing problems in the field of investor-state arbitration. But, this reform effort has not convinced critics. The enforceable rights the ICS proposal creates for foreign investors would still infringe upon government's decision-making power to produce laws and decisions in the public interest. Yet, the Dutch government has continuously supported the inclusion of ISDS mechanisms in International Investment Agreements (IIAs). Why does the Dutch government advocate for an Investment Court System in TTIP that may have a negative impact on government's policy space? This dissertation aims to answer this question from a Political Science perspective, through the conduct of qualitative desk research and empirical data collection.

The study finds that, although the ICS proposal would solve many of the existing problems in the field of ISDS, it bears the risk of negatively impacting legitimate policy space. As commonly accepted principles of treatment of foreign investors do not impede government's right to regulate, under ICS, governments face the risk of reduced policy space through the (perceived) threat of arbitration. Findings suggest that the Dutch government underestimates this risk.

A number of factors have been identified that explain the Dutch position in favor of ICS. The Netherlands is one of the biggest players in the global field of investor-state arbitration through the maintenance of a large network of IIAs. Investors based in The Netherlands regularly sue foreign governments under the substantive terms of these IIAs. However, the Dutch government itself has never been taken to arbitration – the country enjoys a professional and independent legal system. As the Dutch economy is heavily dependent on the general state of the world, mechanisms which are perceived to promote the rule of law would contribute to prosperity. Through ICS in TTIP, Dutch investors would also benefit from an extra layer of protection in the United States. But most importantly, ICS would provide leverage in future negotiations with third countries by setting a global standard for international investor protection.

However, this study suggests a rebalancing of the Dutch government's position toward the ICS proposal would be justified. As only three percent of Dutch incoming foreign direct investments are currently covered by IIAs, including ICS in TTIP would significantly expand the scope of liability of investor-state arbitration cases for the Dutch government.

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**List of abbreviations**

BIT	Bilateral Investment Treaty
CETA	Comprehensive Economic and Trade Agreement
CPB	Centraal Planbureau
EC	European Commission
ECJ	European Court of Justice
ECT	Energy Charter Treaty
EP	European Parliament
EU	European Union
FDI	Foreign Direct Investment
FET	Fair -and Equitable Treatment
FTA	Free Trade Agreement
ICJ	International Court of Justice
ICS	Investment Court System
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
ISDS	Investor-State Dispute Settlement
MEP	Member of the European Parliament
MFN	Most-Favored Nation
NGO	Non-Governmental Organization
NTB	Non-Tariff Barrier
OECD	Organization for Economic Cooperation and Development
OFII	Organization For International Investment
PEL	Professor of Economic Law
PO	Policy Officer
PvdA	Partij van de Arbeid
SME	Small and Medium-sized Enterprise
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
US	United States of America



VVD	Volkspartij voor Vrijheid en Democratie
WTI	World Trade Institute
WTO	World Trade Organization

## **(1) Introduction to the study**

### **a. Introduction**

In July 2013, the EU and US launched negotiations on the Transatlantic Trade and Investment Partnership (TTIP). The latest round of negotiations took place in October 2015 and the aim is to complete negotiations by the end of this year (2016). The bilateral trade deal could be the world's biggest trade agreement in history. Its goal is to increase trade and investment by removing where possible barriers to trade between the EU and US. These barriers would be tackled by creating rules to increase market access, greater regulatory compatibility and through investment protection mechanisms, among others. This would create the largest free-trade zone in the world and set worldwide standards on goods, services and rules. According to some studies, an ambitious deal would result in a 0.5% net increase in EU GDP over a ten year period.

Since the 2009 Lisbon Treaty, investment policy competence has moved from EU member state governments to the European Commission. National leaders have provided the Commission with a mandate that sets out the parameters within which negotiations are to be conducted. While the Commission has the sole right to negotiate trade agreements, it is expected that national parliaments will be allowed to exercise a final judgment over whether the agreement is adopted or not.

Clearly, the most controversial part of the TTIP agreement deals with investor protection: the investor-state dispute settlement (ISDS) clause. Unprecedented public opposition has led to some pro-TTIP commentators to call for the exclusion of ISDS in TTIP to avoid sinking the deal entirely. The main point of criticism of ISDS arises from the fear that the proposed mechanism could infringe upon the EU and Member States' ability to regulate in the public interest. Proponents of ISDS promote the necessity and benefits of investor protection.

Relatively unknown is the fact that International Investment Agreements (IIAs) have seen a rapid expansion over the past decades. This has been accompanied by a rise in controversial ISDS cases related to public health and environmental legislation and measures. The European Commission has since mounted a PR offensive to highlight the merits of investor-state arbitration. At the same time, some European governments, including the Dutch government, have set out to propose a reformed version of ISDS - which has been adopted by the Commission. A permanent investment court or Investment Court System (ICS) would secure the independence of arbitrators and safeguard government's right to regulate. However, public interest groups are claiming that

the reforms are cosmetic, and that the system is still inherently flawed.

As in negotiations, “nothing is agreed until everything is agreed”, it is tremendously difficult to say what the outcome of the TTIP negotiations will be. The effects of a potential ISDS-deal between the EU and US would heavily depend on the eventual text and interpretation of that text. Proponents of ISDS in TTIP claim most governments have nothing to fear if they follow the rules established in IIA’s. Opponents of ISDS claim that it will create a parallel legal system that will strait-jacket governments to the whims of large corporations. The creation of a court of arbitration solely accessible to foreign investors naturally raises questions of legitimacy in countries with generally trusted legal systems and has already invigorated a debate on states’ policy space.

International agreements often involve some kind of loss of sovereignty on the signatories’ part and this time in TTIP it could involve constraints in actual day-to-day policymaking. Yet, governments (like the Government of The Netherlands) have continuously supported the inclusion of ISDS mechanisms in IIAs – of which the ICS proposal is the most recent. Why would the Dutch government advocate for such a deal? And does the ICS proposal actually limit policy space?

This dissertation is an attempt to explain why the Dutch government advocates for the ICS proposal considering it may negatively affect its own policy space. Therefore, the central research question of this dissertation has been formulated as follows:

*Why does the Government of The Netherlands advocate for an Investment Court System (ICS) in the Transatlantic Trade and Investment Partnership (TTIP) agreement that may have a negative impact on government’s policy space?*

## **b. Research objectives**

For the purposes of this Bachelor thesis, the researcher applies the research skills gained from the *European Studies Program at The Hague University of Applied Sciences*.

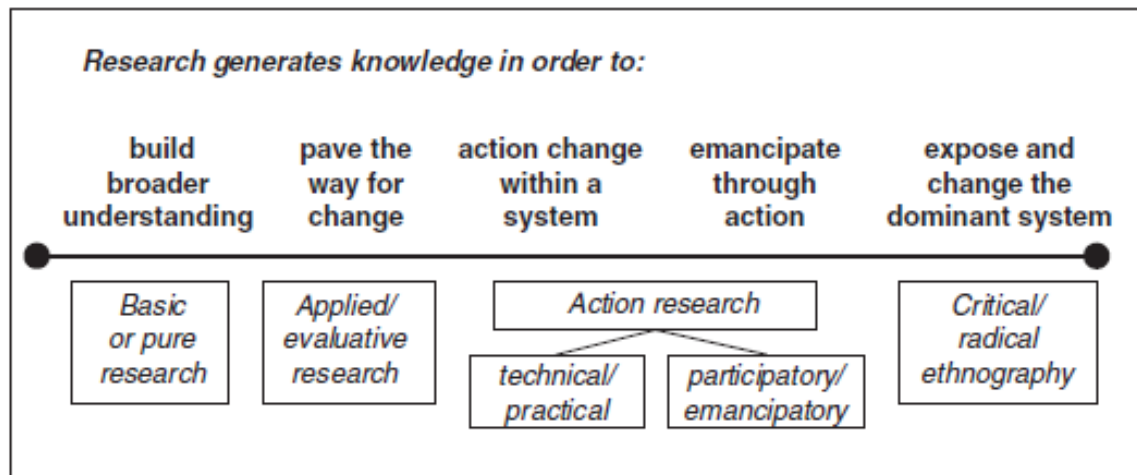
The research question of this dissertation appears to ask a simple question: why does the Dutch government advocate for an Investment Court System in TTIP? Thus, firstly, it is important that the context surrounding the research question is explored, namely: the conventional ISDS system, the TTIP negotiations and the position of The Netherlands. Also, a theoretical framework on the creation of international institutions should assist in answering the research question. However, the research question consists of two questions. The second being an implicit assumption: it is expected that ISDS provisions have a negative impact on government's policy space. Therefore, secondly, it is imperative that this dissertation shall investigate whether the ICS will have a negative impact on policy space of governments, and if so, to what degree. Therefore, a comparison between the effects of conventional investment treaty arbitration and the provisions of the ICS proposal shall be made. If the ICS proposal turns out not to limit policy space, the report will state these findings and continue its focus on the following research objective. Finally, the dissertation will try to answer the research question by probing the Dutch position towards the ICS proposal and identifying the motivating factors behind the Dutch governments' position.

Listed below are the research objectives of this report:

- Explore context and literature on the creation of international institutions and ISDS.
- Investigate whether the proposed Investment Court System may limit government's policy space, and if so, to what degree.
- Identify motivating factors for the Dutch government to advocate for the proposed Investment Court System.

As a final point, research is not conducted for the sake of research. During the process of writing this dissertation, the author shall bear in mind that 'the goals of research can be placed on a continuum from knowledge to change (O'Leary, 2004, p.132)', as is illustrated below in figure 1. Though one does not exclude the other, the author notes that as of yet, the goal of this research is limited to building a broader understanding of the topic at hand.

Figure 1: Knowledge/change continuum.



(O'Leary, 2004, p.133)

### c. Structure

This study is structured as followed so as to facilitate a systematic evaluation of the content. It is presented in a way that should provide reading comfort on a step-by-step basis, delving deeper into the topic as the reader advances. After having briefly introduced the reader to the topic and having stated the objectives of the research (1), a methods chapter elaborates on the methodology used to conduct the research and empirical data collection (2). Following, a theoretical framework (3) consisting of two parts outlines the boundaries of the academic literature and presents the reader with important context on the design of international institutions. This is followed by the main body of content of the study: the literature review and analysis chapter (4). This chapter explores and discusses relevant information to achieve the goal of answering the main research question. Each section is concluded by an overview of the relevant empirical data that has been collected and an analysis of the content presented in each section. The literature review starts with an exploration of the position of The Netherlands with regards to the European Commissions' ICS proposal. It mainly focuses on investment policy and investment relations. The second section explores the main benefits and costs related to ISDS provisions and it discusses arguments in favor and against ISDS in TTIP. This chapter's third and final section aims to investigate to what extent the ICS proposal limits government's policy space.

It explores concepts related to policy space and compares the ICS proposal with traditional investment protection practices. Finally, (5) a conclusion is drawn from the analyses that have been conducted. The conclusion aims to answer the central research question of this dissertation. This is followed by some recommendations made to the Dutch government. The appendices section (6) includes the negotiating mandate for an investment chapter delivered to the European Commission and an overview of what investment treaties generally consist of. These provide the reader with some additional context and information. Also included is an informed consent form which informs participants in the research and ensures confidentiality.

## **(2) Methods**

### **a. Research methods**

The potential effects involved with the proposed Investment Court System are inherently broad. Therefore, academic fields like Law and Economics will be touched upon, but only as complementary to the Political Science approach that this dissertation will adhere to. This dissertation conducts qualitative research in the form of desk research and empirical data collection through interviews. It conducts an exploration and analysis of legal, economic and political science literature. Considering the political nature of this Bachelor dissertation, it was decided not to delve too deep in the analysis of arbitration cases. Rather, for the purpose of this dissertation, an analysis of literature on arbitration cases should suffice.

Because policy analysis requires a degree of measurability, it was decided to conduct a simple cost-benefit analysis that consists of a review of literature on the economic, political and substantial and procedural aspects of the topic at hand. Here, it should be noted that there are shortcomings to taking a rational approach to policy analysis; not all policy decisions are fit for cost-benefit analyses. Weighing low-probability high-cost variables with high-probability low-benefit variables - as might be the case for ISDS in TTIP - is incredibly hard to do. Besides, many variables are simply incalculable. Predicting policy outcomes is often tremendously difficult and the potential size and scope of the TTIP agreement add to this uncertainty. The argument put forward by Manski (2013) that public policy analysis is often based on misleading assertions of certitude and the failure to take uncertainty into account highlights the importance of comprehensive and honest research in the context of TTIP. For this study, it was decided that a cost-benefit analysis of ISDS in TTIP could shed some light on the motivating factors behind the Dutch governments' position on the Investor Court System but only as complementary to the research.

Furthermore, desk research shall be supplemented by empirical research in the form of semi-structured interviews; a representative sample of expert interviewees should provide relevant data to fill potential gaps in the desk research. As 'conducting an interview that can generate relevant and credible data requires thorough planning, considered preparation of an interview schedule and recording system [...] and appropriate analysis (O'Leary, 2004, p.183)', it was decided to commence with these activities relatively early in the process of this study. The following section elaborates on the empirical research.

## **b. Empirical data**

A representative sample of experts was approached to fill potential gaps in the desk research. Three interviews were conducted in a semi-structured method. This method allows for a structured, yet animated discussion, whilst leaving ample room for the interviewee to elaborate on topics of choice. It was also decided that, in order to achieve maximum empirical results, the interviews were conducted in a relatively large time-span. This allowed for a relaxed environment, the minimization of stress-related mistakes and elaboration on certain topics of choice. Transcripts of the conducted interviews have been sent to the supervisor to this Bachelor dissertation.

Each section of the literature review concludes with a summary of the empirical data relevant to that section under the header: “empirical data”. This increases reading comfort and makes it easier to analyze the empirical data in relation to the literature review.

The interviewees’ names are redacted to accommodate for privacy concerns<sup>1</sup>, and to diminish any adverse effects resulting from potential misrepresentation. Pseudonyms are used to indicate who said what. Interviews were conducted with the following experts:

- One interview was conducted with a prominent Brussels-based Professor of Economic Law (hereafter: PEL).
- One interview was conducted with a Member of the European Parliament from the Confederal Group of the European United Left - Nordic Green Left Group (hereafter: MEP). Also relevant: Member of the EP Committee on International Trade.
- One interview was conducted with a Policy Officer of the Investment Protection department of the Dutch Ministry of Foreign Affairs (hereafter: PO). The PO is responsible for the Dutch bilateral- and multilateral investment policy, as well as the Dutch position regarding European investment protection policy.

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<sup>1</sup> Not all interviewees shared an equally strong concern for confidentiality. It was decided, however, to redact all names to provide for coherence and for the simple reason that it is easier to publish a name than it is to retract one.



### **(3) Theoretical framework**

The theoretical framework consists of two parts: it (a) outlines the boundaries and opportunities of the academic literature in relation to the academic field of investor-state arbitration and (b) presents a sensible point of departure by discussing literature on the design of international institutions.

#### **a. Academic boundaries and opportunities**

At the start of this century, Mattli observed that:

*The study of private settlement of cross-border trade and investment disputes through international commercial arbitration or other mechanisms has been much neglected by scholars of international political economy and international institutions. (Mattli, 2001, p.919)*

Mattli (2001) continued his analysis by stating that ‘this oversight is attributable in part to the traditional focus of international relations on intergovernmental international organizations and the lack of attention to private international institutional arrangements. A further reason for the oversight is that arbitration is resolutely private, making information exceedingly difficult to obtain (p.919).’ Another reason for this inattention on the hand of political science scholars might be that the constantly evolving field of investment law, and the lack of centralization and coherence, make it hard to draw valuable conclusions.

