



The Trans-Pacific Partnership Series  
**NAVIGATING A NEW ERA OF  
TRADE IN THE PACIFIC RIM**

Part I – Investment Protections & Investor-State  
Dispute Settlement

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## INVESTMENT PROTECTIONS & INVESTOR-STATE DISPUTE SETTLEMENT

The Trans-Pacific Partnership (**TPP**) was signed on 4 February 2016. It is the end product of five years of negotiations between the 12 participating countries, and more importantly, the largest global trade agreement in the last 20 years. The TPP is a regional free trade agreement between the United States, Canada, Australia, New Zealand, Japan, Singapore, Malaysia, Vietnam, Mexico, Chile, Peru and Brunei (**TPP Parties**). The signatories represent around 40 per cent of the global economy and a quarter of world trade. Membership to the TPP is also open to other Asia-Pacific countries, with both Korea and Indonesia expressing a strong interest in becoming signatories.

In this **first part of a two-part series**, we look at the protections offered to foreign investors in TPP countries, and the effect of the frequently debated Investor-State Dispute Settlement (**ISDS**) mechanism. In the second part of our series we will look at the impact of the TPP on business and industry.

**Section 1** of this article explains how the investment protections and ISDS provisions of the TPP work and the key areas for investor attention.

**Section 2** of this article provides an overview of the TPP 'safeguards' and discusses the implication of recent trends in ISDS.

With investment in TPP countries accounting for approximately 45 per cent of all outward Australian investment, it is crucial for global investors to understand how the TPP's modernised ISDS provisions operate and how any change may affect them.

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## SECTION I INVESTMENTS & ISDS UNDER THE TPP

### INVESTMENT PROTECTIONS

The Investment Chapter of the TPP offers investors of TPP Parties with what is considered to be the ‘standard suite’ of investment protections. The key investment protections in the TPP are shown below.



#### National Treatment

TPP Parties are to accord investors of other TPP Parties treatment no less favourable than that given to domestic investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments within their territory.

This ensures that foreign direct investors will be able to compete with domestic investors on a level playing field.



#### Most-Favoured-Nation Treatment

TPP Parties must give investors of other TPP Parties no less favourable treatment than is provided, in like circumstances, to investors of any other TPP Party, or any non-party to the TPP with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.

This protection enables an investor from a TPP Party to receive the benefits of any future investment arrangements between a TPP Party and any other party. However, this provision does not apply to ISDS arrangements. As such, the ISDS provisions within the TPP will not be affected by any other arrangements entered into by TPP Parties.



#### Minimum Standard of Treatment

TPP Parties are to accord investments with certain minimum standards of treatment in accordance with international law, including fair and equitable treatment and full protection and security. Investors should be aware that this protection is not breached merely because a TPP Party takes or fails to take an action that may be considered inconsistent with an investor’s expectations, or does not issue, renew or maintain, or modifies or reduces, a subsidy or grant.



#### Expropriation and Compensation Claims

Expropriation is where a public body takes private property for a public purpose. There have been various juggernaut disputes between investors and States concerning expropriation. For example, the Yukos arbitration, where the Permanent Court of Arbitration in the Hague found that Russia deliberately expropriated OAO Yukos Oil Company and awarded the Yukos Shareholders approximately USD 50.2 billion. [For more information on the Yukos arbitration see our article in the December 2015 ACICA Review.](#)

The TPP addresses expropriation by providing that no party shall expropriate or nationalise an investment, directly or indirectly, except (i) for a public purpose; (ii) in a non-discriminatory manner; (iii) with prompt, adequate and effective compensation; and (iv) in accordance with due process.

The TPP protects investors from both direct and indirect expropriation. Indirect expropriation refers to an action or series of actions by a TPP Party that have an effect equivalent to direct expropriation without formal transfer of title or outright seizure. Generally the assessment of whether an action constitutes an indirect expropriation occurs on a case by case basis.

Importantly, investors should be aware that any nondiscriminatory regulatory actions by a TPP Party that are designed and applied to protect legitimate public welfare objectives, such as public health, do not constitute indirect expropriations, except in rare circumstances.



