HOUSE OF LORDS

International Agreements Committee

Corrected oral evidence: Non-inquiry session: Investment protection and investor-state dispute settlement (ISDS) provisions in trade agreements

Wednesday 19 May 2021

11 am

Watch the meeting

Members present: Lord Lansley (in the Chair); Lord Astor of Hever; Lord Foster of Bath; Lord Gold; Lord Goldsmith; Lord Kerr of Kinlochard; Baroness Liddell of Coatdyke; Lord Morris of Aberavon; The Earl of Sandwich; Lord Watts.

Evidence Session No. 1 Virtual Proceeding Questions 1 - 12

Witnesses

I: Dr Jonathan Bonnitcha, Senior Lecturer in Law, University of New South Wales; Lise Johnson, Head of Investment Law and Policy, Columbia Center on Sustainable Investment; Toby Landau QC, Duxton Hill Chambers.

Examination of witnesses

Dr Jonathan Bonnitcha, Lise Johnson and Toby Landau.

Q1 **The Chair:** Welcome to this public evidence session of the International Agreements Committee in the House of Lords. We are charged with scrutiny of the Government's international agreements. In this session we are looking, in anticipation of the Government entering into free trade agreements in coming months and years, at the Government's approach to investor protection and investment treaties and the investor protection elements of free trade agreements.

I am Lord Lansley and I am Chair for this session. Lord Goldsmith is with us and would normally chair, but because of his legal involvement in investor-state dispute settlement proceedings I am chairing this session to avoid any appearance of any conflict of interest.

This is a public session and our witnesses will have the opportunity to look at any transcript that is subsequently published and will be able to provide us additional material.

A very warm welcome to our three witnesses: Lise Johnson, who is the head of investment law and policy at the Columbia Center on Sustainable Investment; Dr Jonathan Bonnitcha, senior lecturer in law at the University of New South Wales; and Toby Landau QC, of Duxton Hill Chambers, in Singapore, London and probably elsewhere, but no doubt that will become clear in the course of our discussion.

We anticipate the session being probably not much more than an hour, if that is possible, but I just want to say how grateful we are to our witnesses, who have joined us from America, Singapore and Australia for this purpose, so we are spanning time zones.

We have apologies from Lord Oates. We are also welcoming as our member for the first time, following the resolution of the House earlier in the week, Lord Astor of Hever. You are very welcome to our committee proceedings and we look forward to hearing from you during the course of our discussion.

As the witnesses may well be aware, I will open with the first question and then invite colleagues to ask their own questions, but we want to keep this an open discussion as far as possible, because we are looking to try to learn more about what options our Government will have in the future in terms of investor protection.

I will begin by saying that there are indeed a series of options for the Government with regard to investor protection. Could our witnesses tell us something of the value of trade agreements providing protection for foreign direct investors, and what some of the main models for investor protection might be that they would look to?

Toby Landau: It is a great pleasure to address the committee. Thank you very much for the invitation.

I will start by telling you a little bit about my perspective, which it might be important just to bear in mind. I am active almost day to day as an arbitrator and as counsel in investor-state dispute settlements, so I am much more on the practical side—the kind of cutting edge, grubby side of it, not the policy side. You will probably hear more from my colleagues on the policy issues, but I can bring a bit of a sense to bear on what is happening in the implementation of these agreements.

I will start with a quick rider to that, which is that, because I am involved in many active cases, I have to be a little bit vague on some of the details of some of the issues that are exercising people at the moment so that I am not subject to any challenges or questions about my own impartiality on live cases.

To the Chair's question, one has to address this issue analytically in two steps. When one talks about investor protection, we are talking first about substantive standards of protection, and secondly the procedural mechanism by which rights are protected—for example, international arbitration.

To understand the area, I think one has very briefly to remember its genesis; why we have protection in these treaties in the first place. It is because historically the protection of foreign investors has always been incredibly troubled. That is for two reasons. First, the substantive standards of protection in international law have never really been settled. Customary international law has been vague as to what rights aliens abroad might have. There are undeveloped standards normally locally in local law. Secondly, traditionally there has been no reliable place to have your rights enforced. One would not ordinarily, if you are having trouble in a host country, resort to the local courts, especially if the issue is political or sensitive and if the local courts are unreliable or unfamiliar.