A year after Mattli’s observations, Lalive (2002) noted that, ‘in this era of globalisation and worldwide integration of markets, we are witnessing an extraordinary growth of arbitration in the field of foreign direct investment (p.25).’ Some years later, Van Harten and Loughlin (2006) argued that ‘the emerging regime of investment arbitration is to be understood as constituting an important and powerful manifestation of global administrative law (p.121).’

As of today, very little to none is known about around *a third* of all investor-state dispute settlement (ISDS) cases. However, since 2001, an increasing amount of scholars has shown an interest in investor-state arbitration and the academic body has consequently grown. This is partly due to an increasing relevance of, and thus interest in, International Investment

Agreements (IIAs), Free Trade Agreements (FTAs) and Bilateral Investment Agreements (BITs), and partly due to the fact that the amount of investor-state arbitration cases has over the years accumulated to such an extent (in spite of its “resolutely private” nature) that statistical research has become more accurate and thus relevant.

Legal analyses on the effects of investment treaties and ISDS, however, are still dominant in the academic literature. Tienhaara (2010) sees it ‘imperative that scholars from other disciplines now become more actively engaged in the critical debates surrounding investment law and investment arbitration in particular’; political scientists may be more familiar with methods to investigate issues like “regulatory chill” (p.1). Alschner (n.d.) adds that while many European legal scholars ‘are skeptical about the use of “non-legal” tools in the analysis of law [...] there is an intellectual need for legal scholars to reflect upon to what extent and how social sciences can and should be used to answer legal questions (p.2)’.

As much as political science scholars may have neglected the implications of ISDS for their academic field in the past, in recent years they have begun to recognize the value of this relatively undiscovered area of inquiry. Developments like the TTIP negotiations have only emphasized the importance of research on the effects of ISDS and the political science community has already begun producing political explanations and empirical studies on, for example, the elusive issue of regulatory chill and its influence on governments’ decision making processes.

## **b. Design of international institutions**

According to rational design scholars, ‘design differences in international treaties are not random, but rather an efficient response to solve collective action problems (Alschner, n.d.).’ Similarly, Koremenos et al. (2001) argue that differences in design ‘are the result of rational, purposive interactions among states and other international actors to solve specific problems (p.762).’ States would rarely allow institutions to become powerful autonomous actors. Contrary to what theories of constructivism would largely adhere to - namely, international institutions playing a vital role in independently spreading global norms - international institutions are rather ‘self-conscious creation[s] of states (and, to a lesser extent, of interest groups and corporations) (p.761).’ But Wendt (2001) critiques the rational design approach, noting that the core of the rational design theory, proposed by Koremenos et al., is the argument that ‘states and other actors choose international institutions to further their own interests.’ He argues that this is in essence a functionalist proposal: ‘actors choose institutions because they expect them to have a

positive function (p.1020).’ Besides, “‘design” seems to imply that [...] designs are choices’, which implies a freedom to act (p.1038). Alschner (n.d.) comments that in real life, treaties are not necessarily “optimal” or “efficient” solutions to collective action problems. Rather the opposite is often true: they are negotiated compromises that are “suboptimal” and “inefficient” (p.3)’

Dietz and Dotzauer (2015) critically argue that ‘a functionalist explanation underestimates the political processes inherent in the creation of an investor-state dispute settlement mechanism (p.6).’ Rather ‘the design of an institution is shaped by conflicts of interests and the settlement of those conflicts (p.6, 7).’ Power relations and preferences of states in designing institutions ought to be properly taken into account. Drawing on Allee and Peinhardt (2014) Dietz and Dotzauer (2015) argue that ‘a complex set of institutional influence, power relations between states and domestic support structures the negotiation process to investment treaties. Conflicts of interest and asymmetries of power become decisive variables.’ Therefore, they argue that the “power and preferences” and “hands-tying” approaches are better points of departure, for both ‘provide a more realistic and more complete account to the politics of investment arbitration, because [they] give priority to the influences of power and interests.’<sup>2</sup> ‘The analysis of power and interests of a broad spectrum of actors, consisting of governmental actors, NGOs and economic actors, is more adequate to draw a realistic picture of the political processes that drives the investment arbitration system (p.7).’ The power and preferences approach relates to this complex set of power relations at play. The hands tying approach departs from a point of view of capital importing states. These states would enter into investment treaties by trading in a part of their nations’ sovereignty to attract foreign investment.

Allee and Peinhardt (2008) observe that states’ decisions on the design of investor protection instruments in BITs are not consistent. They pose the question why ‘some important international institutions contain centralized and rigid options for dispute settlement, while others contain far more informal and flexible procedures (p. 2).’<sup>3</sup> These are two important features of the design of international institutions that literature on rational design attempts to explain: centralization and flexibility. For example, Mattli (2001) points to ‘procedural and adaptive flexibility’ and ‘centralization of procedural safeguards and information collection’ as constituting ‘key institutional dimensions along which the various methods of international dispute resolution vary (p.922).’ Centralization relates to ‘the degree to which the investment treaty includes procedures for dispute settlement that rely upon [...] independent, third-party

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<sup>2</sup> For the “power and preferences” theory, see: Allee & Peinhardt (2014). For the “hands-tying” theory, see: Simmons (2014).

<sup>3</sup> Think about the options for different avenues of arbitration that treaties often provide: centralized international institutions (e.g. ICSID), decentralized ad hoc arbitration or states’ national judicial systems.

institutions to enforce the terms of the BIT (Allee & Peinhardt, p.14).’ Flexibility relates to the extent ‘to which an investment treaty provides the signatories with a range of options for settling investment-related disputes.’ Flexibility is important because ‘different avenues for dispute settlement may return different outcomes or different time horizons for dispute resolution (Allee & Peinhardt, 2008, p.17).’ Drawing on earlier work by Koremenos et al., Mattli (2001) illustrates the benefits of the conjectures found by rational design theories for the study of international institutions. He argues that ‘centralization of forums to which private international parties resort to resolve their disputes increases with’ enforcement problems, uncertainty about behavior and uncertainty about the state of the world. The preference for flexible dispute arrangements would also increase with the degree of uncertainty about the world (p.944, 945).

However, Allee and Peinhardt (2008) ‘are surprised by [the] systematic lack of support for the rational design conjectures (p.43)’ as found in their empirical study on rational design theories on investment treaties. Their main concern has to do with these theories’ ‘lack of attention to the specification of the actors who negotiate treaties and establish international organizations.’ Rational design theories would instead primarily focus on ‘structural conditions or features of the issue-based environment (p.45).’ Yet, the process by which states design international organizations is important. ‘Factors such as power and domestic political interests play a major role in the design of investment arbitration clauses.’ The world’s economically strongest states prefer centralized ISDS because this would disproportionately tie the hands of the weaker, capital importing states. Likewise, ‘domestic politics [also] shapes the design of investment treaties. These treaties become much more centralized when numerous multinational corporations, who view centralization as in their interest, are present on either or both sides. On the other hand, these multinational corporations view flexibility of dispute settlement arrangement as running contrary to their interests, since flexibility provides opportunities for delay and exit to those who have violated the terms of BITs (p.46).’

Gordon and Pohl (2015) suggest that ‘more government voice could enhance the benefits from and long term viability of investment treaty law by making it more responsive to treaty partners’ evolving needs and circumstances and by decreasing incentives for countries to withdraw from the treaty system (p.40).’ They observe that ‘a number of OECD surveys suggest that treaty partners are trying to make their treaty language more detailed on substance and procedure.’ And that ‘is arguably the most important avenue for state influence on treaty interpretation (p.6).’ However, the study suggests that, while there are possibilities for governments to influence the interpretation of treaties, few have done so (p. 40).

In the advancement of Allee and Peinhardt’s work, Dietz and Dotzauer (2015) have taken

significant steps to develop a political explanation of the emergence, development and politicization of investment arbitration. They specify six findings from their empirical study on the political dimensions of the TTIP negotiations. In short, they find that ISDS in TTIP encounters a diverse opposition in the public sphere stressing the risks of investment arbitration, whereas proponents of investment arbitration promote its necessity and functionality. And while some form of investment arbitration in TTIP is a 'common goal of the EU Commission and the US Government', it 'is politically contested between the EU institutions.' Also, they 'identified some aspects that caused [...] politicization during the TTIP negotiations such as the perceived and actual impact of the agreement or the experience of an ISDS claim.' Finally, they '[outline] some effects of [...] politicization that [complicate] the whole negotiation process.' Departing from these empirical findings, Dietz and Dotzauer develop two promising political dimensions of investment treaty arbitration: 'on a horizontal dimension, interest groups argue about the risks and benefits of arbitration' and 'on a vertical dimension, government authorities struggle to balance national sovereignty and global interests (p.22).' The literature review of this dissertation loosely explores these dimensions in relation to the ICS proposal in TTIP, with an emphasis on the Government of The Netherlands.



#### **(4) Literature review and analysis**

##### **I. What is the position of the Government of The Netherlands regarding ISDS in TTIP?**

In order to come to a closer understanding of the reasoning behind the Dutch governments' position on the ICS proposal, one must have an understanding of the Dutch point of departure. Therefore, the position of the Netherlands in relation to ISDS and the ICS proposal is explored below.

##### **a. Brief introduction to the position of the Government of The Netherlands**

In November 2012, a new cabinet of Ministers was installed after general elections (Rutte II).<sup>4</sup> The cabinet consists of members of the liberal Volkspartij voor Vrijheid en Democratie (VVD) party and the social-democrat Partij van de Arbeid (PvdA) party. The new government has created a separate ministerial post under the guidance of the Ministry of Foreign Affairs. The new post goes by the name of Minister for Foreign Trade and Development Cooperation and is currently occupied by PvdA politician E.M.J. Ploumen. The Minister meets (on average 4 times a year) with other EU states' ministers at the trade meetings of the Foreign Affairs Council. In these meetings, EU member states' Ministers or representatives debate and defend their positions on TTIP. The Dutch government has generally been in favor of including an investment protection mechanism in TTIP. Indeed, Tietje and Baetens (2014) explain that '[...] the Netherlands has been a long-standing supporter of ISDS [...] (p.38).' The Dutch government has actually been advocating for an expansion of ICS to EU countries to make up for the loss of intra-EU BITs<sup>5</sup> (TNI, 2016).

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<sup>4</sup> This is the second cabinet chaired by prime-minister Mark Rutte of the VVD party, also known as: Cabinet-Rutte-Asscher.

<sup>5</sup> The European Commission is in the process of phasing out intra-EU BITs on the basis that they are incompatible with EU law and the EU single market.

## **b. BITs and investment policy**

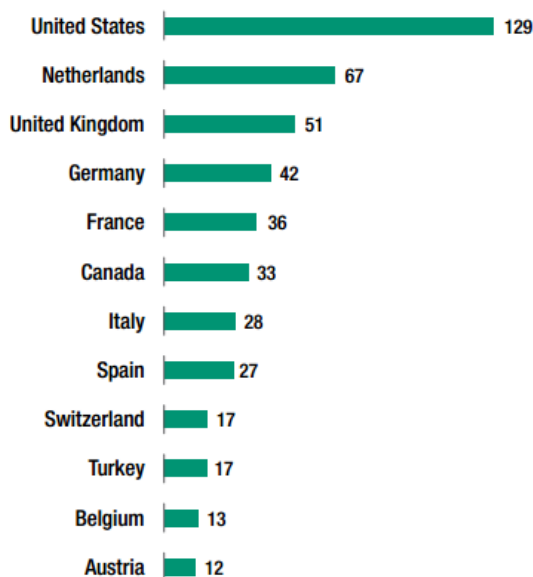
International trade is considered to be extremely important for the Dutch economy. A large portion of Dutch income is earned abroad. International economic diplomacy aims at strengthening trade and energy- and resource security interests. Through economic diplomacy, The Netherlands also aims to strengthen contacts with upcoming economies like China, India, Brazil and South-Korea. Strengthening the international legal order would benefit trade and prosperity.

Tietje and Baetens (2014) explain that, 'like other EU Member States' BITs concluded prior to the entry into force of the Treaty of Lisbon, the 2004 Dutch Model BIT contains broadly formulated definitions and protection standards (p.37).'<sup>6</sup> The Netherlands is currently party to at least 91 BITs that are in force (UNCTAD, 2016), which puts the country in the top ten of concluded BITs worldwide. The Tietje and Baetens (2014) study observes that, 'by the end of 2013, United States investors had brought 125 claims against states, followed by The Netherlands (61), United Kingdom (42), and Germany (39) (p.26).' In spite of the large amount of investment treaties in place, the Netherlands has never been taken to arbitration. The study suggests that, 'in light of the different market size of the Dutch and the US economy, [these statistics] indicate that ISDS has been a comparatively popular mechanism for Dutch investors (p.38).' According to UNCTAD figures, of all (42) known ISDS cases in 2014, 'the most frequent home States were the Netherlands (with 7 cases brought by Dutch investors), followed by the United Kingdom and the United States (5 each) (UNCTAD, 2015, 112).' The following figure (2) displays the most frequent home states of (known) investor-state arbitration cases, as end of 2014.

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<sup>6</sup> The Dutch model BIT (2004) can be found at:

<https://www.rijksoverheid.nl/documenten/convenanten/2004/08/27/ibo-modelovereenkomst>

**Figure 2:** Most frequent home states of claimants, total (known) cases as end of 2014.

Based on UNCTAD ISDS database, (UNCTAD, 2015, p.115).

However, some question the assumption that these are Dutch investors. Olivet (2013) claims that '[the Dutch Government] is not only protecting its own companies operating abroad. It is also protecting an estimated 20,000 [letterbox] companies availing themselves of the investment protections offered by Dutch BITs. [...] These are companies registered in the Netherlands, but with no employees on their payroll and no real economic activity in the country.' Indeed, the Netherlands could be considered as a "transit country", facilitating the flow of international investments. She continues by stating that 'it is a known fact that many transnational companies choose the jurisdiction of the Netherlands as the base for their global trade and investment operations, because of its favourable tax regime that facilitates corporate tax avoidance strategies (p.5).' A relatively large amount of headquarters situated in The Netherlands together with the already high flow of international investments could explain why Dutch investors (or rather, investors suing under Dutch BITs) rank so high in taking governments to arbitration.

According to the CPB (2014) 'the Netherlands is one of the most important countries worldwide that attract and distribute FDI to other countries. Almost all of these investments originate from other high-income countries. In 2011, 94% of incoming FDI came from countries without BIT relations [whereas] [...] 85% of the Dutch foreign capital stock was located in



countries without BIT relations (p.4).<sup>7</sup> About 15% of all Dutch outgoing FDI is stationed in BIT partner countries. Only about 3% of all incoming FDI comes from BIT partner countries (p.10, 11). As such, a relatively small proportion of Dutch incoming (about 3%) and outgoing (about 15%) FDI is covered by BITs.

### **c. US - NL investment relations**

The Netherlands and the United States traditionally have a strong economic relationship. This is exemplified by the strong investment relations between the countries. The *World Trade Institute* (WTI, 2016) estimates that 'over 300.000 Dutch jobs come from US controlled firms active in the Netherlands (p.126).'

#### **1. Investments**

According to Ploumen (2014), Dutch companies consistently rank in the annual top three of foreign companies investing in the US (p.1). The *Organization For International Investment* (OFII, 2014) states that in 2013, the Netherlands was the third-largest investor in the US (p.3).

The Netherlands is the 'largest single recipient of US investment at 14% of total US FDI abroad, (with US FDI in the Netherlands amounting to EUR 59.6 billion in 2013).' Also, 'as of the end of 2011, among EU Member States, the Netherlands was the largest host to US FDI with USD 595 billion (Tietje & Baetens, 2014, p.12).' In other words, the US is the largest single-nation location of departure of FDI to The Netherlands, accounting for about 20% of total incoming FDI according to the CPB (2012, p. 5). In comparison, incoming FDI from all EU countries combined accounts for about 70% of total incoming FDI in The Netherlands (CPB, 2012, p.4).

