TTIP (TAFTA) Dispute Resolution System: Arbitrators or Judges?

1. The subject of this article[*] is the current position of arbitration in the context of international dispute resolution mechanisms, namely vis-à-vis the emergence of projects to replace arbitration with international courts, in particular the EU Commission's proposal to the US of TTIP (which is known in the US as TAFTA Transatlantic Free Trade Agreement).

2. Is this a justifiable proposal and, more specifically, is it likely to succeed in its purpose?

3. Criticism on arbitration, which is rooted in an alleged lack of transparency, lack of independence and impartiality on the part of arbitrators, relates basically to investment arbitration and not so much to commercial arbitration.

4. As a matter of fact, transparency in commercial arbitration is not necessarily a requirement in order to be effective given the confidential, or at least private nature of commercial disputes. On the other hand, investment disputes concern public and private entities, and it has been said that in such cases the public needs to know the contents of the proceedings or the most important parts of the proceedings.

5. But other points of criticism have been made about the dispute resolution system of investment arbitration (ISDS). This was demonstrated, for instance, in the public consultation the European Commission launched which resulted in the raising of the following issues: that ISDS (1) causes erosion of national sovereignty by restricting the states' right to regulate, (2) compromises the principle of fair and equitable treatment and (3) reduces the right to appeal.

[*] This article is a longer version of a speech delivered by the author in July 2016 at the Annual Meeting of IADC (International Association of Defense Counsel), in Bermuda.

6. It is rather strange that these issues, including the alleged lack of transparency, appeared not as a reason or justification for ISDS to be replaced, but as a need to improve the ISDS system. For example, lack of transparency of investment arbitration led to the recent publication of the UNCITRAL Transparency Rules effective on 1 April 2014 and the UN Mauritius Convention on Transparency for investment treaties concluded before 1 April 2014. These rules were ready to be applied to investment arbitration, but the EU TTIP proposal required them to be also applied to judges in the ICS created by that proposal.

   However, it should be pointed out that the EU proposal for TTIP's new system of dispute resolution does not come on its own. It is part of other measures in the area of the so-named investment protection, which includes a radical change of the state's right to regulate. In our opinion, this is the reason behind the option to replace arbitrators with judges. All other criticisms, such as lack of transparency of arbitration or lack of independence or impartiality of arbitrators, are merely arguments not the bottom-line.

   As a matter of fact and in accordance with the EU proposal, the right to regulate public policies should be understood in the sense that the states have the right to change the legal basis under which the investment contracts were entered into, including any matter that may negatively affect the investor's expectations of profits.

   Consequently, the EU Commission is now of the opinion that judges may understand this much better than arbitrators and not disregard the states' interests.

   However, the right to regulate has also made its appearance in the EU proposal in connection with cases where the concept of *indirect expropriation* has grounded a number of charges, adjudicated by arbitrators, of many states, for violating treaties. This has led countries, such as Canada and USA, to review

their BIT models in order to define, as clearly as possible, to what extent states are free to regulate reasonably, that is to say, in a non-discriminatory way, activities without infringing the treaties. Such is the case *inter alia* on matters of health, environment, consumer protection, safety, promotion and protection of cultural diversity.

In this case as well, a similar regime was appropriated by the EU's TTIP proposal.

7. At this moment in time, a good question to ask is whether there is, in fact, any justification for the system of international dispute resolution to be drastically changed for any other reason than some people are biased against private mechanisms for settling investment disputes?

   Under the EU proposal, grounds for disputing a state's decision on any foreign investment according to the TTIP proposal may only be based on the following guarantees: (1) expropriation without compensation (2) possibility to transfer or repatriate funds relating to an investment (3) a guarantee of fair and equitable treatment of the investment and physical security (4) a commitment that governments will respect their own written (and legally binding) contractual obligations towards an investor and (5) a commitment to compensate for losses in certain circumstances linked to war or armed conflict. All other defense grounds more accurately defined and provided for in the ICSID Convention and thousands of BITs may disappear.

8. In brief, the EU's TTIP proposal to the US created a different system that set aside the traditional arbitration system and intends to replace it with an international court composed of 15 judges (five to be proposed by the EU, five by the US and another five by both parties but that have to be non-nationals of any EU member state or the US). An Appellate Court has also been proposed which is to consist of 6 judges (two judges from the EU member states, two from the US and two non-nationals of either the EU or the US).

9. In October 2016, a new round of negotiations will be held during which the US delegation is expected to reply to this EU proposal, as well as other important matters still under discussion.

10. It should be emphasized that the original TTIP proposal made by the EU contemplated not an international court, but the traditional ISDS. The Commission had a change of mind because of pressure from the European Parliament, more specifically from several anti-globalization, anti-liberal and anti-capitalist political forces represented there and supported in Europe by the left-wing press and media which have followed the position of NGOs. These forces support a system where states would take the lead in the dispute resolution system by means of judges and not arbitrators, in other words, people selected and appointed by the public sectors themselves.

11. However, to return to the traditional dispute resolution system based on arbitration and the attack by supporters of an international court, the question is whether the alleged lack of transparency of proceedings is a defect of arbitration tribunals or is it a procedural defect which can be solved by changing the arbitration rules? Investment arbitration has been mainly organized and administered either by ICSID or in accordance with UNCITRAL Rules through *ad hoc* arbitration with the cooperation of the Permanent Court of Arbitration in The Hague.

12. The EU's TTIP proposal to the US includes some procedural documents, in addition to the award, which must be made available to the public.
    Why not follow the same regime of existing arbitration rules? Is this such a sensitive matter for arbitrators? This is definitely not the case. As already mentioned, the UNCITRAL Rules on Transparency and the UN Mauritius Transparency Convention were conceived to be applied to investment arbitration, not only to create a set of rules specifying which documents should be made public in addition to the award, but also to create a repository of

documents dealing with arbitration subject to UNCITRAL Rules that is aimed at setting up a publication service.