Historically, traditionally, the only recourse was diplomatic protection, and that was to seek your own Government's espousal of your claim, if they were sufficiently interested to do so. That of course was an imperfect solution. Many Governments were not interested because they had their own agendas.

That led to the creation of this concept of protection for foreign investors in treaties. In a sense, it has been an incredible success, because it has given rise to a whole body of practice, a whole body of law, and it has meant that the resort in the old days to things like gunboat diplomacy is no longer needed.

In answer to the question "Why provide such protection?" the position today is the same. It is still the situation today that customary international law itself is not sufficiently detailed and not sufficiently settled in all respects to cover all the protections substantively that foreign investors may need. Secondly, without recourse to a treaty mechanism for dispute resolution, there are very limited options for

foreign investors. Where do they go? It is no different from how it was historically.

That is why this system of dispute resolution and substantive protection has worked so well. I can probably test it simply by saying that I regularly sit as arbitrator in international law investor-state disputes arising out of a whole range of government activity: a sovereign discretion that has adversely affected a foreign investment, where there are justifiable grievances. Those grievances may not always succeed in the end, but if it was not for the treaty network and this system those grievances would never be heard. There would be nowhere to go for them.

That is the critical importance of this area, in my view. There can be any number of exercises of sovereign discretion that impact on a foreign investment: changes in government policy, arbitrary conduct, discrimination, expropriation, failure to protect from unstable conditions—and so the list goes on. It is rather a barometer of world events. That is why we do it.

Whether to do it is ultimately, of course, a big policy question, and that may turn on, "Do we want to promote foreign investment?" Economists have struggled in making the connection empirically between foreign investment and the existence of investor protection, but it is certainly an element that many foreign investors would take into account in a situation where capital is free-flowing. In areas where it is more protected it is easier and one can be more confident to place it there. That is a rather long first answer, I apologise.

The Chair: No, do not apologise. That was an extremely helpful introduction. Could I invite our other witnesses to take that on, particularly as to whether trade agreements should provide this, but more to the point, by what means? What are the models that they could use? Ms Johnson, would you be kind enough to take that on next?

Lise Johnson: Sure. I echo the thanks for the introduction; I am honoured by the invitation and really pleased to be here.

This is a great question to start with. There are a couple of parts to it. One is what international investment agreements should do, in particular with respect to protection, and what the models are.

When thinking about what we should do with investment protection, there are two different aspects to that. There is what we should do domestically with respect to investment protection in order to ensure that we are attracting and benefiting from investment, and then what role international treaties play in that policy framework in providing the appropriate level of investment protection. Here it is important to be strategic in thinking about our asks of our international treaties. What is the role for international agreements? Often we use international agreements to do what is too challenging to do domestically, what we cannot do alone and what is better done together. We can use them to

address collective action challenges, such as preventing prisoners' dilemmas or protecting the global commons.

With respect to the issue of protection of international investment, it is not clear that there is this problem that international treaties need to solve. I say that, because states have their own very strong interests to establish and maintain investment-friendly climates and to protect foreign investors. Data shows that they do.

Just a little bit of background: in our work with the Columbia Center on Sustainable Investment, we are part of the Earth Institute in Columbia Law School and we do a lot of work with Governments on the strategies and tools that they can use in order to attract investment. There is a lot of concern throughout the world, developing and developed states alike, about how best to attract and retain investment. Governments are really interested in improving their business climates.

Given the incentives and the efforts of states to attract FDI, the rationale for international rules requiring investment protection become less clear. It might be important now to consider where we need international co-operation to address some of the challenges presented by international investment and the governance thereof. This could include addressing things like races to the bottom that countries might engage in in order to attract investment or closing some of the governance gaps that might arise due to international investment in some of the complex corporate structures that are associated with it.

Moving on to the second part of the question about the models, every year we do an annual review of investment treaties as part of the *Yearbook on International Investment Law and Policy,* published by Oxford University Press. One thing we see is an incredible diversity in approaches as states are experimenting with the treaties, trying to design agreements that best suit their need. We have moved past the standard short template of the 1980s and 1990s to more elaborate texts that are more broadly based on domestic reflections. There is a lot of innovation and a lot of experimentation.