Figure 3 illustrates the US - NL investment relationship over recent years.

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<sup>7</sup> Freely translated from Dutch.

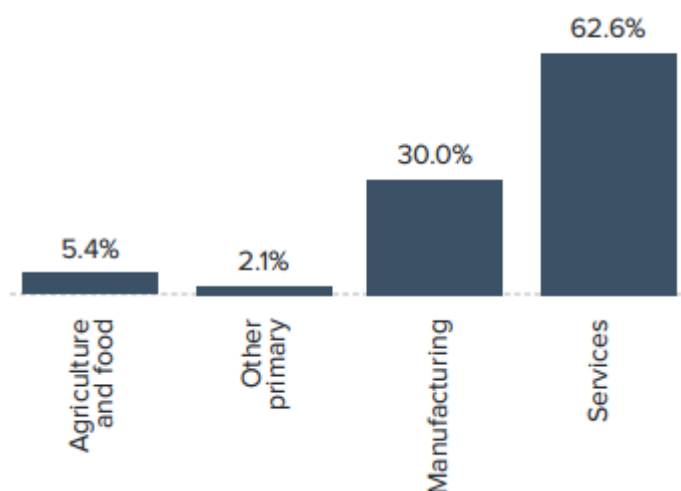
**Figure 3:** Investments between the US and the Netherlands (in € billion).

Year	Investments from the US to The Netherlands	Investments from The Netherlands to the US
2009	372.1	154.6
2010	404.0	184.0
2011	445.6	166.4
2012	541.5	222.4

(WTI, 2016, p.126)

## 2. Trade and investments by sector

According to the WTI (2016), and illustrated by figure 4, ‘the Netherlands is predominantly a services economy, but also has a sizeable manufacturing sector (p.126).

**Figure 4:** Structure of the Dutch economy (in %).

(WTI, 2016, p.126)

The Government of The Netherlands emphasizes the importance of Dutch “key sectors” (Rijksoverheid, 2012). Economic policy pays extra attention to the following nine key sectors (Government of The Netherlands, n.d.):

- Agriculture and Food
- Creative industries
- Chemical industry
- Energy
- High tech
- Horticulture and Starting Materials
- Life Sciences and Health
- Logistics
- Water

The US is the largest (extra-EU) destination of Dutch goods and services. ‘The main export sectors for the Netherlands to the US are chemicals and pharmaceuticals, machinery, business and ICT services, and petrochemicals (WTI, 2016, p.126).’ Tietje and Baetens (2014) make a sectoral comparison of FDI stock between the US and NL. What stands out is a great difference in composition of the FDI stock. ‘The largest [US and NL] investment positions are held in professional, administrative, and transport and storage (logistics) services. While particularly Dutch transportation companies invest in the US, most American investments in the Netherlands are in the professional services sector. In the latter sector investments are majorly driven by activities of headquarters (p.31).’

#### **d. Facts on EU - NL relations**

The following paragraphs explore some important aspects concerning the relation of the Netherlands with the EU (especially the EC) in the context of the TTIP negotiations.

The Dutch government recognizes the importance of the European Union for its foreign policy. Cooperation between European nations would leverage the Dutch position in the rest of the world. The Dutch government works in Brussels to achieve (1) financial-economic stability in Europe, (2) a strong internal market that increases growth and prosperity, (3) a Europe that strictly abides by its own rules, (4) a Europe where rights are securely anchored and acted-upon

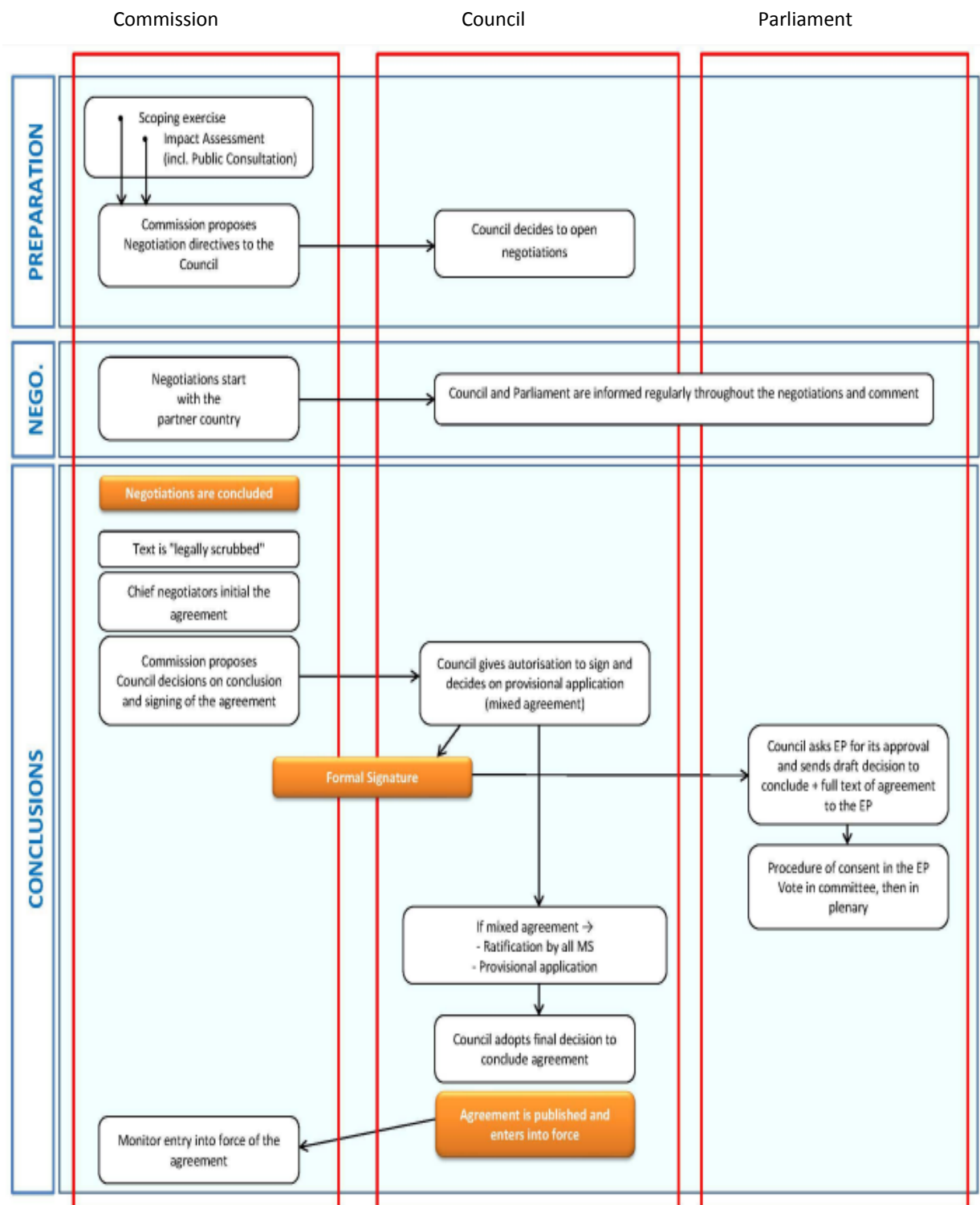
and (5) a Europe that enjoys a worldwide influence and advocates for the interests of European citizens and member states (Rijksoverheid, 2012).

The EC is of the opinion that intra-EU BITs are incompatible with EU law. In June 2015, the Commission ‘initiated infringement proceedings against five Member States today requesting them to terminate intra-EU bilateral investment treaties between them (EC, 2015).’ The Netherlands is one of the countries that have seen the initiation of such proceedings against them. Olivet (2013) observes that ‘the Dutch Government [is] among the most outspoken MS against the [European Commissions’ proposal to phase out intra EU-BITs] (p.5).’

Additionally, more than twenty EU member states’ parliaments, including the Dutch parliament, have called upon the Commission to consider TTIP as a mixed agreement ‘since they contain provisions that concern [elements of policy areas such as services, transport and investor protection] which are within the competences of the member states.’ This would allow EU member state parliaments to ultimately have a say over the final text of TTIP. ‘The Dutch House of Representatives believes that the legitimacy of the EU will be compromised if national parliaments do not have the opportunity to express their opinion on the outcome of the negotiations that directly concern national policy areas, and therefore considers trade agreements to have a mixed status (Knops, p.1, 2).’

Finally, the following page presents a schematic overview of EU trade negotiations:

Figure 5: EU trade negotiations - schematic overview



(EC, 2013, p.7)

### **e. Empirical data**

This section summarizes the empirical findings most relevant to this section (I).

The Policy Officer (PO) admits that the Dutch government now realizes that its traditional investment treaties, in some respects, had undesirable consequences. That is why, in 2014, the government started advocating for reform of the system. The most important reform was the clarification, or rather confirmation, of the right to regulate. The Professor of Economic Law (PEL) confirms that Minister Ploumen has always claimed that the ISDS system is in need of reform. The PO states that The Netherlands sees the potential ISDS provisions in TTIP more or less as a model for future IIAs. The intention is to renegotiate all 91 Dutch BITs in a way that balances the rights of investors and states. The Netherlands is the fourth largest investor in the world. The country enjoys an investor-friendly climate. Protecting investors is part of the strategy to attract foreign companies to settle in The Netherlands. However, tax treaties are much more important motives for foreign companies to settle in The Netherlands than are investment treaties. Tax policies that attract a lot of letterbox companies are not something the PO is proud of. These letterbox companies are said to frequently use Dutch investment treaties. The PO states that the Dutch government has been actively engaged in the ISDS negotiations in TTIP reduce the amount of letterbox companies that make use of Dutch BITs.

According to the PO, Dutch investment treaty policy is primarily focused on the protection of Dutch foreign investments, as opposed to the attraction of investments. The Netherlands already attracts a lot of investments. The Member of the European Parliament (MEP) confirms that The Netherlands is an attractive country for investors by noting that The Netherlands is an export -and transit country; investment treaties do little to attract investments.

The PEL mentions that prime-minister Rutte often claims to be in favor of a trustworthy government, a government that does what it says. ISDS would be a prime example of the enforcement of government's promises.

Finally, the PO states that The Netherlands disagrees with the Commissions' opinion that intra-EU BITs are incompatible with EU law.

## **f. Analysis**

### **1. Empirical data**

The empirical findings for this section (I) indicate that the Government of The Netherlands is aware of the need for reform of the current ISDS system. Undesirable outcomes of the ISDS system (i.e. infringement upon the right to regulate, letterbox companies' use of the system) need to be tackled. This would be done through the establishment of an ISDS clause in TTIP that would serve as a model for future IIAs. All current BITs are set to be renegotiated. Since The Netherlands already attracts a lot of investments, the governments' emphasis lies on protecting Dutch investors abroad. Moreover, this position reflects the general position of The Netherlands (i.e. the global promotion of rule of law and predictability).

### **2. Literature**

The Dutch government has long been a supporter of ISDS mechanisms. Today, The Netherlands still supports ISDS provisions, albeit a reformed version. The Netherlands has grown to become the fourth largest investor worldwide. International trade and investment is considered to be extremely important for this "transit" country. Promoting international trade and investments and strengthening the international rule of law are seen as to support the interests of this relatively small state, which economy relies heavily on its services sector.

The Netherlands is the second most frequent home state to ISDS cases, yet, it has never been taken to arbitration. It also enjoys a large set of concluded IIAs which have traditionally been characterized by loosely phrased articles, allowing a wide range of investors to challenge government decisions on the basis of potentially broadly interpreted standards of treatment. Moreover, the country has a favourable tax regime that attracts many of the worlds' largest companies to channel revenues through the state. Dutch policy aims to attract headquarters of large companies. Next to tax benefits, these companies enjoy a bonus for settling (minimally or partly through subsidiaries or wholly through headquarters) in The Netherlands: Investment Treaties. This is the likely explanation for the fact that letterbox companies are frequent users of Dutch BITs. However, almost all incoming and outgoing FDI is currently not covered by BITs. Only about 3% of all incoming and 15% of all outgoing FDI is covered by BITs. As The Netherlands already attracts a lot of investments, the main focus for its support for ISDS mechanisms appears to originate from the fact that it wants to protect Dutch investments abroad.

While The Netherlands appears to have largely benefited from traditional ISDS practices, it has recently recognized the importance of reform of the ISDS system. TTIP represents a great opportunity to re-shape its traditional ISDS model: not only would it set a standard that would be adopted by two of the largest economies. It would also provide the Dutch government with leverage over third countries, for the state plans to renegotiate all of its current BITs on the basis of the new model.

The Netherlands and the United States share a strong investment relationship. However, it is a relationship characterized by asymmetry. About 20% of all incoming FDI in The Netherlands comes from the US. The amount of US investments in The Netherlands is generally more than double the amount of investments from The Netherlands in the US. Dutch investment positions in the US are primarily held in the transportation sector. Additionally, the Dutch government is generally considered to look for ways to expand its companies' operations in the US in the area of professional water-related services.

Moreover, whereas the Dutch government is actively defending its BITs with other European nations, the nation is broadly supportive of the European Commissions' approach to investment policy in TTIP. However, the Dutch parliament considers TTIP to be a mixed agreement, allowing the state to have a final say over whether it accepts the final text of TTIP.



## II. Benefits and costs of ISDS

This section explores the benefits and costs of the global ISDS system in order to identify motivating factors for the Dutch government to advocate for the proposed Investment Court System, contributing to a greater understanding of the aspects that the Dutch government has, or could have, considered in the development of its position towards the ICS proposal. The following overview provides a brief summary of the main arguments put forward in favor and against ISDS:

Main arguments made in favour of ISDS	Main arguments made against ISDS
<p>ISDS:</p> <ul style="list-style-type: none"> <li>• Provides an additional avenue of legal redress to covered foreign investors and enforces the substantive treaty obligations.</li> <li>• Allows foreign investors to avoid national courts of the host State if they have little trust in their independence, efficiency or competence.</li> <li>• Avoids recourse to diplomatic protection (investors do not need to convince their home State to bring claims or to exercise diplomatic protection).</li> <li>• Ensures adjudication of claims by a qualified and neutral tribunal.</li> <li>• Removes any State immunity obstacles that may complicate domestic legal claims in some States.</li> <li>• May be faster than domestic court procedures in some countries.</li> <li>• Allows recognition and enforcement of arbitral awards in many jurisdictions (under the ICSID Convention or the New York Convention).</li> </ul>	<p>ISDS:</p> <ul style="list-style-type: none"> <li>• Grants foreign investors greater rights than those of domestic investors, creating unequal competitive conditions.</li> <li>• Exposes host States to legal and financial risks, without bringing any additional benefits, and can lead to "regulatory chill".</li> <li>• Lacks sufficient legitimacy (is modelled on private commercial arbitration, lacks transparency, raises concerns about arbitrators' independence and impartiality).</li> <li>• Fails to ensure consistency between decisions adopted by different tribunals on identical or similar issues.</li> <li>• Does not allow for correcting erroneous decisions.</li> <li>• Creates incentives for "nationality planning" by investors from third countries (or from the host State itself) in order to gain access to ISDS.</li> <li>• Is very expensive for users.</li> <li>• Holds little additional value in the presence of well-established and well-functioning domestic legal systems.</li> </ul>

(UNCTAD, 2015, p.147)

### a. Economic benefits and costs

One of the main arguments for ISDS in TTIP is the promotion of foreign investment. If IIAs are tools to promote foreign investment between the EU and US, one would expect to see a positive relation between the conclusion of IIAs and foreign direct investment (FDI). However, literature suggests that economic benefits would be minimal with regards to the inclusion of ISDS in TTIP.