## EXCEPTIONS & LIMITS TO INVESTMENT PROTECTION

In contrast with other historical trade arrangements, the TPP provides certain limits on the scope of the investment protections, designed to preserve the freedom of TPP Parties to regulate in areas of public welfare, such as environment and health. The TPP also allows its members to establish appropriate measures to respect, preserve and promote traditional knowledge and traditional cultural expressions.

An example of such a ‘carve out’ in the TPP is that a TPP Party may elect to deny the benefits of ISDS with respect to claims challenging a tobacco control measure. This is discussed in more detail later in this article.

## INVESTOR-STATE DISPUTE SETTLEMENT

The Investment Chapter of the TPP also provides an ISDS mechanism, which allows foreign direct investors of TPP Parties to dispute a host country’s actions and seek remedy for the same.

Although there has been considerable debate about the ISDS mechanism in the media, the TPP includes modernised ISDS ‘safeguards’ to ensure TPP Parties are not unduly constrained and ISDS is not abused. These ‘safeguards’ are a notable step in the evolution of ISDS, although the shift is less than seismic.

## WHAT IS ISDS?

Where there is a dispute between a TPP Party and an investor from a TPP Party, that dispute will be settled under the ISDS provisions, which are contained in the TPP’s Investment chapter. ISDS enables an investor to directly sue a TPP Party in respect of an investment authorisation, an investment agreement, or one of the investment protections.

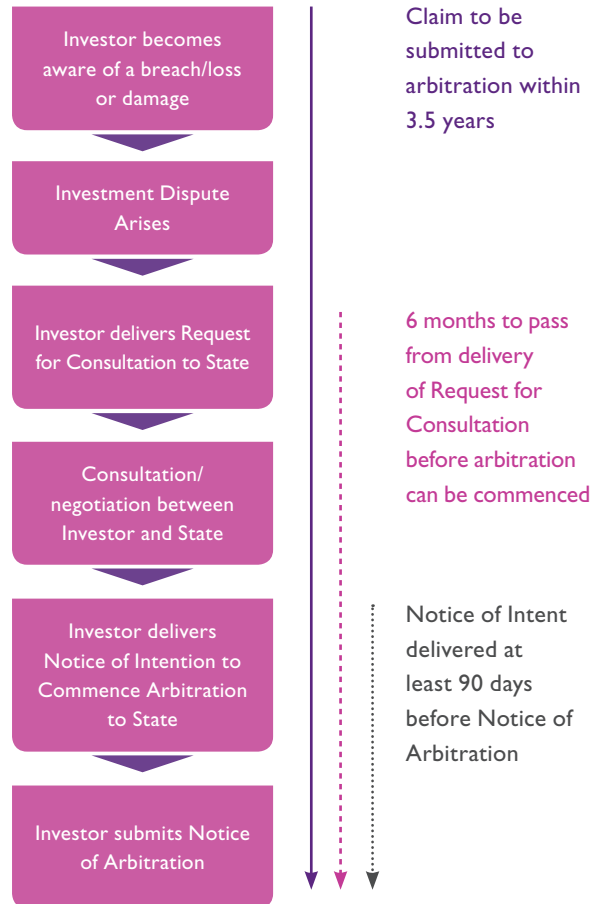
ISDS provisions are found in the majority of recent investment treaties. Australia is, to date, a signatory to 6 free trade agreements (**FTAs**) and 21 bilateral investment treaties (**BITs**) containing ISDS provisions or a commitment to negotiate such a provision. For more information, see our [litigation update](#) providing a snapshot of the ISDS framework in Australia’s Asian Free Trade Agreement trifecta.

The development of ISDS through these instruments has been incremental, yet substantial. The TPP is another step in this progression, evolving from the United States Model Bilateral Investment Treaty, with ‘safeguards’ drafted to water down some of the more controversial aspects of ISDS.