13. Another major criticism made about investment arbitration is the alleged lack of independence and impartiality of arbitrators resulting in a tendency to benefit the investors rather than public entities.
    It is true that some large law firms compete in order to get good mandates as counsels for important corporations, and we should not forget the immense power of these large corporations.

14. However, we do not know of any reliable statistics that reveal the number of arbitrations in which arbitrators, or a majority of arbitrators with a decisive influence in the award, have been set aside for showing partiality or lack of independence.

15. On the contrary, statistics published by UNCTAD (a United Nations agency) show (see World Investment Report 2014, page 124) that between 1987 and 2013:

    - the total number of investment arbitration was 568. European countries were involved in 53% of these arbitral cases. Of that total number, 43% were decided in favor of public entities; 31% in favor of investors and 26% ended in settlements.

16. More importantly than these considerations, it is imperative to ask ourselves if on shifting the power of decision from arbitrators to judges, we can be absolutely certain that judges will demonstrate greater impartiality than arbitrators. After all, judges are civil servants nominated and paid by the states involved, or else academics or retired politicians who may also be chosen to be judges and were probably trained in the public sector with the consequent tendency to favor or understand public interest in a certain manner.

17. It should be highlighted that there is a setting aside regime of awards in arbitration, in which lack of independence may be scrutinized and awards declared null and void by courts of law, that is to say, by independent and professional judges in ordinary courts of law.
    Considering that the Appellate Court provided for in the EU proposal is made up of judges of similar background to those of the first instance court, is there any guarantee that it will have the independence of mind to examine awards influenced by any lack of independence or lack of impartiality that favors public entities?

18. Other criticisms could be made of the EU proposal in favor of international courts instead of traditional arbitration, such as:

    18.1. How to enforce a judgment that has been adjudicated by the International Court against the European Union EU bearing in mind Article 1 of the NY Convention which only refers to states and not international organizations? Of course, not only the EU but all EU member states are expected to sign TTIP, but this may not be sufficient.

    As a matter of fact, a few remarks should be made on this matter.

    1. Under Regulation No. 912/2014, the EU bears financial responsibility for consequences that result from how the EU and its organisms and agencies deal with investment protection agreements (BITs, MITs, etc) entered upon by the EU or by the latter one and all or part of its member states, or alternatively, the treatment received by any member state alone but in compliance with EU laws.
    2. It should also be borne in mind that the EU enjoys immunity vis-à-vis any court of law.
       How can this central problem about the enforcement of judgments be solved?

3. The EU proposal fails to do enough to provide for the application of the NY Convention to the decisions adjudicated by the International Court, and is indeed open to criticism because the EU is not a state nor a member of that convention. Moreover, the International Court is not now nor will it become an arbitral tribunal. On the other hand, the application of the Convention of 1 February 1971 on the Recognition and Enforcement of Foreign Judgments in Civil and Commercial Matters is still not of any real significance for the enforcing of judgments adjudicated by the International Court seeing that the US is not a member of that convention and only five countries are. Furthermore, the draft text of a new Hague Convention is still at a very early stage.

18.2. Another issue is how to decide who bears the costs of any EU charge? Which of the member states? All of them? Only some of them? Should there be a compensation fund? If so, to be provided with funds from which resources?

18.3. In addition, article 8.21 of the proposal provides that the EU shall designate, on a case by case basis, who the respondent party should be. Is that the EU? Some member state? Both?
And what kind of appeal exists if a member state does not accept its designation? The proposal makes no mention of this possibility.
And what is the position of the investor in the matter of designation of the respondent? There is nothing about this either in the proposal.

18.4. Another pertinent question is if we are going to have an increased judicial bureaucracy with legalistic minded judges rather than arbitrators selected case by case by the parties. In sum, more delays and further backlogs?

18.5. Are we going to have a system involving more protection for host countries and consequently a reduction of investments?

18.6. International arbitration has boosted international trade and investment particularly since 1958.
Then, it was suddenly thought possible to create - by the mere wave of magician's wand - an international court composed of judges in the guise of arbitrators to solve investment disputes. And this has happened merely because of criticisms leveled at arbitration and arbitrators, criticisms that have not been validated.
In short, surely this is really simply an exercise of a narrow-minded protectionist movement against modernity and progress?

18.7. Nomination of judges in the most democratic countries falls within the competence of a body of judges. They are not nominated by the state seeing that states may be, directly or indirectly, interested parties with regard to court disputes. So why should the EU commission not opt for ICSID or UNCITRAL Rules?

18.8. A number of challenges for judges may arise with the "Code of Conduct for Judges" provided for in article 5 of the proposal. This code requires an appointed judge to show real "purification status" (free of pressure of any kind at present and in the past, has no political considerations, no influence through political clamor, no loyalty to disputing party and no fear of criticism).

18.9. It is a rule in arbitration that if an arbitrator commits any serious fault or mistake in their functions, they should be removed from further arbitration cases. What sanctions for judges in similar circumstances are provided for in TTIP's proposal?

18.10. Finally, do we know what the relationship will be like between the International Court and the EU Court of Justice? It should be noted that the EU Court of Justice is the only entity with the competence to construe and create jurisprudence on community laws in the EU.

19. The US Chamber of Commerce has already criticized the EU proposal saying that it is not perfect and the US Government should not use it as a model. Finally, it should also be pointed out that the US adopted the traditional arbitration system in the Trans-Pacific Partnership Agreement.

July 2016

Manuel Pereira Barrocas