While some studies<sup>8</sup> find a positive correlation between FDI flows and IIAs, the evidence for increased FDI flows between two developed economies is largely questioned by scholars. Tietje and Baetens (2014), for example, conclude that ‘it is [...] difficult to predict whether ISDS provisions in the TTIP will have a discernable effect on FDI flows (p.8),’ whereas Poulsen et al. (2015) find ‘little convincing empirical evidence that investment treaties containing ISDS actually promote FDI in any significant way (p.4).’ A recent study commissioned by the Dutch Ministry of Foreign Affairs and executed by the CPB (2014) reveals that BITs which have been concluded by high-income countries have zero - or negative - effect on incoming FDI flows originating from partner countries. The researchers attribute this result to the fact that high-income countries enjoy a high degree of legal certainty (p.10). At the very least, the results of empirical research on FDI flows in relation to IIAs are ambiguous (p.7).

UNCTAD (2015) explains that ‘IIAs can help encourage cross-border investment flows by reducing political risks for foreign investors, liberalizing investment flows (depending upon the treaty’s provisions) and, more generally, signalling a better investment climate to international investors, especially in countries with weak domestic investment frameworks and enforcement. However, IIAs are only one of many determinants of FDI decision-making, and their importance is contingent on other variables. IIAs cannot substitute for sound domestic policies and regulatory and institutional frameworks. IIAs alone cannot turn a weak domestic investment climate into a strong one, like other treaties, they cannot guarantee market outcomes in the form of inflows of foreign investment (p.126).’ Indeed, it is likely that, for example, tax treaties would have a much greater impact on attracting foreign investments. Poulsen et al. (2015) conclude that ‘including an investment protection chapter in TTIP that is accompanied by ISDS is unlikely to generate significant economic [...] benefits for the EU (p.30).’

The literature distinguishes two economic costs arising from ISDS: legal expenses and potential awards or settlements. Legal expenses average 8 million US dollars per case whereas in some cases this figure can reach 30 million US dollars (Gaukrodger & Gordon, 2012, p.19). Concerning potential awards, Frank and Wylie (2015) find that for ‘the subset of cases where investors won, investors generally only obtained roughly one-third of their claimed compensation (p.520, 521),’ This could indicate several things, for example: investors consistently sue for much more than could be considered reasonable, or tribunals tend to consistently award less than governments are sued for.

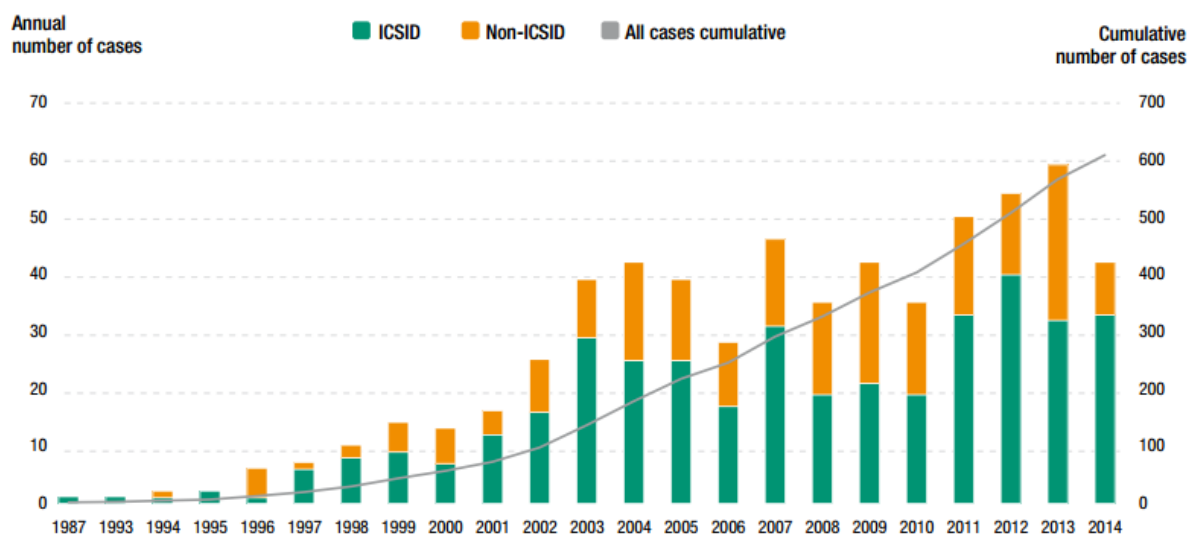
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<sup>8</sup> For example: the CPB study conducted for the Dutch government finds a positive correlation between the conclusion of IIAs and FDI: FDI flows could increase by 30% between high middle-income countries with ratified investment treaties. This positive correlation would not apply to incoming FDI of developed economies; the correlation would be zero or negative (CPB, 2014, p.10).

EU countries across the board receive substantially more investments from the US than from developing countries with whom most previous BITs have been concluded. As the size of investments falling under the scope of an IIA or BIT increases, the risk of ISDS cases would, theoretically, also increase. Tietje and Baetens (2014) pose that ‘the risk of ISDS cases [may be] positively correlated with the size of FDI stocks in the respective economies. Other factors that could also contribute to the risk of the Netherlands facing ISDS cases are the characteristics of investments, i.e. their size and whether they consist of (im)mobile assets (p.29).’ Poulsen et al. (2015) argue that ‘the inclusion of [ISDS] provisions [in TTIP] would lead to significant economic [...] costs for the EU (p.30).’

Since the 1990’s, cumulative number of ISDS cases has steadily risen, as displayed in figure 6. UNCTAD (2015) statistics show that the number of total known ISDS claims had reached 608 by the end of 2014, although this number is most likely to be higher in reality, given that ‘[...] most IIAs allow for fully confidential arbitration (p.5).’

**Figure 6:** Trends in (known) ISDS cases between 1987-2014.



Based on UNCTAD ISDS database figures, (UNCTAD, 2015, p.114).

## **b. (Geo-) political benefits and costs**

Proponents of ISDS claim that ISDS is necessary in TTIP for it would increase the chance that China (and other countries) accept(s) our high standards of investment protection. If the EU and US

were to conclude an agreement of the magnitude of TTIP, the investor protection provisions and investor-state arbitration system included in such agreement could set a global “gold standard” for investment protection. This is important because investors are hesitant to invest in China because of actual or perceived biases in the Chinese judicial system; the Chinese government or (local) judiciary is not trusted to treat foreign investors fairly. Foreign investors from The Netherlands demand a certain level of protection against for example indirect expropriation. Notwithstanding the flaws involved with investing in China, the argument in favor of ISDS in TTIP is one based on the assumption of increased leverage. Tietje and Baetens (2014) find that, ‘although the geopolitical argument for the TTIP may be valid, for ISDS specifically this argument is less strong. [...] To what extent an agreement on ISDS in the TTIP would indeed lead to a better bargaining position with countries like China is difficult to predict. [...] It is unlikely that China will not agree to include ISDS in a future potential trade and investment agreement with the EU if it is not included in the TTIP. China has a large and growing FDI stock abroad, and is therefore increasingly interested in investor protection itself (p.35, 36).’ Perhaps surprisingly, China has concluded the most amount of IIA’s in the world; it cannot be said that they are inexperienced with regards to investment protection. Also: ‘TPP may be a more relevant reference point than TTIP given that TPP also covers many of [China’s] regional trade partners (Tietje & Baetens, p.35, 36).’ Besides, the US has already concluded the TPP agreement, including what it considers to be the gold standard for investment protection.

While it might be true that ‘only a common approach will deliver an IIA regime in which stability, clarity and predictability help achieve the objectives of all stakeholders: effectively harnessing international investment relations for the pursuit of sustainable development (UNCTAD, 2015, p.12)’, it is less clear how, in the current economic and political climate, this “common approach” would translate into an encouragement of investments into areas related to sustainable development. UNCTAD (2015) admits that ‘liberalization and promotion policies related to investment in sectors related to sustainable development do not in themselves guarantee a positive development impact of the investment (p.105).’ UNCTADs 2015 *World Investment Report* observes that in 2014, ‘countries’ investment policy measures continue to be geared predominantly towards investment liberalization, promotion and facilitation [while] measures geared towards investment in sectors important for sustainable development are still relatively few.’ Achieving sustainable development goals would thus require an overturn of current trends.

Poulsen et al. (2015) find that ‘including an investment protection chapter in TTIP that is accompanied by ISDS is unlikely to generate significant [...] political benefits for the EU (p.30).’ It

is especially difficult to discern any domestic political benefits of the inclusion of ISDS mechanisms in TTIP. The (perceived or not) erosion of policy space and undemocratic features of the ISDS system could present policymakers with considerable political costs. Indeed, Poulsen et al. (2015), conclude that ‘the inclusion of [ISDS] provisions would lead to significant [...] political costs for the EU (p.30).’

### **c. Substantive and procedural benefits and costs.**

Proponents of ISDS in TTIP rely on a couple of (dissatisfactory) concluded ISDS cases in the US to support its argument for the necessity of ISDS in TTIP. For example, Tietje and Baetens cite ‘investment cases such as Loewen [which] suggest that US courts, and especially civil juries, may be biased against foreign investors (p.8)’, thus indicating the need for investment protection. But critics are not convinced by this argument. Poulsen et al. pose that ‘in short, [...] Loewen [is an] exceptional [case]; furthermore, [it is a case] in which the investor lost in ISDS [...] due to a lack of jurisdiction [...]. [This is] not evidence of systematic, serious flaws in the US judicial system’s treatment of foreign investment (p.12).’

Investor-state arbitration is often presented as a quicker alternative to domestic court procedures. While this may vary per country, it is generally true for countries with less-developed legal systems. However, this argument is much less valid when it comes to (western) European and US judicial systems; EU and US judicial systems are considered to be of the highest standard in the world. Besides, the argument reveals an inherent discriminatory feature of the ISDS system. Pernice (2014) explains that, if adopted in TTIP, ‘foreign investors [...] could use the ISDS as a “fast track” procedure and be privileged compared to EU investors both in procedure as well as in substance, depending on what interpretation is given to EU law by the tribunal.’ Gaukrodger and Gordon (2012) agree that ‘this raises the issue of the relationship between standards of protection for international investors and those that apply to domestic investors (p.14).’ The issue of asymmetry between domestic and foreign investors is argued by many to be a fundamental flaw in the ISDS system.

The argument that current investor-state arbitral tribunals provide a neutral and independent forum has gradually become controversial. Most stakeholders now seem to agree that reform on the procedural side of ISDS is needed. This relates mainly to the role of arbitrators in ISDS cases. The configuration of three arbitrators per case has been widely adopted in IIAs: one arbitrator is chosen by the investor, another by the host state, and together they choose the third arbitrator. Inevitably, the system has gravitated towards a situation where the first two

arbitrators essentially act as advocates for either the investor or host state. The third arbitrator would be decisive. Most IIAs allow for the president of, for example, the ICSID to choose the third arbitrator in case the parties do not manage to mutually agree on the third choice. Research by the *Corporate Europe Observatory* (CEO, 2012) suggests that only a handful of arbitrators have decided on more than half of all ICSID arbitration cases. In the current system investment arbitrators would have financial incentives to rule in favor of investors; arbitrators benefit from ruling in favor of investors for it perpetuates and expands a system from which they themselves benefit.

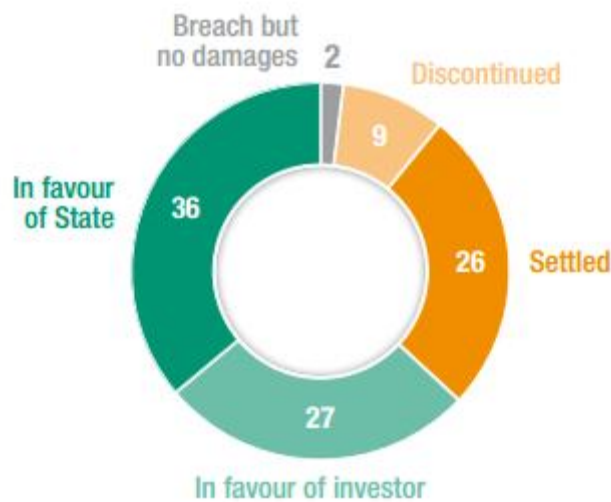
The system itself, however, would provide investors with a neutral forum, as opposed to seeking redress at national courts. But Western judicial systems are generally considered to function well as neutral arbiters; they are professional and most independent. The concept of neutrality also implies a link with the concept of de-politicization of investor-state disputes. Arguing in line with Paparinskis, Poulsen et al. (2015) pose that '[...] it is rarely clear what exactly is meant by de-politicization of investment disputes. While the involvement of home states in a dispute is one type of politicization, it is not the only one. Few would argue that the Phillip Morris claim against Australia is not politicized.' Also, 'while the de-politicisation thesis is widely shared amongst lawyers, it has never been subject to any rigorous empirical testing (p.15).' Indeed, one could pose the question whether or not international investment disputes are *inherently* political.

Investors not only choose arbitrators in the current system, they often also enjoy a range of options as regards to the avenue for the settlement of investment disputes, of which the (centralized) ICSID is the most popular. It could be argued that these forums provide a feasible alternative to state-to-state arbitration, which is often burdensome. The interests of states and their investors are not necessarily aligned and ISDS reduces the burden on states to advocate for investors.

#### **d. Winners and losers**

The global investor-state dispute settlement system is producing winners and losers, at the very least through the (non-) conclusion of arbitration cases. Whereas opponents of the ISDS system emphasize the costs involved for governments, proponents argue that costs for governments are in reality not that high. Often cited figures show that as of end 2014, 'States won 36 per cent [and] investors 27 per cent. The remainder was either settled or discontinued (UNCTAD, 2015, p.11),' as shown by figure 7.

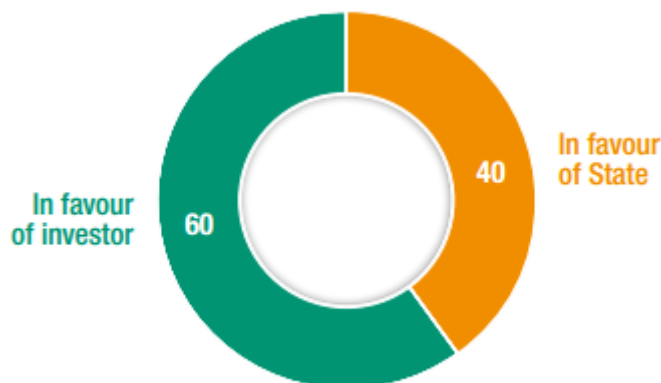
Figure 7: Results of (known) concluded cases as of end 2014 (in %).



Based on UNCTAD ISDS database, (UNCTAD, 2015, p.116).

But these figures have been met with criticism. Mann (2015), for example, is annoyed by simplistic arguments put forward by supporters of the ISDS system. He explains that, ‘based only on the annual numbers resulting from UNCTAD’s traditional methodology, many proponents of the system have argued that investor–state arbitration or international investment agreements in general are not biased against states because the United Nations’ own numbers show that states win more than investors do (p.1).’ However, a recent change in methodology employed by UNCTAD has revealed that often-cited figures by proponents (i.e. states win more cases than investors) do not hold upon closer scrutiny. Before the change in methodology, decisions on jurisdiction that terminated arbitration cases were counted as a “win” by a state. Most cases initially deal with jurisdictional decisions (i.e. when to allow an investor to bring a case) to determine whether a tribunal has the legal right to arbitrate. Even though states (justifiably or not) use jurisdictional arguments to defend against arbitration cases, it is a stretch to say that states “win” a case when jurisdictional competence is not granted. On the contrary, one could argue that *states can only not lose cases*. When decisions on the merits and jurisdiction are separated it becomes clear that, based on the merits, investors have won 60% of the cases and states 40%, as shown in figure 8.