One trend that I want to highlight is a retrenchment from strong ISDS among states that had been traditional proponents of the system. As an example, there have been over 260 ISDS cases against present EU member states. Roughly 70% of those cases have been brought by other EU member states, so the reaction has been an attempt to neutralise that source of vulnerability by terminating the intra-EU agreements or reforming the Energy Charter Treaty.

Similarly, roughly 85% of the claims against the US have been brought by Canadian investors under the NAFTA. In the recent renegotiation of that treaty, the US and Canada decided to exclude ISDS. A final example: roughly 96% of the claims against Canada were by US investors. Again, they have removed ISDS between those two countries. You see that, where countries have felt exposure, they have taken steps to neutralise that exposure by reducing or eliminating the role of ISDS.

The Chair: Thank you. That is extremely helpful and very interesting. Dr Bonnitcha, please.

Dr Jonathan Bonnitcha: Thank you. Like the other witnesses, I am delighted to be here this evening, Sydney time, and honoured by the invitation.

It might be useful, as Lise and Toby did, if I set out briefly my background in the field. I have also worked as a lawyer in investor-state dispute settlements for several years, primarily for the Australian Government, defending a multi-billion dollar claim about Australia's tobacco plain packaging legislation.

But my primary involvement in this field—I no longer work for the Australian Government or have any ongoing affiliation with them—is as an academic. In that capacity, a lot of my research involves trying to set investment treaties within a bigger picture of investment governance. That includes interviewing foreign investors in developing countries and asking them whether they find the protections contained in investment treaties useful, and interviewing foreign investment lawyers and government officials and talking to them about the impact that these treaty obligations have on regulatory decision-making processes and how they interact with foreign investors in situations of disputes. That is my background.

To come directly to the question about whether trade agreements should provide protections for foreign investors, I want to give quite a different perspective to Toby here, particularly on the point about the availability of other mechanisms in the absence of investment treaty protections and ISDS mechanisms to enforce those.

The bilateral investment relationship between Australia and the UK is enormous. It is not currently covered by an investment treaty. Disputes happen all the time. The ordinary way of dealing with a dispute, if a UK investor had an issue with a tax assessment by an Australian Government authority, with a denial of an environmental permit, with a claim about the tort liability of a public authority, or with a claim for breach of contract, it would bring those claims in the Australian court system. Indeed, that is what happens all the time. The same is the case for Australian investors in the UK, so that goes to the question of the ISDS mechanism and whether there are other mechanisms for resolving disputes in the absence of ISDS.

It also points to a wider issue about the traditional standards of investment protection that were found in historical investment treaties and are still relatively common today. These were developed largely with the decolonisation context of the 1960s and 1970s in mind, so there is potential for disputes about expropriation of foreign-owned assets between newly independent developing countries and foreign investors from developed countries.

That is a very different context from the world we are living in now. The standards contained in the treaties are just not adapted to the level of detail and sophistication required to adequately govern investment relationships.

If we look at the texture of domestic law governing foreign investment, to understand how foreign investment—let us say UK investment in Australia—is governed or how a dispute might be resolved, we have very detailed doctrines, depending on the type of dispute and the type of interactions we are talking about. There would be very detailed principles to govern, let us say, disputes about the tort liabilities of public authorities, or breaches of contracts, or even unilateral legislative Acts purporting to override agreed contractual terms, or environmental regulation.

These would all be the subject of very detailed doctrines of domestic law in developed democracies, whereas what investment treaties try to do is just layer over the top some very vague, general and, frankly, quite unsatisfactory standards, such as obligations to treat foreign investors fairly and equitably and then leave all the work of applying these vague and unsatisfactory general formulations to an arbitral tribunal in the event of a dispute.

The Chair: Thank you very much. I will bring in my colleagues now. I see Lord Goldsmith is with us and has his hand raised.