## STEPS PRECEDENT AND TIME BARS

ISDS under the TPP is ultimately achieved by arbitration. However, prior to any arbitration being commenced an investor must comply with various 'steps precedent' within particular time limits. These initial steps are shown below:



The steps precedent are important for an investor to be aware of, as they may significantly impact on the investor's ability to bring a claim. A claim can become time barred if it is not commenced within 3.5 years of the investor becoming aware of a breach or loss/damage. This 3.5 year time limitation is longer than other recent FTAs to which Australia is a party, for example, the period is 3 years under the FTAs between Australia and China (**ChAFTA**) and Australia and Korea (**KAFTA**). Ultimately, this longer period in the TPP affords investors greater opportunity to bring a claim while still affording protection to the State against stale claims.

## FORM OF ARBITRATION

The TPP adopts the usual choices for the arbitral rules and institutions: (i) the International Centre for Settlement of Investment Disputes (**ICSID**) Convention and its Rules of Procedure; (ii) the ICSID Additional Facility Rules; (iii) the United Nations Commission on International Trade Law Arbitration Rule; and (iv) if agreed between the parties, any other arbitral institution or arbitral rules.

Investors should ensure that the legal representatives they engage for the purpose of ISDS are familiar with these rules and their operation.

## COUNTERCLAIMS AND FRIVOLOUS CLAIMS

In an attempt to overcome potential abuses of ISDS and respond to the usual criticisms levied against such clauses, the TPP provides for TPP Parties to make counterclaims, as well as tribunals to make cost awards in respect of frivolous claims.

The TPP allows for firm treatment of potentially unmeritorious claims. A TPP Party can lodge an objection to a claim on the basis that it is 'manifestly without legal merit'. There is provision for this objection to then be decided expeditiously.



Additionally, following a decision, the tribunal may award to the prevailing party reasonable costs and legal fees, taking into consideration if the claim or objection was frivolous.

These are procedural innovations for ISDS and make it more important than ever for an investor to be comfortable with the merit of a claim before commencing ISDS under the TPP.

## TRANSPARENCY

Investors should be aware of the public nature that ISDS takes under the TPP. The emphasis on transparency is noteworthy and highlights the trend for ISDS to move further away from the traditional commercial arbitration model where confidentiality is fundamental.

Under the TPP, a TPP Party will be *required* to transmit certain documents to non-disputing parties, as well as make public those documents. Such documents include: the notice of intent, the notice of arbitration, pleadings, memorials, briefs to the tribunal, written submissions, minutes or transcripts of the hearing and orders, awards and decisions of the tribunal. This is a marginally broader transparency requirement than seen under Australia's recent FTAs and most other IITs and FTAs.

A tribunal is also able to accept and consider written *amicus curiae* submissions from non-disputing parties regarding matters of fact or law within the scope of the dispute, further highlighting the increasingly public and transparent nature of ISDS.

## CARVE OUTS

The TPP avoids a blanket application of the ISDS provisions through general and Party-specific carve outs.

General carve outs in the TPP are broad and give TPP Parties the ability to take measures that are otherwise consistent with the Investment Chapter but are sensitive to certain matters. An example of the general carve outs in the TPP is that a TPP Party is not prevented from adopting, maintaining or enforcing any measures “*that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental, health or other regulatory objectives.*”

Certain TPP Parties also have access to Party-specific carve outs. These Party-specific carve outs maintain existing non-conforming measures, as annexed to the Investment Chapter, which prevent the full application of the investment protections to those non-conforming measures. In this regard, as expected, Australia has included, as a non-conforming measure, actions that it has taken that relate to tobacco products, alcoholic beverages and firearms. Additionally, at Article 29.5 there is a broader carve-out preventing the ISDS provisions from applying in the case of any tobacco control measures. These carve-outs protect Australia from being involved in an investor-State dispute similar to the one commenced by [Phillip Morris Asia Limited against Australia](#) in relation to Australia's Tobacco Plain Packaging legislation.

## SECTION II – THE TPP & THE EVOLUTION OF ISDS

Anti-ISDS rhetoric has surrounded the TPP negotiations, with criticisms that it constrains State sovereignty, favours foreign over domestic investors, offers a covert and undemocratic dispute system and lacks transparency. While the commentary is mostly inflammatory, it has resulted in some TPP Parties resisting ISDS provisions during negotiations.