**Figure 8:** Results of decisions on the merits of (known) concluded cases as of end 2014 (in %).



‘Note: Excluding cases (1) dismissed by tribunals for lack of jurisdiction, (2) settled, (3) discontinued for reasons other than settlement (or for unknown reasons), and (4) in which a treat breach was found but no monetary compensation was awarded to the investor (UNCTAD, 2015, p.116).’

Based on UNCTAD ISDS database, (UNCTAD, 2015, p.116).

The alternative figures exclude (among other things) settled cases, of which it can safely be assumed that governments have made some sort of concession(s): financial, legislative or otherwise. Based on the new UNCTAD figures, Mann also calculates that investors also proportionally win more jurisdictional determinations, about 70% (p.1). The new figures give way to a new perspective on the ISDS system; critics of the system may have been right all along in claiming that the system is skewed towards investors. However, Mann argues that ‘the balance in the ISDS system cannot be measured by wins and losses alone. The impacts of the current dominant approach to investment treaties and ISDS go well beyond simply a tally of wins and losses. But with these new numbers, at least it can no longer be said, simplistically, that the system is balanced because states win more than investors—they clearly do not when comparing the proper numbers (p.2).’

#### **e. Empirical data**

This section summarizes the empirical findings most relevant to this chapter (II).

The Professor of Economic Law (PEL) comments that the academic and practical fields of investment arbitration have only been around for about twenty years. The fields would have



developed in a rapid pace. The fact that more treaties are being concluded between developed, or capital-exporting countries, is distinctly different than treaties which were traditionally concluded between capital-exporting and capital-importing countries. The Policy Officer (PO) adds that since around 2010, developed countries are facing more claims than before (where developing countries predominantly saw claims initiated against them). The rise in arbitration cases could be explained by the rise in investments. However, the PO opines that treaties should be adjusted in time in response to the increase in ISDS cases. The PO explains that the ICS proposal is a “closing chapter” of a long history of investment treaties. Investment protection would evolve around the question: what level of protection of foreign investors abroad do we find normal or reasonable?

The PEL states that, because of the fact that under the current ISDS system different arbitral tribunals and their jurisprudence are often not linked to each other, arbitrators have sometimes ruled in contradiction with each other, although not often. The PO remarks that ISDS is meant to protect investors against the most egregious cases of government wrongdoing. In support of this argument, the PO alludes to what appears to have been a revolution in Zimbabwe where foreign property was confiscated. The Member of the European Parliament (MEP) argues that an important difference between investor-investor arbitration and investor-state arbitration is that states are (often) democratically accountable, whereas private investors are not bound by such principle like democratic accountability. Information on arbitration cases should be public in any way so that states can be held accountable. The PO finds that, in a sense, the ISDS debate has turned sour; businesses would largely have stopped speaking their mind, except for the employers organization VNO-NCW. The MEP indicates that the European Parliament’s first mandate to the Commission regarding TTIP was to a large degree inspired by a letter from BusinessEurope and the American Chamber of Commerce.

The effects of IIAs on FDI are incredibly hard to measure, according to the Professor of Economic Law. The idea that ISDS in TTIP would grow investments is ludicrous. IIAs would have a negligible effect on investors’ decision making in the case of investments between Europe and the US. In reference to a CPB study, the Policy Officer (PO) states that investment treaties between two countries can increase FDI flows by 35 to 75%. This would indicate that increased certainty due to the protection of investments attracts FDI. However, this would not be the case for high income countries like The Netherlands, because the Dutch justice system is (already) highly developed. The Netherlands does not need additional certainty to attract investments.

In the context of the already high amount of investments that are made between the US and The Netherlands, the PO is asked what the advantages are to include an ISDS mechanism in

TTIP. The PO agrees that the direct economic argument would be weak; direct economic effects would be negligible. However, ISDS would be needed in TTIP to leverage our “gold standard” so that the EU can conclude a satisfactory agreement with China and others. This would be a very strong argument for ISDS in TTIP according to the PO. BITs would especially be of use in countries with weak domestic legal systems. Therefore, including ISDS mechanisms in TTIP would amount to an indirect economic interest of The Netherlands, for it would benefit economically from having such an agreement with China. The PEL, however, does not see the need to create a “model-treaty” with the US in order to reform all BITs that The Netherlands shares with other countries. If reform of investment treaties with developing countries is the goal, why not approach these countries directly? The Member of the European Parliament (MEP) also does not agree with the notion that ISDS in TTIP is needed to set global standards on investment protection. If global standards are the goal, then why not pursue that goal directly? But, the PO questions the chances of including investment protection in treaties with other countries if it is not included in TTIP.

According to the MEP, instead of pursuing high global standards, TTIP aims to eliminate a range of rules, as would be the wish of BusinessEurope and the American Chamber of Commerce. The fact that the idea for TTIP originates from the side of these organizations underscores that fact. A closer look at the proposals for TTIP would reveal that the deal is not about raising standards. To the contrary, it would lower standards. The fact that TTIP and CETA are considered to be ‘living agreements’, and that mostly businesses would shape the treaties, would amount to businesses deciding on the rules which they have to obey themselves. Reducing standards would result in the greatest amount of economic profit. As profit is the main driver behind corporations’ actions, their motives would be self explanatory.

According to the PO, it is primarily the US that wants an ISDS provision to be included in the TTIP deal with the EU. The US trusts the Dutch justice system, but has its reservations regarding countries like Slovakia or Romania. However, the PEL is not convinced by this argument. The US already has investment treaties with exactly those nine eastern European countries which have less-trusted judicial systems. The US would not need to conclude an agreement with the entire EU to reach the goal of modernizing these treaties. Besides, these countries account for about one percent of transatlantic investments. Including ISDS in TTIP would massively increase the scope of ISDS from about one percent to a hundred percent of investments. The PO considers it a coincidence that the US has never lost a case.

The PO largely disagrees with the notion that ICS or ISDS would bear substantial risks for the Dutch government. The PEL, however, is not so sure. In reference to Spain, which has seen

about twenty ISDS cases brought against the country under the Energy Treaty Charter for the withdrawal of solar energy subsidies of which the cumulative amount claimed would amount to billions of Euro's, the PEL argues that the Dutch government should think twice before agreeing to ISDS provisions. But at the same time, the PEL does not expect The Netherlands, Europe and the US to suffer from a lot of claims. Its justice systems are of an extraordinarily high standard.

The PO remarks that, in the case of the Dutch government, ISDS in TTIP is a defensive interest. The Netherlands would like to see their investors in the US protected from discrimination, although it is not imperative that this happen. The Loewen case is the only case that comes to mind in support of the argument that ISDS in TTIP is needed to combat discrimination of foreign investors in the US. The PEL completely disagrees with the notion that European investors are mistreated or discriminated against in the US.

The perception of proponents of the ISDS system that national judges would be biased against investors does not seem to convince the MEP either. There would still be a possibility for foreign investors to appeal the decisions of domestic courts, if not in the host country, then, for example, the ECJ or the European Court of Human Rights. The PEL argues that the ISDS system is fundamentally asymmetric because of the fact that only investors can bring cases. If the system is to survive and thrive, the only way to do this is to, now and then, give investors what they want. Therefore, the system would nudge towards investors and there would be no incentives for anyone within the ISDS system to reform it, even for lawyers that usually represent states. Besides, allowing investors to choose an arbitrator is part of the problem, not the solution. It is not the intention of the ISDS system that arbitrators essentially act as lawyers for the parties. Over the past decade, lots of parties would have lost trust in the system, while trust is essential for the system to function well. ISDS would only work when both parties have faith in the system.

According to the PO, the study which was commissioned by the Ministry of Foreign Affairs and conducted by the CPB (2014) finds that the judicial impact of investment treaties is fairly negative. The system would need improvements here and there, considering that letterbox companies are frequent users of Dutch investment treaties. The PEL mentions that it would not only be American companies that can sue governments under the ICS. The definition of investments is broad. This could lead to a situation where a European company, (partly) owned by American investors through stocks, could sue a European state. This would lead to a situation described as discriminatory under European law: a (partly or wholly American owned) European company would be granted more rights under international law than a (partly or wholly European owned) European company. The situation could lead to all sorts of undesired consequences.

The PO is of the opinion that investment protection is still necessary in today's

world. The MEP argues that the fundamental problem with ISDS is that it gives special rights to foreign investors to question government policies. The PEL is not convinced of the need for ISDS in TTIP. ISDS would be a “solution” without a problem.

## **f. Analysis**

### **1. Empirical data**

The interviewees largely agree that the current ISDS system is untenable, developed countries see more cases being brought against them and the explosive rise in ISDS cases should be brought to a halt. The Policy Officer attributes the rise in cases to an increase in investments, implying a positive correlation between the amount of investments a country receives and the amount of arbitration cases it faces. But clearly, there are more variables that ought to be taken into account if one is to explain the rise in ISDS cases such as: an increase in IIAs and/or an increase in the size of investments falling under IIAs. The argument made by the Policy Officer also highlights the dangers of expanding the size of investments falling under TTIP investment protection provisions, although the Policy Officer regularly downplays this risk by pointing at the similarities between Dutch law and investment protection principles and the fact that the Dutch government has never been taken to arbitration. While both the Policy officer and the Professor of Economic Law agree that the Dutch judicial system has an extraordinarily high standard, and that therefore the Dutch government should not fear too many arbitration cases, the Professor of Economic Law suggests that that high judicial standard (in the US and EU generally) is exactly the reason why ISDS or ICS is not necessary. This undermines an important argument in favor of ISDS: we need ISDS to protect European companies from discrimination in the US. The Professor of Economic Law categorically rejects the notion that EU investors are mistreated in the US. The Policy Officer admits that the Loewen case is the only case of mistreatment known to him/her and points to the perceived necessity of ISDS in TTIP to make China agree to include ISDS in future IIAs. Both the Professor and MEP disagree with this argument and point out that an agreement with China should be dealt with directly. The Professor and MEP also agree on an essential argument against ISDS: it would not be necessary between countries with highly developed legal systems. The Policy Officer more or less agrees that such protection clauses are not necessary between countries with developed legal systems and admits that it is primarily the US that wants ISDS to be included in TTIP, citing US concerns with legal systems in for example Romania. But apart from

the fact that countries like Romania and Bulgaria account for a very small percentage of total EU-US investments, the US already has in place IIAs including ISDS with these countries, thus eliminating the need for ISDS in TTIP.

Both the Professor of Economic Law and the Member of European Parliament see inherent flaws in ISDS/ICS: it is fundamentally asymmetric because only foreign investors can bring cases, thus skewing the system to favor foreign investors; it would also discriminate against domestic investors, because they would not have access to the faster investor-state arbitration courts. The Policy Officer is not as preoccupied by these concerns and points to countries like India where the national court system is in lock jam, investors would be discouraged to invest unless there was some fast-track judicial system.

Time and again, what are considered to be prime arguments in favor of ICS in TTIP are refuted and the burden of proof seems to continuously shift from measurable facts to intangible geopolitical arguments (which are not as strong either). Another example: the Policy Officer, in defense of his/her position, has stated that investment treaties can increase FDI flows 35% to 75% due to investments being attracted by the increase in investor certainty thanks to the treaty. But the figure - cited from a CPB study – does not pertain to countries with highly developed legal systems, such as (most) EU countries and the US. Therefore, the use of such figures in the context of an EU-US agreement could be labeled as misleading.

In conclusion, the PO is of the opinion that investment protection is still necessary in today's world. The MEP argues that the fundamental problem with ISDS is that it gives special rights to foreign investors to question government policies. The PEL is not convinced of the need for ISDS in TTIP. ISDS would be a "solution" without a problem.

## **2. Literature**

Many of the perceived benefits of ISDS seem to be overstated and some of the perceived risks seem to be understated. Most stakeholders agree that the current ISDS system is in need of reform. As it stands now, the system is unsustainable. It suffers from a chronic legitimacy problem and although reform will not solve the fundamental flaws perceived by critics, it would be an improvement compared to the current situation. Improvements on both the procedural and substantive sides could reduce political costs.

The main argument in support of the Dutch position is that European investors face discriminatory policies in the United States. However, systematic flaws in its judicial system warranting the need for ISDS have not been discerned. Moreover, US investors in the EU do not face substantial barriers of unfair treatment and the likes.

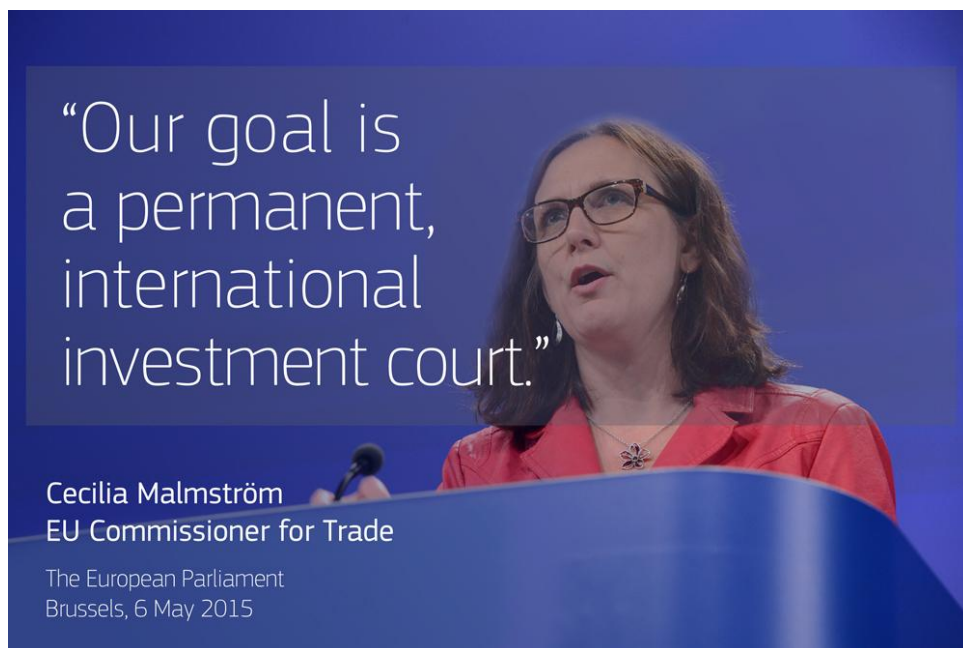
The economic argument for ISDS in TTIP is also weak. The Netherlands would see very little to no direct benefits or costs arising from ISDS in TTIP. This is primarily attributed to the fact that legal systems in the US and The Netherlands are already highly-developed. Although it is expected that few ISDS cases will be brought against the state as a result of TTIP, this risk should not be neglected. Tietje and Baetens (2014) explain that ‘given that a large US outward capital flow to the Netherlands will be covered by the TTIP, US investors’ claims against the Netherlands under ISDS cannot be ruled out (p.74).’ The scope of incoming investments covered by BITs (because of TTIP) would substantially increase. As it stands, about 3% of incoming FDI is covered by BITs. But an agreement with the US could see this percentage increase by an estimated factor of six to about 20% percent (US investments in The Netherlands account for about 20% of total incoming FDI). This could result in unexpected costs, both economically and politically.

Although the strategic argument for ISDS in TTIP appears to be stronger, stakeholder views on this issue vary greatly. Indirect economic benefits arising from a deal with the US, achieved through increased investor protection in countries like China does seem appealing. However, achieving such a goal would not be straightforward. Setting a common standard with the US does not guarantee success with China. On the other hand, ISDS with the US might not even be necessary to negotiate a favourable deal. This is nonetheless an appealing argument, considering that The Netherlands does not expect ISDS in TTIP to bear considerable downsides. The interview with the Dutch Policy Officer revealed that, while ISDS in TTIP is primarily the wish from the US, The Netherlands considers this to be a bonus to the agreement. Dutch investors in the US would enjoy an extra layer of protection, in addition to the prospect of increased leverage over China in investment protection negotiations.

