



## **Factsheet on Investor-State Dispute Settlement**

3 October 2013

### **1. What is Investor-State Dispute Settlement ('ISDS')?**

ISDS is a procedural mechanism provided for in international agreements on investment. Countries sign such agreements in order to set out ground rules when foreign companies invest on their territory, for example by building factories. ISDS allows an investor from one country to bring a case directly against the country in which they have invested before an arbitration tribunal.

In order to bring a case, an investor must claim that the Party has breached rules set out in the agreement. For example, an investment agreement will often say that a government can only take over or 'expropriate' (for example, nationalise) an investment if it pays adequate compensation to the investor.

If a country seizes an investment or passes new laws which make it worthless (for example, it suddenly bans a product produced in a factory owned by a foreign investor) and pays insufficient compensation, or none at all, the investor could use ISDS to bring a claim directly against that country, claiming a breach of the expropriation provision in the agreement and seeking compensation.

### **2. Why does the European Commission negotiate ISDS provisions?**

Since 2009 the EU has been responsible for negotiating investment agreements on behalf of the EU as a whole, rather than individual Member States dealing with other countries on their own.

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ISDS is an important tool for protecting investments and therefore for promoting and securing economic growth in the EU.

The European Commission considers that ISDS is an effective way of enforcing the obligations our trading partners agree towards our investors when they sign investment agreements with the EU.

### **3. Why do we need ISDS in investment agreements with developed countries?**

The fact that a country is a developed country and has a strong legal system does not always guarantee that foreign investors will be adequately protected. There are several examples of cases where a developed country has expropriated a foreign investor, not paid compensation and prevented them from going to local courts. In these circumstances, investors are left without anywhere to bring a claim for compensation, unless there is an ISDS provision in the investment agreement.

### **4. Why do we need to include an ISDS mechanism when investors can go to national courts?**

Relying on the national courts of the host country to enforce obligations in an investment agreement is not always easy.

Firstly, the investor may not want to bring an action against the host country in that country's courts because it might think they are biased or lack independence.

Secondly, investors might not be able to access the local courts in the host country. There are examples of cases where countries have expropriated foreign investors, not paid compensation and denied them access to local courts. In such situations, investors have nowhere to bring a claim, unless there is an ISDS provision in the investment agreement.

Thirdly, countries do not always incorporate the rules they sign up to in an investment agreement into their national laws. When this happens, even if investors have access to local courts, they may not be able to rely on the obligations the government has committed itself to in the agreement.

## **5. Why include an ISDS mechanism when an investment agreement provides for state-to-state (country-to-country) dispute settlement?**

The Commission believes that an investor will be better protected if the investment agreement provides for ISDS in addition to state-to-state dispute settlement. ISDS means an investor can bring a case directly against the country hosting its investment, without the intervention of the government of the investor's country of origin.

In contrast, state-to-state dispute settlement requires the involvement of both Parties (usually governments) to the agreement. This can have political implications and raises questions of managing resources, such as costs. Consequently, the investor runs the risk of the government refusing to bring a state-to-state claim, even in cases where there is a clear breach of treaty obligations.

## **6. Will the ISDS mechanism limit the EU's right to regulate?**

No. Including an ISDS mechanism in an investment agreement will not make it more difficult for the EU or its Member States to pass laws or regulations.

The EU is working to ensure that the rules for ISDS and for protecting investments are clarified so that it is clear that genuine regulations and laws are consistent with investment agreements.

Under ISDS, a foreign investor could challenge a piece of legislation adopted at EU or Member State level, claiming that it is contrary to the obligations they committed themselves to in the investment agreement in question. If the claim were successful, the EU or the Member State would have to pay compensation to the investor, or return any seized property to its owner. So ISDS does not limit the EU's or a Member State's right to regulate. A country cannot be compelled to repeal a measure: it always has the option of paying compensation instead.

## **7. What about the growing concerns over conflict of interests in ISDS? What is the EU going to do about these?**

The EU wants to tackle new issues that have come up in the context of ISDS, including conflicts of interests. An example of a conflict of interest would be where the arbitrators judging a case had business links with one of the disputing parties. The EU wants to introduce

specific obligations for arbitrators in any future agreements on investment it negotiates with other countries. These obligations will cover conflicts of interests as well as broader questions about the ethics of arbitrators i.e. how they should act in particular situations. So the EU is adopting an innovative approach to ISDS in order to address concerns about conflicts of interests.

## **8. How will the EU prevent investors from abusing ISDS?**

The EU plans to stop two major ways for potential abuse of ISDS proceedings.

Firstly, the EU wants to prohibit two claims being brought at the same time before different tribunals. Avoiding parallel claims will prevent investors winning twice and also avoid a situation where two different tribunals come to different decisions based on the same facts.

Secondly, the EU wants to fight investors taking their case to the tribunal they think will provide the most favourable judgement. The EU wants to ensure that its agreements will stop investors from creating a shell company in a particular country with the sole purpose of benefiting from the ISDS provisions contained in that country's investment agreement with the EU.

Third, the EU would like to include provisions that prevent frivolous claims.

## **9. How will the EU address the issue of consistency of arbitral awards?**

The EU is looking to develop rules that will ensure that tribunals are consistent in the way they treat similar matters of law. The EU's aim is to include in the investment agreements it negotiates a list of people who can act as arbitrators in a particular dispute. This could create an '*esprit de corps*' among arbitrators and encourage tribunals to be consistent when awarding damages under the same agreement.

The EU will also push for clauses that allow countries that have signed an agreement to agree jointly on how they interpret the agreement or that allow the investor's home country to make submissions in on-going procedures.

In addition, the EU believes that on the basis of the agreements we have signed with our trading partners there should be a debate

setting up an appeals mechanism for ISDS disputes. This would also lead to greater consistency in how the provisions of investment agreements are interpreted.

#### **10. How will the EU lower the cost of ISDS?**

The EU wants to keep the cost of arbitration as low as possible. The European Commission sees three ways to do this:

- using the rules of the International Centre for the Settlement of Investment Dispute to decide the costs of the proceedings;
- making it possible to have tribunals with just one arbitrator;
- encouraging peaceful settlement of disputes instead of going to tribunals.

These innovative proposals will make it easier for small and medium-sized firms to use ISDS.

#### **11. What effect will ISDS cases have on the EU's budget?**

If a foreign investor successfully challenged an EU law, the EU would have to pay compensation to that investor. Compensation would have to be paid from the EU budget. The issue of who pays in a particular dispute is an internal EU matter covered by the EU's internal rules. A draft EU law to deal with that situation is currently working its way through the legislative procedure.

#### **12. What will the EU do to make ISDS more transparent?**

The EU wants to make ISDS more transparent, especially the tribunal proceedings.

Firstly, it wants rules on greater transparency in the EU's bilateral agreements with foreign countries by introducing wide-ranging transparency obligations in such agreements.

Secondly, the EU wants more transparency at international level. The EU is playing a leading role in the negotiations in the United Nations Commission for International Trade Law (UNCITRAL) where countries are deciding rules on the transparency of international arbitral proceedings. These rules are the most advanced yet for ensuring that the proceedings of international tribunals are transparent. The

rules will make documents available to the public, provide access to hearings and allow interested parties (like environmental NGOs) to make submissions.