The resistance to the ISDS provisions in the TPP has brought about what are known as the ‘ISDS safeguards’, which serve to water-down some of the more controversial aspects of the TPP and are designed to more sensitively preserve the right of Governments to regulate in the public interest. The safeguards also reduce the opportunity for any abuse of the ISDS process.

The below table provides a snapshot of the TPP’s answers to certain criticisms of ISDS:

### ISSUE

**A State’s ability to regulate is diluted by ISDS.**

**There should be public access as ISDS may involve matters that concern public issues.**

**ISDS often involves matters of public concern, shouldn’t the public have the ability to comment?**

**ISDS should not burden public resources with frivolous, politically motivated and un-meritorious claims.**

**ISDS may result in overlapping proceedings and inconsistent/conflicting awards.**

**The pool of suitable arbitrators is limited and may result in impartiality.**

### THE TPP’S ANSWER

Increased carve-outs, especially in respect of health, safety, social services and environment, such as with respect to public education, tobacco and firearms.

Significant public access to arbitral proceedings and documents.

Non-parties to an ISDS can make oral and written submissions, which the tribunal can then consider.

Tribunals can decide objections to claims on an expedited basis, allowing frivolous/unmeritorious claims to be dealt with quickly.

Tribunals can also award costs (allowing a TPP Party to recoup costs), including by considering if a claim is un-meritorious and/or frivolous.

A claimant cannot pursue a claim in parallel proceedings, e.g. by domestic court action or an administrative tribunal.

Arbitrators are required to comply with rules of independence and impartiality, including with respect to conflicts of interest.



These responses and innovations in the TPP, while not necessarily significant themselves, speak volumes for the ongoing evolution of ISDS. Some of the amendments are a dramatic shift from the classical hallmarks of arbitration, such as the transparency provisions which move away from confidentiality and privacy. Other amendments are not so radical, but are nonetheless novel for ISDS arbitrations, such as the treatment of frivolous claims. What is apparent however is that when looked at cumulatively, these changes mirror existing mechanisms in domestic court systems, perhaps heralding a more court-styled approach to ISDS.

### **COURT-STYLED ISDS? THE TPP VS THE TTIP**

With the debate over the ISDS mechanism, the possibility of court-styled ISDS has become a hot topic. On 16 September 2015, in response to criticism regarding the inclusion of an ISDS mechanism in the Trans-Atlantic Trade and Investment Partnership agreement between the European Union and the United States, the European Commission announced that it had approved a proposal to establish a new mechanism dubbed the '[Investment Court System](#)'.

The proposed Investment Court System mirrors many aspects of a domestic court system. It would comprise of fifteen first instance judges and six appellate judges publicly appointed by States, public proceedings and an appeal process. However, access to the Investment Court System would be exclusive to investors.

Already the potential Investment Court System has faced criticism and scepticism, including on the basis that it affords foreign investors greater protections than domestic investors

and individuals, that an appeal process would worsen the burden of ISDS, that setting up such a court would be enormously costly, that recognition and enforcement of judgements would be complex and that the proposed system of State appointed judges is likely to result in a pro-State bias.

In light of such criticisms, investors may still prefer ISDS over the Investment Court System. ISDS itself however is far from perfect. Its track record shows that it can be costly, slow and lacking effectiveness. Despite this, the mechanism is necessary and the users of ISDS, the investors, still demand its existence. ISDS provides a level of security to investors that is necessary in a global economy.

The TPP is a step in resolving the imperfections of ISDS. The 'safeguards' effectively leave the purpose of ISDS intact, while addressing some of its flaws. We are yet to see how effective the TPP's 'safeguards' truly are in a practical sense.

### **STAYING ABREAST OF THE CHANGE**

An investor impacted by the actions of a TPP Party should consider if the ISDS provisions are available to them to seek recompense. Investors also need to be aware of the changing landscape of investment agreements and ISDS. To stay abreast of the change, global businesses should remain proactive in reviewing or seeking advice on the agreements and treaties that impact them, with particular attention given to ISDS provisions.



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