The general weakness of arguments in favour of ISDS in TTIP suggests that the Dutch advocacy for ICS is based on favourable past experiences with the current ISDS system. The Netherlands has never lost a case and perceives itself to be benefiting from the ISDS system. Another country with a highly developed legal system and considerably a “winner” of the ISDS system is the United Kingdom. But the only study that the UK government has conducted on the benefits and costs of concludes that there are significant economic and political costs involved with ISDS in TTIP and little to no benefits. Yet, the UK government also advocates for ISDS to be included in TTIP. This implies that, when it comes to the issue of ISDS in TTIP, the UK and Dutch governments are not rational decision makers and seem to act on incentives other than rational arguments in the feature based environment.

### III. To what extent does the European Commissions' proposed Investor Court System limit government's policy space?

The research question contains the implicit assumption that the ICS proposal may limit governments' policy space. Therefore, this section shall investigate to what extent the ICS proposal actually limits policy space, if at all.



#### a. Current limits to policy space

With IIAs - and consequently arbitration cases - becoming more prevalent over the years, and increasingly seeming to encroach upon states' sovereignty, governments, scholars and NGOs have been gradually paying more attention to the so called "right to regulate". Pernice (2014) argues that '[IIAs] must be recognized as an important step forward in international law to give international law more bite,' but, he recognizes that 'there are tensions between [IIAs] and the concept of national sovereignty in international law (p.19).' Hindelang (2014) underscores the fact that 'current investor-state dispute settlement practice is perceived as not paying sufficient attention to legitimate public interests such as human rights, environmental protection, or public health. It is said to excessively curtail national regulatory space to implement policies directed at

general welfare.’ This sub-section explores to what extent governments’ legitimate public policy space is negatively affected by investor-state arbitration.

### 1. Policy space and the right to regulate

Government’s “right to regulate” is generally considered to be the main feature of international law that protects government’s policy space. While ‘the right to regulate [could be considered to be] a basic attribute of sovereignty under international law’<sup>9</sup>, it has only over the past decade been incorporated in IIAs. This started with party’s clarifying their intentions in the preamble. It would, for example, include recognitions of the right to regulate and required a demonstrable public interest objective. ‘A preamble that recognized this approach would reverse the current trends in trade law of seeing the right to regulate as an exception to be narrowly interpreted (Mann, 2003, p.216).’ For example, an OECD (2006) analysis of tribunals’ decisions reveals that in a number of cases, tribunals have recognized the right of governments to protect for instance social policies without paying compensation. But, ‘only a handful of international agreements articulated [the] difference [between for example] [...] the concept of indirect expropriation and non-compensable regulatory governmental measures (OECD, 2006, p.71, 72).

It is characteristic of the ISDS system that ‘few legal texts attempted to address directly how to distinguish legitimate non-compensable regulations having an effect on the economic value of foreign investments and indirect expropriation, requiring compensation. [...] This may reflect reluctance to attempt to lay down simple, clear rules in a matter that is subject to so many varying and complex factual patterns and preferences to leave the resolution of the problem to the development of arbitral decisions on a case-by-case basis (OECD, 2006, p.53).’ But the development of case-by-case arbitral decisions has not resulted in a coherent body of law, which has created uncertainty and undermined the legitimacy of the investor-state arbitration system.<sup>10</sup>

Titi (2014) explains that ‘the capacity of a state to regulate is well-entrenched in customary international law.’ But while ‘investment treaties impose restrictions on [...] state freedom’, states committing to IIAs is in itself seen as exercising ones regulatory sovereignty (p.32). Pernice (2014), however, argues that committing to international investment obligations

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<sup>9</sup> Van Harten (2015) notes that ‘the “right to regulate” in foreign investor protection system is a euphemism for decision-making by institutions of democracy, regulation, government, and courts in countries. Using the term reduces these institutions to a position of equality with foreign investor protection in the priorities of the state (p.4).’

<sup>10</sup> Instances have been reported where arbitral tribunals have decided, in similar cases, both in favor and against investors.



may be a manifestation of regulatory sovereignty, but ‘this assumption is questionable if external bodies are given the power to assess and effectively sanction acts of the sovereign (p.19).’ IIAs do not impose restrictions on states’ right to regulate as such; under IIAs, states can regulate as they see fit, but if they do, they risk paying compensation to foreign investors. Pernice (2014) continues to explain that governments ‘may therefore be limited by such chilling effects in the democratic choice of its policies; the more foreign investment it has accepted, the more costly certain political choices may become, for the damages or compensation expected to be awarded by arbitral tribunals. Such financial risks may even amount to reach a prohibitive size (p.19).’ Consequently, states find themselves in the awkward situation where the official right to regulate is not violated, but in practice, this right is undermined nonetheless.

UNCTAD (2015) observes that ISDS cases against developed countries are on the rise. According to figures, the relative share of cases brought against developed states reached 40% (p.112). This might explain why ‘a small but growing number of IIAs include pre-establishment commitments; new treaties include provisions safeguarding the right to regulate for sustainable development objectives (UNCTAD, 2015, p.110).’ Mann (2003) sees two main drivers behind an increase in the recognition of the importance of the concept of the right to regulate. One; civil society has been instrumental in creating awareness of eroding sovereignty and two; ‘the growing body of cases where public welfare legislation has been challenged under trade and investment agreements (p.211).’

There are several options available if one is to safeguard the right to regulate in IIAs. According to UNCTAD (2015), the right to regulate could be safeguarded by ‘clarifying or circumscribing provisions such as most-favoured-nation (MFN) treatment, fair and equitable treatment (FET), and indirect expropriation, as well as including exceptions, e.g. for public policies or national security (p.12).’ Thus, the clarification of definitions and consequently positive and/or negative formulations of standards or obligations<sup>11</sup> and exceptions are all important tools for governments to preserve policy space through the design of IIAs.

## **2. Regulatory chill**

Closely related to the right to regulate, is the development of the concept of “regulatory chill”. Tietje and Baetens (2014) assert that ‘political scientists, legal scholars, and non-academics have

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<sup>11</sup> i.e. what constitutes an obligation (positive) and what does not (negative)? Also important: is this a closed list or open ended?

applied the concept [of regulatory chill] inconsistently (p.40).’ Without consistence, it is hard to produce a viable body of academic literature.

But generally, regulatory chill is considered to have occurred when policymakers depart from their original intention by adjusting *bona fide* measures for fear of incurring high fines arising from arbitration. Tienhaara, for example, proposes the following working definition of regulatory chill:

*In some circumstances, governments will respond to a high (perceived) threat of investment arbitration by failing to enact or enforce bona fide regulatory measures (or by modifying measures to such an extent that their original intent is undermined or their effectiveness is severely diminished).* (Tienhaara, 2010, p.5, 6)

Tietje and Baetens (2014) discern three categories of regulatory chill: (1) anticipatory chill (occurring before the drafting of legislative or regulatory changes), (2) specific response chill (the ‘chilling of a specific regulatory measure’) and (3) precedential chill (occurring when ‘state actors change a regulation in response to a settled or resolved investor-state dispute’) (p.41). One might add to these three points a fourth: chill that occurs when a government decides to delay the implementation of a measure which could be affected by the outcome of another government’s arbitration case.

While each regulatory case may face different circumstances when it comes to the threat of arbitration (e.g. the nature of the measure, wording of the particular treaty, financial and political context, etc.), one can imagine that the threat of arbitration could potentially play a negative role in making legitimate and non-discriminatory public policy. Indeed, Tienhaara (2010) concludes that ‘arbitration is a high-risk, high-cost option for both governments and investors. In contrast, the threat of arbitration is cheap and potentially very effective [...] (p.27).’

But, identifying fears of arbitration as the source (or contributing to) the modification of a policy measure is extremely difficult. UNCTAD (2015) explains that ‘anticipating IIAs’ effect on regulatory space is not straightforward. Although ISDS cases expose the constraints that IIAs can place on regulatory powers, there is no clear methodology for conducting regulatory impact assessments and for managing attendant risks. The IIA impact will depend on the actual drafting and design of the IIA and the capacity of national and subnational entities to effectively implement the treaty (p.126).’ The often-cited study commissioned by the Dutch Ministry of Foreign Affairs ‘recognize[s] that regulatory chill is difficult to prove or disprove’, claiming that empirical evidence from NAFTA does not support the regulatory chill theory (Tietje & Baetens,

2014, p.9).

They further pose that the very ‘purpose of investment law is to “chill” the promulgation of measures designed with discrimination and protectionism in mind (p.41),’ though the authors must surely be aware that critics are trying to protect legitimate public policy measures, not discriminatory measures. Côté (2015) on the other hand, claims that ‘the inconsistency between the interpretations of the different substantive provisions of IIAs from one case to the other, as well as the very large financial compensations awarded by these tribunals, are having a chilling effect on host country governments (p.14).’ The following remark, made by Toby Landau, arbitration lawyer, perhaps sheds some light on the issue:

*Without doubt, "regulatory chill", in my view, definitely exists, and there's palpable evidence of it. There are those who deny it, but I can say that in my role as counsel, on a number of occasions now I've actually been instructed by governments to advise on possible adverse implications or consequences of a particular policy in terms of investor-state (ISDS) cases. (Côté, 2015, p.12)*

While it is true that the regulatory chill hypothesis has been predominantly supported by anecdotal “evidence”, a range of scholars has sought to refute the claim that the theory is not supported by enough empirical evidence. Some scholars find it ‘an issue that has been inadequately addressed and often prematurely dismissed by legal scholars (Tienhaara, 2010, p.1).’ Tienhaara suggests that ‘it is not the actual threat that is critical but rather the government’s perception of the threat of arbitration (p.4).’ Regulatory chill is thus a phenomenon that could not only present itself *after* having initiated a new policy or measure, the consideration of the (ISDS) risk involved with creating legislation or measures could affect policy-makers in the initial stages of policymaking, even *before* the drafting stage. Tienhaara (2010) agrees that, for students of regulatory chill, ‘it is not possible to open up the minds of regulators and peer in to see what they are really thinking, but careful research based on interviews, media reports and observance of government behaviour can produce a reasonable approximation (p.4).’

In one of the first attempts to shed empirical light on the elusive regulatory chill phenomenon, Van Harten and Scott (2015) investigate ‘whether ISDS contributed to changes in internal vetting of government decisions related to environmental protection in the province of Ontario, Canada (p.1).’<sup>12</sup> While admittedly incomprehensive, the results of the interviews with 52 government officials and other actors are ‘best viewed as investigative revelations’. Preliminary

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<sup>12</sup> Canada has a substantial amount of experience with ISDS cases under NAFTA.

as the study may be, it reports some interesting findings. Firstly, it suggests that Canadian ‘government ministries have changed their decision-making to account for trade concerns including ISDS (p.2).’ Although most interviewees could not share specific changes in decisions, a picture emerged of ISDS having a general and, at the very least, subtle effect on public policy-making. ISDS or trade risks seem to be one of the many risks that decision-makers have to take into account when making a decision (others being for example: financial, social or reputational risks). Secondly, it reports that ‘government lawyers play a key role in assessing trade and ISDS risks.’ And thirdly, ‘the Ontario trade ministry has pushed to expand a centralized regulatory assessment process for evaluating proposed government decisions for trade and ISDS risks (p.2).’ These findings suggest that the act of testing government decisions’ compatibility with international agreements has become more or less institutionalized in the case of the local Ontarian government.<sup>13</sup>

This implies that even countries with highly developed legal systems and liberal, free market policies would still be at risk of unwarranted limits to its policy space due to ISDS provisions in IIAs. Côté (2015) underscores the threat of ISDS for developed legal systems: ‘the repeated use of ISDS against developed countries, such as Canada, with mature, reliable legal systems, indicates that investors are bypassing national courts and using this mechanism against any government action they deem unfavorable to their profits. Canada itself has already paid more than \$200 million in compensation to investors under NAFTA and is currently facing multiple claims which add up to \$6 billion (p.11).’

### 3. The way forward

UNCTADs 2015 *World Investment Report* observes a pressing need for reform of the global IIA regime: ‘the question is not about whether or not to reform, but about the what, how and extent of such reform (p.12).’ The current ISDS system could be either reformed or replaced. It is noted that, ‘should countries wish to replace the current ISDS system, they can do so by creating a standing international investment court, or by relying on State-State and/or domestic dispute resolution (p.12).’

States broadly have five response paths available to them in order to address the challenges of the current ISDS system: (1) making selective adjustments to existing investment

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<sup>13</sup> It should be noted that Canada is widely considered to have an open, high-standard, professional and independent justice system. Moreover, Canadian policies over the past decade can hardly be seen as protectionist.

treaties while leaving the its core intact, (2) embark upon comprehensive systematic reform of ISDS, including a permanent court and protections to the right to regulate, (3) disengage from all existing IIAs, (4) seek alternatives to ISDS like state-to-state arbitration and (5) enforcing human rights by creating an international human rights court that regulates transnational companies to balance investor protection and human rights (Côté, 2015, p.25). The EC has clearly chosen the second path of action. ‘For some States, disengaging from existing IIAs may be appealing where IIA-related concerns feature particularly high in the domestic policy debate and where policymakers no longer consider IIAs to be an important element of their investment promotion strategies, both inward and outward’ whereas ‘[engaging in IIA reform] may be particularly attractive for countries with a strong outward investment perspective and with no – or little – ISDS experiences (UNCTAD, 2015, p.130).’

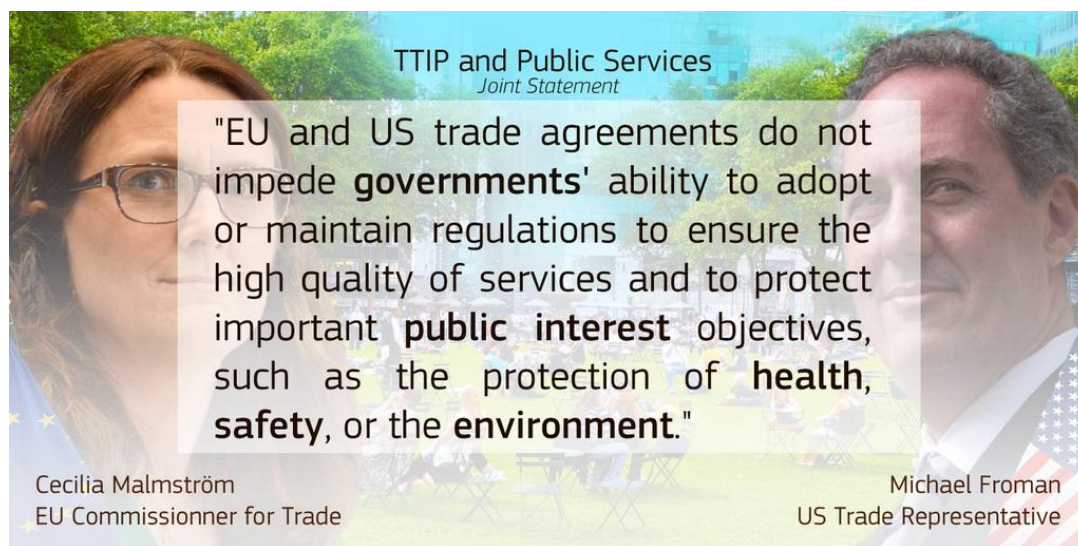
UNCTAD (2015) lists five main areas for reform, namely: ‘ [1] safeguarding the right to regulate in the public interest so as to ensure that IIAs’ limits on the sovereignty of States do not unduly constrain public policymaking, [2] reforming investment dispute settlement to address the legitimacy crisis of the current system, [3] promoting and facilitating investment by effectively expanding this dimension in IIAs, [4] ensuring responsible investment to maximize the positive impact of foreign investment and minimize its potential negative effects and [5] enhancing the systemic consistency of the IIA regime so as to overcome the gaps, overlaps and inconsistencies of the current system and establish coherence in investment relationships (p.12).’ Furthermore, Tietje and Baetens (2014) suggest that ‘the ‘loser pays’ approach could ensure a more equitable outcome (p.9)’, by deterring investors from bringing frivolous claims.

