THIRD WAY

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TPP in Brief: Investor-State Dispute Settlement

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Now that the Trans-Pacific Partnership (TPP) has been signed, policymakers are looking to better understand all the components of this Asia-Pacific trade deal. In this memo, we tackle one of the most widely criticized, yet misunderstood, areas: investor-state dispute settlement (ISDS). Below, we summarize what ISDS is and how it is handled in TPP.

What is ISDS?

Let's say a U.S. seafood company, ACME Oysters, owned a factory in another country. That country then illegally seized the factory without just cause or any compensation. What options does ACME Oysters have? They could take their case to that country's courts, but not all foreign courts are as fair as those in the United States—and may not provide a just venue for out-of-towners.

Enter ISDS.

ISDS is a legal mechanism aimed at settling investment disputes between investors and countries using a panel of three adjudicators (one person selected by each party in the dispute, with the chair selected based on agreement between the two sides).

While the U.S. Constitution ensures that everyone gets fair protection through our legal system, many other countries fail to offer these types of protections, making it difficult for American companies. ISDS aims to provide an impartial approach to ensure companies have basic rights like they do under U.S. law.

ISDS guarantees five rights—all of which are ensured in the United States but not necessarily overseas. These include: [1]

1. Freedom from discrimination, which ensures that companies can play on a level field and will not be treated less favorably than local companies or companies from other countries;

2. Protection against seizure (expropriation), which prevents companies' property from being seized or unfairly devalued without fair compensation;

3. Protection against arbitrary and unfair government action and the denial of justice, which means that no company will be denied justice in any criminal or civil proceeding;

4. Right to transfer capital, which gives companies the freedom and flexibility to move money and investments across national borders; and

5. Freedom from forced use of local content or local technology, or forced technology transfer, which prevents a company from being required to use the foreign country's technology or tools rather than their preferred option—or other performance requirements which might otherwise require forced exports or use of local workers.

While ISDS offers these critical benefits, it does so in a way that doesn't weaken the U.S. regulatory structure. Despite what the critics say, ISDS does not and cannot require any change to any U.S. law or regulation, nor will it prevent the United States from passing new laws designed to regulate in the public interest. With or without ISDS, any change to U.S.

law must be approved by Congress and any regulatory change must be adopted by the appropriate agency. There's been a lot of misinformation that ISDS gives foreign companies the opportunity to affect and weaken U.S. laws—particularly environmental, health, and labor regulations. However, the reality is that ISDS cannot force any country to change any law or regulation. The only thing that ISDS panels can do is require the payment of "monetary penalties" when appropriate legal protections are not provided. [2]

For example, California banned a gasoline additive in the 1990s due to concerns about it leaching into groundwater. A Canadian company that made the additive wanted to stop the ban, but their claim was rejected because the United States is allowed to regulate for health and the environment as well as other areas that are considered public welfare. [3] And, as we discuss below, TPP strongly reaffirms that the U.S. retains the right to regulate.

ISDS in Action

ISDS is a part of more than 3,000 worldwide agreements—including in 51 U.S. agreements. [4] In its basic form, this process has been around since the 1700s but has been used increasingly often since the 1950s. No U.S. ISDS claim was filed until the 1980s.

The United States has rarely been the subject (or respondent) of an ISDS claim, having only faced 18 ISDS claims. Notably, the United States is undefeated in all the claims that have been decided. Of those cases, the United States has won 13 times, the plaintiff abandoned their case in two instances, one case was made moot by the conclusion of the U.S.-Canada Softwood Lumber agreement, one case is dormant, and one case (the recently filed TransCanada claim) is pending. [5]

On the other side, through 2015, U.S. companies have used ISDS 132 times since 1987, accounting for 22% of global ISDS claims, which is equivalent to the U.S. share of global foreign investment. U.S. companies have won or settled 48 cases, lost 35, and have 37 cases (nearly all of the remaining cases) pending. [6]

These ISDS claims tend to be filed against developing countries, especially those with weak rule of law and poor governance structures, with historically 72% of all ISDS cases worldwide going against these countries. [7] And, as the United Nations Conference on Trade and Development has repeatedly found, most cases relate to licenses, permits, and contracts and have nothing to do with general regulatory or policy issues. [8]

How is ISDS Handled in TPP?