Another option suggested by UNCTAD (2015) in relation to indirect expropriation is that ‘the IIA can provide that the measure must be “necessary” to achieve the policy objective (strict test) or that it must simply be “related to” (“aimed at”, “directed to” or “designed to achieve”) the policy objective (less strict test): the stricter the relationship, the stronger the protective character of the agreement (p.140, 141).’

Recently concluded trade and investment agreements have tried to deal a final blow to the issue of policy space by articulating explicit definitions, instances and situations that may constitute an indirect expropriation. A good and relevant example is CETA, where ‘for the first time in an EU agreement, detailed language has been agreed upon to clarify what constitutes indirect expropriation in order to avoid claims against legitimate public policy measures (EC, 2013).’

**b. Analysis: to what extent is policy space better protected under the ICS proposal compared to traditional ISDS mechanisms?**

This section analyzes the main differences (and similarities) between the ECs ICS proposal and traditional ISDS mechanisms. Tensions between EU law and ISDS provisions or the ICS proposal shall not be discussed in this dissertation. While this issue is very important<sup>14</sup>, gathered data indicates that the EC has solved the most pressing issues concerning ICS-compatibility with EU law.



**1. The right to regulate**

The ICS proposal defines the right to regulate more clearly than traditional ISDS mechanisms. The 2004 Dutch Model BIT, for example, does not include any references to governments' right to regulate, whereas Article 2, paragraph 1, of the ICS proposal states that:

<sup>14</sup> The ECJ, for example, does not accept challenges to its autonomy in interpreting EU law. The ECJ is in the process of determining whether the EU-Singapore trade agreement (containing ISDS) is compatible with EU law.

*The provisions of this section shall not affect the right of the Parties to regulate within their territories through measures necessary to achieve legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity. (EU, 2015, p.3)*

The EC claims that the policy space of governments to regulate in the public interest is fully preserved by including an article (article 2, paragraph 2) which states that sovereign states do have the right to regulate within their territories (EC, 2015):

*For greater certainty, the provisions of this section shall not be interpreted as a commitment from a Party that it will not change the legal and regulatory framework, including in a manner that may negatively affect the operation of covered investments or the investor's expectations of profits. (EU, 2015, p.3)*

However, as is clear, the right to regulate is only protected if the government regulation is done through *not affecting measures necessary to achieve legitimate* policy objectives. So before being protected, a legal measure should pass the so called “necessity test”. It may very well be that the burden of proof of the right to regulate lies with the states, which will have to follow a strict necessity test, as is done according to WTO rules. A very strict necessity test would still limit government’s policy space. The fact that the ICS proposals’ right to regulate provision contains a (strict) necessity test has been criticized by scholars and NGOs. Van Harten (2015) explains that ‘the necessity test has been applied to require that a country made no contribution to the state of affairs requiring the passage of the law or regulation and that the country selected the policy option that would have the least impact on the foreign investor (p.4).’ Besides, according to analysts, ‘the formulation used by the Commission reduces the right of governments to regulate since it limits it of “measures necessary” to achieve “legitimate” objectives. The criteria to define what measures are necessary and what constitutes legitimate objectives are open for interpretation. Ultimately, the decision will be made by arbitrators [...] (S2B Network, 2015, p.6, 7).’

Also, according to Van Harten (2015), in article 2, paragraph 2, the wording of the state’s right to “change the legal and regulatory framework”, read again in the context of article 2, paragraph 4, shows that compensation orders for legal or regulatory changes are limited by the state’s right in article 2, paragraph 2 (p.4). This indicates that the act of changing state-granted subsidies is not protected by the right to regulate, whereas decisions on state-aid by the

commission or domestic judiciaries (“competent authorities”, Annex 3) are.

In short, it appears that the right to regulate has been much more clearly defined, but important loopholes remain that could infringe upon states’ policy space. Nonetheless, it signifies a clear departure from traditional ISDS mechanisms.

## 2. Fair -and equitable treatment

The traditional 2004 Dutch Model BIT states that ‘each Contracting Party shall ensure fair -and equitable treatment of the investments of nationals of the other Contracting Party (Rijksoverheid, 2004).’ Compared to this traditional ISDS mechanism, the key concept of “fair and -equitable treatment” (FET) is more clearly defined.

Under the ICS, a state would breach the obligation of fair and equitable treatment towards investors referenced in article 3, paragraph 1 only in case of certain specific measures, such as (a) denial of justice in criminal, civil or administrative proceedings; or (b) fundamental breach of due process, including a fundamental breach of transparency and obstacles to effective access to justice, in judicial and administrative proceedings; or (c) manifest arbitrariness. The ICS proposal also leaves open the option to amend the standard through a review of the obligation to provide fair -and equitable treatment through negotiations of an (as of yet elusive) Trade Committee.

On first sight this change of the FET standard clearly seems to limit the investor’s chances to protection under the fair -and equitable treatment standard. However words such as the following (in italic hereafter): “*fundamental breach*”, “*manifest arbitrariness*” and “*targeted discrimination*”, give rise to uncertainty and may be interpreted in a strict or broad sense. Whether or not this wording will have effect remains to be seen in practice. It has been remarked by some that ‘this will not be sufficient to prevent expansive interpretations of this standard by arbitrators (or “judges”) as the list of breaches is not fully closed. Moreover this article is criticized as having codified a major expansion of this term compared to its widely accepted customary meaning before the investor-state arbitrators arrived on the scene about 15 years ago. Investors such as Philip Morris (in its claim against anti-smoking legislation in Australia) or Lone Pine (in its lawsuit against Canada over a fracking moratorium in Quebec) based their arguments on the exact same elements of the FET standard that are now explicitly included in this proposal (S2B Network, 2015, p.7).’ In reference to past abuse of the concept of “legitimate expectations”, analysts argue that ‘by including [this concept in the FET standard], foreign investors can claim that government officials made “specific representations” that created “legitimate expectations”



on their side, for instance: by granting special incentives, by lacking plans for stronger labour or environmental rules, by having provided certain exemptions (S2B Network, 2015, p.7).’ In addition to a potential for expansive interpretation, a practical outcome of the provision seems to imply that foreign investors are granted more rights than domestic investors.

In short, an attempt has been made to restrict the FET standard to a limited set of situations. This signifies a clear departure from the FET standard in traditional ISDS mechanisms. However, similar to traditional ISDS mechanisms, the standard is heavily subject to arbitral interpretation. It also appears to have adopted a concept that has been perceived as to abuse government’s policy space in the past.

### 3. (In) direct expropriation

Traditional ISDS mechanisms, like the 2004 Dutch Model BIT, have defined (in) direct expropriation as follows (article 6):

*Neither Contracting Party shall take any measures depriving, directly or indirectly, nationals of the other Contracting Party of their investments unless the following conditions are complied with:*

- a) the measures are taken in the public interest and under due process of law;*
- b) the measures are not discriminatory or contrary to any undertaking which the Contracting Party which takes such measures may have given;*
- c) the measures are taken against just compensation. Such compensation shall represent the genuine value of the investments affected, shall include interest at a normal commercial rate until the date of payment and shall, in order to be effective for the claimants, be paid and made transferable, without delay, to the country designated by the claimants concerned and in the currency of the country of which the claimants are nationals or in any freely convertible currency accepted by the claimants.*

(Rijksoverheid, 2004)

The ICS proposal, however, includes detailed language to clarify what constitutes indirect expropriation, particularly excluding claims against public purpose measures. For example, article 5, paragraph 1, reads as follows:

*Neither Party shall nationalize or expropriate a covered investment either directly or indirectly through measures having an effect equivalent to nationalisation 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.*

(EU, 2015, p.5)

This paragraph shall be interpreted in accordance with Annex I: Expropriation, in which guidelines for the interpretation of the standard have been given:

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

- (a) 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;*
- (b) the duration of the measure or series of measures by a Party;*
- (c) the character of the measure or series of measures, notably their object and content.*

(EU, 2015, p.9)

Thus, the ICS proposal and the 2004 Dutch Model BIT appear to show a close resemblance. In contrast with the 2004 Dutch Model BIT, however, the ICS proposal offers guidelines (based on arbitration practice) for the interpretation of this provision. However the interpretation of the expropriation provision in ICS is left to the persons deciding on claims and their decisions may vary much depending upon their valuation of the case-by-case, fact-based inquiry of the claim. There is no guarantee that their decisions will not extend the interpretation of the words used in the ICS.

#### 4. Procedural differences

This subchapter summarizes the main procedural differences (and similarities) between ICS and traditional ISDS mechanisms. According to the EC (2015), the establishment of a permanent Investment Court System would increase the efficiency, consistency and legitimacy of the international investment dispute resolution system. The creation of a permanent court highlights a clear departure from existing ISDS mechanisms, most notably in the areas of: (1) the establishment of the court itself, (2) the establishment of an Appeal Tribunal, (3) the appointment of arbitrators or “judges”, (4) the establishment of strict ethical requirements, (5) increased transparency, (6) a ban on forum shopping, (7) the “loser pays” principle, (8) the “No U-turn” approach and (9) government control over interpretation. Other improvements would consist of procedural deadlines and improved mediation procedures, among other things.

The permanent court would consist of a Tribunal of First Instance and an Appeal Tribunal. The Tribunal of First Instance would consist of fifteen members, appointed by the EU and US: five EU nationals, five US nationals and five nationals from third countries. The Appeal Tribunal would consist of six members, appointed by the EU and US: two EU nationals, two US nationals and two nationals from third countries. ‘Disputes under TTIP would be allocated randomly, so disputing parties would have no influence on which of the three judges will be hearing a particular case (EC, 2015).’ The EU and US would thus appoint the judges at the moment of the establishment of the court. ‘This represents a complete transformation of the current system characterised by its *ad hoc* nature with tribunals chosen for each case and the ability of the disputing parties to appoint the arbitrator of their choice (EC, 2015).’

The arbitrators would be bound by strict ethical requirements. Under the traditional ISDS system, arbitrators could act hear a case on one day and defend an investor or government as a lawyer the next day (albeit in a different case). Under the ICS proposal, judges would not be able to practice as an attorney. However, they would be able to arbitrate cases in different forums like ICSID. According to the EC (2015), ‘strict qualifications and ethical requirements [...] would ensure that there could be no doubt as to the legal correctness of the decisions of tribunals.’ This would include a code of conduct.

In a clear departure from existing ISDS practices<sup>15</sup>, the ECs proposal establishes *full* transparency in the court proceedings. All hearings would be open to the public and all

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<sup>15</sup> Although UNCITRAL has recently established clear and rigorous transparency rules.

documents posted online. Also, investors would be obliged to disclose who is funding the claim.<sup>16</sup>

A ban on forum shopping should prevent investors from bringing cases under other investment treaties than TTIP. In the past, this has been a problem. Sometimes, investors could “import” provisions from other treaties under the Most-Favored Nation principle. The MFN principle states that investors shall be treated no less favorable than a country treats investors from third countries. While the MFN principle is still included in TTIP, the EC now seems to prevent abuse of this principle in the ICS proposal.

Whereas under the current, traditional ISDS system, parties would each bear the burden of their legal expenses, the ICS proposal introduces the “loser pays” principle. This principle would significantly reduce the amount of frivolous claims by deterring investors to bring a case for the legal expenses would be, if lost, entirely theirs. In order to not deter small and medium-sized enterprises (SME) from bringing a case (as opposed to large companies with deep pockets), the ICS proposal limits the amount paid by SMEs under the loser pays principle.

The ICS proposal aims to clarify the relationship between ISDS and domestic courts. The ‘No U-turn’ approach would prevent parallel claims. ‘Investors would be able to first seek to obtain redress in domestic courts but if they wanted to submit a claim to the Investment Tribunal they would first have to withdraw from any domestic proceedings they had started. [...] This approach is intended to encourage resolving a dispute in the domestic courts while leaving the possibility to access the investment dispute resolution system under TTIP where the treatment in the domestic system falls short of the very basic guarantees provided for in the investment protection provisions (EC, 2015).’ This approach has been fairly common in modern IIAs.

Government control over interpretation of the investment provisions is aimed to be achieved through several aspects of the proposal. The FET standard is subject to amending through a special committee. Moreover, ‘the Investment Tribunal would only be able to take a domestic law of each Party taken into account as a matter of fact. Where the Tribunal would be required to ascertain the meaning of a provision of a domestic law of a Party it would have to follow the interpretation made by that Party’s domestic courts. The draft TTIP text further clarifies that the meaning given to domestic law by the Tribunal would not be binding on domestic courts (EC, 2015).’ It is unclear to what extent this is common practice.

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<sup>16</sup> This in reference to the phenomenon of ‘third party funding’: an industry of third party funders would be growing around the ISDS system. These companies generally provide loans to claimants on the basis that they receive a percentage of the eventual award. The loan would not have to be paid back in the instance where a case is lost.

### c. Empirical data

This section summarizes the empirical findings most relevant to this chapter.

The Professor of Economic Law (PEL) agrees that regulatory chill is empirically hard to measure. However, the PEL questions why investors spend so much on legal fees when bringing a case if so little is gained in awards. It is coined that it is the threat of arbitration that is logically the main benefit of ISDS for investors. This would be part of a business strategy. The PEL admits that while this is hard to prove, it makes sense. The point of ISDS is to force governments to behave in a certain way. This is not necessarily bad because sometimes governments behave in undesirable ways (corruption, discrimination). However, investors sometimes abuse ISDS provisions. Bringing a case could, for example, not only influence a government, it could also deter other governments from taking certain measures in the public interest.

The Policy Officer (PO) reiterates that the idea of international law is all about sovereign states agreeing on ways to treat each other. Which is why, under ISDS, a state only commits to such things as fair treatment and non-expropriation - not a reduction of policy space. The PO remarks that Dutch investment treaties do not bestow greater rights upon investors than under Dutch law. They would give the same rights, but in a different manner. The FET and “no expropriation without compensation” standards would also exist under Dutch law (‘redelijke en billijke behandeling’). The ECs ICS proposal would limit the scope of the FET standard compared to traditional (less defined) Dutch BITs.

The PO states that one of the reasons that traditional Dutch BITs are so broadly formulated is that more investors could make use of these treaties. The PO suggests that, in the expectation of the development of a body of law, undefined provisions would be beneficial, for one does not know how certain defined provisions would be interpreted in the future. Defining these provisions could, in the future, amount to the unjustified exclusion of investors that have been unfairly treated. However, the PO recognizes that this could have led to the expansion of the interpretation of the FET standard. The PO admits that, especially over the past five years, the traditional ISDS system has exhibited undesirable effects: expansive interpretations and the fact that letterbox companies have been using Dutch treaties without adding value to the Dutch economy. According to the PO, letterbox companies are excluded from bringing cases under the ICS due to the wording in chapter one: services and definitions. Substantial business activity would be better defined.

However, according to the PO, traditional, less defined Dutch BITs are much better for Dutch investors than what will be agreed upon in TTIP. Despite of the broad formulations

contained in traditional BITs, the Netherlands has never been taken to arbitration. On the other hand, investors have sued a lot through the national court system. The chances of being sued under TTIP would be smaller than the chances of being sued under traditional BITs, for TTIP contains more comprehensive definitions and stipulations. The PO agrees that this is a positive step forward. Furthermore, the PO notes that cases filed under Dutch administrative law take on average around two and a half years to conclude, the same goes for investor-state arbitration under the current system.

The PO states that arbitral decisions taking place behind closed doors, involving tax-payer money, is undesirable. In reference to the ICS proposal, the PO continues to list some improvements to the procedural side, such as: an appeal mechanism, arbitrators that are picked by states instead of investors and the possibility to challenge the court (arbitrator). An appellate body could, for example, increase the consistency of arbitral decisions. The PEL comments that a permanent court could be a good improvement to the ISDS system. The Member of the European Parliament (MEP) agrees that some flaws of the traditional ISDS system have been solved in the ICS proposal, especially on the procedural side.

However, MEP states that while he/she is in favor of the rule of law and professional domestic legal systems, ICS would undermine the rule of law and the strength of domestic legal systems. The ICS would still create a parallel legal system which allows foreign investors to circumvent domestic legal systems. The MEP would like to see, for example, a possibility to appeal decisions of arbitrators in national courts. Giving foreign investors the possibility to pressure governments through the threat of arbitration (and not through “normal” domestic courts) would be a fundamental flaw that ICS does not solve. The PO argues that ICS does not create a parallel legal system because it applies the ‘no U-turn’ principle. A claim before the national court needs to be withdrawn in order to commence an arbitration case. The fork in the road principle says that one must choose the avenue for settlement of disputes at the start: either the national court or international arbitration. Applying the no U-turn principle would encourage investors to resolve disputes in domestic courts.

According to the PO, there is a similarity between TTIP and the WTO approach, which both include the word “necessary” in the provisions that aim to protect governments’ right to regulate. It is not intended to create unnecessary barriers to the right to regulate. However, in reference to the US shrimp case, the PO argues that the word necessary is needed in some cases to combat hidden protectionism. On the other hand, the PEL mentions that under ICS, the category of measures protected by the right to regulate is small. It would, for example, protect “measures that are necessary to achieve” policy objectives, which limits the scope of the

protection. In any case, the PEL expects the ICS to, more or less, follow the main points of jurisprudence that have been developed over the years in the traditional ISDS system.

#### **d. Analysis**

##### **1. Empirical data**

While the Policy Officer admits that adverse effects stemming from loosely-phrased ISDS provisions are undesirable, the underlying idea of the system – namely, preventing governments from acting unlawfully (under Dutch law) – is admirable. In other words, the underlying idea is good, but adjustments need to be made to counter undesirable symptoms. Besides, the fact that principles and definitions in the ICS proposal have been more clearly defined should reduce to some extent the risk of arbitration compared to ISDS cases being brought under traditional BITs.

Even though the MEP and Professor of Economic Law believe that the ICS proposal contains significant improvements compared to contemporary ISDS practices (especially on the procedural side), they are of the opinion that the system is inherently flawed: it would create a parallel legal system next to national courts. The Policy Officers counters this argument by arguing that the application of the no-U turn principle encourages investors to resolve disputes in domestic courts. This line of thought, however, neglects the fact that even though investors would be encouraged to use national judiciaries, the establishment of a separate court, with its own legal basis, by definition creates a parallel legal system.

##### **2. Literature**

The Government of The Netherlands (and the EC for that matter), through the ICS proposal, is clarifying and circumscribing ISDS provisions, following the expert opinion of UNCTAD. The establishment of an international investment court and protections to the right to regulate are at this point justified and ambitious. They are said to be the most important way to influence the design of international institutions. But such level of engagement with IIAs and the ISDS system is typical for countries with little or no negative ISDS-experiences. Likewise, the ICS proposal contains a strict necessity test (measures must be “necessary to achieve” policy objectives), indicative of the strong position of The Netherlands *vis-à-vis* countries with less professional

judicial systems. The proposal for an ICS appears to be in line with conjectures found by Allee and Peinhardt (2008). The EU and US are both economically strong states and both enjoy a large number of multinational corporations located in each area, possibly explaining for the centralization inherent to the ICS proposal and the fairly rigid procedures it contains. Moreover, the ICS proposal is a great example of governments' efforts to balance national sovereignty and global interests, as put forward by Dietz and Dotzauer (2015). On the one hand governments want to limit their own liability of arbitration cases. On the other hand governments are careful not to limit their investors in seeking redress abroad. This is all done through meticulous phrasing of such international agreements.

The ICS signifies a clear departure from existing investor-state arbitration practices, but problems, particularly on the substantive side, remain. Existing procedural problems have been solved to a great extent. Particularly the standing court itself, the appeal mechanism, increased transparency and the "loser pays" approach are set to increase legitimacy of the system. Definitions have been more clearly defined and principles have been restricted.

However, improvements on the substantive side run the risk of the illusion of retaining policy space. *IIAs do not impose restrictions on states' right to regulate as such; under IIAs, states can regulate as they see fit, but if they do, they risk paying compensation to foreign investors. Consequently, policy space may be undermined while the right to regulate is upheld.* For these reasons, it is important to make a distinction between the right to regulate and policy space. The right to regulate is a given in international law. And since tribunals can only award compensation and not order governments to change laws, academics, policymakers and other stakeholders should therefore focus on the practical outcome of such awards and their effect on policy space. *Consequently, policy space is or would become the essential concept around which future debates could and should evolve.* While the body of literature on the concept of "regulatory chill" needs to develop more, it stands out that regulatory chill is a real phenomenon and deserves more attention from policymakers. The concept touches upon the core of public policymaking and warrants a rebalancing of government priorities.

It is an almost impossible task to define to what extent the ICS proposal would limit governments' policy space. However, it can be stated with some precision that, compared to traditional investment treaties, the ICS reforms still bear the potential for abuse and undesirable effects on policy space of the Government of The Netherlands. In the ICS proposal, measures that are intended to protect governments' ability to regulate in the public interest are open to interpretation and contain certain loopholes. Finally, while the risk for the Dutch governments'



policy space should not be exaggerated, low-probability high-cost risks should equally not be underestimated.

## **(5) Conclusion and recommendations**

### **a. Conclusion**

In conclusion, this study has conducted an exploration of the context of ISDS and literature on the creation of the design of international institutions. Furthermore, it has investigated to what extent the proposed Investment Court System limits government's policy space. Finally, it has identified motivating factors for the Dutch government to advocate for the proposed Investment Court System, which are listed in the following paragraph.

The Government of The Netherlands is considered to be a big player in the global field of investment arbitration for it maintains a large network of International Investment Agreements. It recognizes that the ISDS system is in need of reform and has consequently embarked upon a reform effort. While this effort has resulted in a much-needed improvement of the procedural side of ISDS, this study finds that the ICS proposal does not sufficiently protect government's policy space. Although the right to regulate may have been improved (though its scope remains limited), this does not mean that policy space is safeguarded. As commonly accepted principles of treatment of foreign investors do not impede government's right to regulate (they cannot force a country to change its laws), under ICS, governments face the risk of a limitation of legitimate policy space through the (perceived) threat of arbitration. These observations have consequently not resulted in a clear answer as to why the Dutch government would advocate for before mentioned proposal.

However, a number of motives have been identified which do shed light on the Government's reasoning for its support of the ICS proposal. First of all, it should be noted that the Dutch government does not perceive the ICS proposal to be a threat to its policy space. This could explain its focus on the benefits of ISDS, not the costs. The main argument for including an ISDS mechanism in TTIP is that it would set a global standard of investment protection for third countries with less-developed or independent legal systems. It would also solve a lot of the problems related to the vast web of treaties such as inconsistency of awards and independence of arbitrators. Furthermore, Dutch investors would enjoy an extra layer of protection in the United States. As the Dutch economy is heavily dependent on the general state of the world, mechanisms which are perceived to promote the rule of law would contribute to prosperity.

In short, the Government of The Netherlands is of the opinion that the benefits of ISDS outweigh the costs.

## **b. Recommendations**

Following the conclusion of this dissertation, the author would like to share some observations gained over the course of this study and humbly make some recommendations.

The reasoning for the ICS proposal is based on overstated benefits and understated risks; certain argumentative leaps of faith have resulted in the underestimation of the risks that an Investment Court System would bring. The fact that The Netherlands has not faced any arbitration cases so far is no guarantee that it will not face them in the future through an Investor Court System in TTIP. As only three percent of incoming FDI is currently covered by BITs, an investment agreement including ISDS with the United States would significantly expand the scope of liability of investor-state arbitration cases. The fact that The Netherlands enjoys a highly-developed legal system limits the risk of ISDS cases being brought, although it does not exclude high cost arbitration risks. Notwithstanding that ISDS seems to only serve a very limited purpose; both the European Union and the United States both enjoy highly-developed legal systems. Perceived problems with investing in China and other countries could also be simply dealt with directly, as has been the standard operating procedure for the establishment of IIA's. Finally, the ISDS system is inherently discriminatory towards domestic investors. These observations should lead to a rebalancing of the Dutch governments' current position towards the ICS proposal in TTIP.

Furthermore, it should be noted that in the context of ISDS debates, the concept of the "right to regulate" serves a very limited purpose. Arbitral tribunals can only award compensation – not order governments to change laws. Protecting the right to regulate in the context of phenomena like "regulatory chill" would thus be redundant. The real issue at stake is the protection of "policy space" – a concept that better captures what is so often meant in debates on investor-state dispute settlement and its influence on governments' decision making.

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## **(6) Appendices**

The following two appendices are added to provide some additional information to the interested reader. The third appendix is the informed consent form that has been used to inform participants in the research and ensure confidentiality.

### **Appendix 1: Negotiating mandate**

Negotiating directive/mandate of the *Council of the European Union* for the *European Commission* named:

‘Directives for the negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America.’

Reference: 11103/13 DCL 1. Pages 8, 9, 10.

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The aim of negotiations on investment will be to negotiate investment liberalisation and protection provisions including areas of mixed competence, such as portfolio investment, property and expropriation aspects, on the basis of the highest levels of liberalisation and highest standards of protection that both Parties have negotiated to date. After prior consultation with Member States and in accordance with the EU Treaties the inclusion of investment protection and investor-to-state dispute settlement (ISDS) will depend on whether a satisfactory solution, meeting the EU interests concerning the issues covered by paragraph 23, is achieved. The matter shall also be considered in view of the final balance of the Agreement.

As regards investment protection, the objective of the respective provisions of the Agreement should:

- provide for the highest possible level of legal protection and certainty for European investors in the US,
- provide for the promotion of the European standards of protection which should increase Europe's attractiveness as a destination for foreign investment,
- provide for a level playing field for investors in the US and in the EU,

- build upon the Member States' experience and best practice regarding their bilateral investment agreements with third countries,
- and should be without prejudice to the right of the EU and the Member States to adopt and enforce, in accordance with their respective competences, measures necessary to pursue legitimate public policy objectives such as social, environmental, security, stability of the financial system, public health and safety in a nondiscriminatory manner. The Agreement should respect the policies of the EU and its Member States for the promotion and protection of cultural diversity.

Scope: the investment protection chapter of the Agreement should cover a broad range of investors and their investments, intellectual property rights included, whether the investment is made before or after the entry into force of the Agreement.

Standards of treatment: the negotiations should aim to include in particular, but not exclusively, the following standards of treatment and rules:

- a) fair and equitable treatment, including a prohibition of unreasonable, arbitrary or discriminatory measures,
- b) national treatment,
- c) most-favoured nation treatment,
- d) protection against direct and indirect expropriation, including the right to prompt, adequate and effective compensation,
- e) full protection and security of investors and investments,
- f) other effective protection provisions, such as an "umbrella clause",
- g) free transfer of funds of capital and payments by investors,
- h) rules concerning subrogation.

Enforcement: the Agreement should aim to provide for an effective and state-of-the-art investor-to-state dispute settlement mechanism, providing for transparency, independence of arbitrators and predictability of the Agreement, including through the possibility of binding interpretation of the Agreement by the Parties. State-to-state dispute settlement should be included, but should not interfere with the right of investors to have recourse to the investor-to-state dispute settlement mechanisms. It should provide for investors as wide a range of arbitration fora as is

currently available under the Member States' bilateral investment agreements. The investor-to-state dispute settlement mechanism should contain safeguards against manifestly unjustified or frivolous claims. Consideration should be given to the possibility of creating an appellate mechanism applicable to investor-to-state dispute settlement under the Agreement, and to the appropriate relationship between ISDS and domestic remedies.

Relationship with other parts of the Agreement: investment protection provisions should not be linked to the market access commitments on investment taken elsewhere in the Agreement. ISDS shall not apply to market access provisions. These market access commitments may include, when necessary, rules prohibiting performance requirements.

All sub-central authorities and entities (such as States or municipalities) should effectively comply with the investment protection chapter of this Agreement.

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## Appendix 2: Usual elements of contemporary investment treaties

‘Usual elements of contemporary investment treaties (based on treaty practice)’, put forward by Kuijper, 2014, p.13.

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a. Investment clauses (access and facilitation) and investment protection clauses: they are conceptually different, but they are integral as a package.

b. Core elements of investment treaties

i. Definitions

1. What is an investment? Who is an “investor of the other party”? Etc.

ii. Investment Clauses: access and non-discrimination

1. National Treatment (NT) (i.e. foreign investors have to be treated as national investors).

2. Most-Favoured Nation Clauses (MFN) (i.e. all foreign investors have to be treated in an equal manner).

3. Minimum standard of treatment / Fair and equitable treatment (FET) (i.e. foreign investors are treated to a standard that is considered acceptable between the parties and normally higher than NT).

iii. Investment Protection Clauses

1. Free Transfer of Funds (i.e. import and export of capital, dividends, profits and eventual compensation for expropriation is free).

2. Nationalization protection and compensation clauses (i.e. direct and indirect nationalization, prompt adequate and effective compensation for the full value of the investment in case of expropriation in the public interest is guaranteed).

3. Full protection and security (i.e. are the investments adequately protected by the authorities of the host country in cases of social unrest (strikes) and civil disturbances or even civil war).

iv. Dispute Settlement Clauses

1. Consultations: Obligatory stage of amicable settlement in most BITs.

2. International Arbitration: Exhaustion of local remedies, competent bodies, applicable rules, jurisdiction.

3. Conflicts of Jurisdiction

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### Appendix 3: Informed consent form

The following *informed consent form* was used to inform and protect the privacy of the interviewees.

Signed consent forms are available to the authors' *supervisor* and *second marker* upon request in order to assess the authenticity of the empirical research.

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#### Informed Consent Form

1) Preliminary research question:

"Why does the Government of The Netherlands advocate for an Investment Court System (ICS) in the Transatlantic Trade and Investment Partnership (TTIP) agreement that is expected to have a negative impact on government's policy space?"

2) Preliminary description of study:

"The dissertation firstly explores literature on the design of international institutions and the effects of investment treaty arbitration on government's policy space. It then investigates two political dimensions of the TTIP negotiations by (1) comparing the European Commissions' proposal for an Investment Court System with the effects of conventional investment treaty arbitration and (2) it explores the position of the Government of The Netherlands in relation to the ICS proposal. The findings should contribute to the goal of identifying motivating factors for the Government of The Netherlands to advocate for the ICS proposal."

**If you agree to take part in this study please read the following statement and sign this form.**

**I am 18 years of age or older.**

I can confirm that I have read and understood the description and aims of this research. The researcher has answered all the questions that I had to my satisfaction.

I confirm that I understand that the research question and description of this dissertation are preliminary, and can thus change depending on the findings of the research.

I agree to the audio recording(s) of my interview(s) with the researcher.

I understand that the researcher offers me the following guarantees:

All information will be treated in the strictest confidence. My name will not be used in the study unless I give permission for it.

Recordings will be accessible only by the researcher. Unless otherwise agreed, anonymity will be ensured at all times. Pseudonyms will be used in the transcriptions.

I am allowed to withdraw from the research at any time. Transcriptions or recordings of the interview(s) can be destroyed partly or entirely upon my request before publication of the study.

I consent to take part in the research on the basis of the guarantees outlined above.

**Signature:** \_\_\_\_\_ **Date:** \_\_\_\_\_