In short, TPP has made a number of changes to ISDS, many of which strengthen the process and provide substantial new safeguards. These changes include: [9]

1. **Right to Regulate**. The agreement confirms that a country retains the right to regulate in its public interest, including on health, safety, and environmental protection. This means that ISDS will not allow foreign countries to supersede or change U.S. laws (or those laws in any other TPP country). One controversial aspect that that has received much public attention and discussion is that TPP specifically "carves out" tobacco, stating that countries cannot face ISDS suits for tobacco control measures. While the Obama Administration has touted this provision, trade experts have significant concerns about the precedent it could set for singling out certain sectors in trade deals going forward, especially as ISDS is stated to reduce discrimination and protect a company's property from seizure and devaluation.

2. **Burden of Proof**. TPP explicitly codifies that in any ISDS case the company, not the country, bears the burden of proof to prove its claims. [10] Previous trade and investment agreements have never explicitly followed this rule. This clarification will help prevent frivolous claims.

3. **Grounds for Filing a Claim**. TPP states that a company cannot file an ISDS claim simply because it disagrees(or is frustrated) with a government's laws that, in turn, could hurt that company's profits. To be considered, a claim must be on suitable and legal grounds, defined as a violation of one of the five protected rights. TPP also clarifies rules on filing a claim, including a specific time limit (3.5 years) for a company to file a suit and the amount for which an investor can actually sue.

4. **Frivolous Claims**. What happens if a company brings a suit that doesn't meet muster? TPP has a clear and expedited review process to dismiss frivolous claims. On top of that, if a claim is determined to be particularly egregious, the petitioner (the company who filed the claim) can be required to cover all legal costs for both parties. There are also rules to prevent filing the same claim.

5. **Transparency**. TPP adds another level of transparency. New rules require that every aspect of an ISDS case be made public, meaning that all proceedings will be open and all filings and arbitral awards will be disclosed. The public can also file briefs to ISDS panels. Previously, ISDS cases could be private, limiting public information.

6. **Ethics Rules**. To prevent any conflict of interest, TPP adds clearer ethics guidelines and rules of conduct for attorneys. This is to ensure that each person remains independent and impartial. [11]

Current U.S. ISDS Cases

Two ongoing ISDS cases that involve the United States are most frequently cited. Here's a brief case summary of each:

Clayton/Bilcon vs. Government of Canada [12]

The Clayton family are the owners of Bilcon Inc., a Delaware-based materials company. Working with a Canadian company, Bilcon was planning to build a quarry and marine terminal. Despite early and widespread support from Canadian government officials, it was determined that this project would have a significant and adverse environmental effect on "community core values" and as such, was rejected by the Canadian government in 2007. Bilcon believed that they were not treated fairly because they were foreigners and filed an ISDS claim against Canada in 2008 on the grounds of "national treatment and minimum standard of treatment"—both of which involve treating foreigners and locals the same. The ISDS panel voted in favor of the Clayton family and Bilcon in March 2015. Canada has appealed this decision, and the Clayton Family and Bilcon are waiting to be awarded damages.

TransCanada vs. Government of the United States [13]

TransCanada, a Canadian energy infrastructure company, operates numerous natural gas and oil pipelines throughout North America. In 2008, TransCanada filed an application to build the Keystone XL pipeline, which, in 2015, was rejected by the U.S. government. TransCanada formally filed an ISDS claim against the U.S. government in June 2016. The arbitration claim contends that, despite initial enthusiasm, the United States was not forthcoming in its support and the approval process was unclear, as evidenced by this process taking far beyond the average length of time.# Having just been filed, this case hasn't been heard and is still pending.

Conclusion

U.S. companies can sometimes operate at a severe disadvantage in certain countries and within certain markets. That's why ISDS exists—to guarantee a base level of judicial rights to everyone. On top of that, it is an extremely common legal tool, having been using in thousands of international agreements and never been used successfully against the United States. The Obama Administration has widely touted TPP as the most progressive, high-standard trade deal ever. Updates to ISDS are an important piece of that puzzle, ensuring that the TPP will protect our interests abroad.

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END NOTES

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