Q2 **Lord Goldsmith:** I want to do two things: I want to thank our witnesses for coming, and thank you, Andrew, for chairing this session. I will just explain why I am not chairing it. It is because, as many people know, I practise in much the same area that Toby Landau was describing and therefore declare that interest. I thought it important, therefore, that this session should be chaired by someone who was not affected by that sort of interest.

Having said that, I will put one point on the table at least for consideration, because I noticed the comment made by Ms Johnson about the European Union. At some point it may be helpful to understand the particular circumstances behind that, which concerned a particular decision of the Court of Justice of the European Union. That might give a little bit of a different flavour. Thank you, Andrew. I am not going to intervene further at this point.

The Chair: Thank you very much. Ms Johnson, it is an interesting point. Of course, because investment as such was not part of the competencies of the European Union itself, presumably that is one of the reasons why, over decades, the United Kingdom established a range of bilateral investment treaties, but it also presumably explains why the issues between countries in the European Union had given rise to this kind of issue of investor protection.

Lise Johnson: I have to say that as a non-European lawyer I find EU law exceedingly complex, but my understanding is that the reaction within

the EU is a combination of factors. One is the Achmea decision, indicating that ISDS disputes under intra-EU BITs are inconsistent with EU law and therefore are invalid. The conditions of consent under the underlying investment treaties are also invalid, so there is a question of EU law's inconsistency with investment treaties or, to say it differently, investment treaty and ISDS inconsistency with EU law that is being addressed.

The issue has come to the fore as many decisions that are raising issues and questions of EU and domestic law and policy are prompting some of the issues I think Jonathan referred to. You have these complex norms and laws at the domestic or community level regulating issues that sit uneasily with or feel usurped or side-lined by ISDS decisions that do not adequately take those and other competing and existing domestic or regional principles into account. That is some of the tension, as I understand it—legal and, I would say, political.

Q3 **Lord Gold:** I should declare an interest. I chair a litigation fund, so we are looking at investments in cases such as this.

I understand the comment about alternatives to ISDS resolution, but if we are left with proceedings in certain jurisdictions, we are at the mercy of the local courts and the delays there. For example, if one has a dispute that is going to the Indian courts, one might be there for a lifetime. Does the ISDS not avoid that problem, and should we not be welcoming such a thing, even if the rules are a bit vague?

Dr Jonathan Bonnitcha: Thank you for the question. I agree with its premise, which is there might be different considerations in different countries. Particularly if we are talking about investment protection and ISDS provisions between developed democracies, my view is that they are neither necessary nor appropriate, whereas in the case of the UK's relationship with, say, India, there might be different considerations to take into account, including the fact that the domestic court system is generally fair, I believe, but very slow, as I understand it.

The point is that ISDS provides an available mechanism for only a very tiny class of investors who are grappling with the problems of, let us say, judicial delay in developing countries. Of course, it is only relevant if you have a dispute with the Indian state, so it is no help to UK investors present in India who have private disputes. We know that those are the vast majority of disputes that UK investors will be facing; they will not be disputes with the state.

Even in relation to disputes with the state, not all of those will be capable of being plausibly framed as an investment treaty claim, but I do agree with you that there is at least an argument there or a discussion to be had about the balance between the costs and benefits of ISDS mechanisms when we are talking about the relationships with countries where the domestic court system is not reliable. That is a different discussion, the balance is different, compared with if we were talking about ISDS between developed democracies.

Q4 **Lord Morris of Aberavon:** We have all benefited from the generality of

the answers and it has been very educational. Following Lord Gold's question, may I ask something specific? What does the ISDS as a mechanism for investor protection aim to achieve? We have just heard a comment about undeveloped countries. What are the concrete benefits for investors?

The Chair: Perhaps Ms Johnson would be kind enough to respond to that first.

Lise Johnson: Sure, thank you. That is also a great question. In terms of what ISDS as such aims to achieve, there are several often-stated answers. It is also a question for each country to decide what they want from their treaties. Some will say that it is part of a tool for catalysing outward investment; some say it is part of an approach for catalysing inward investment, but also with the aim of providing investors with compensation for harms, and of depoliticising disputes and moving them to an investor-state claim, or of improving their rule of law.

With respect to each of those aims, the actual aim needs a little bit of unpacking to understand whether that is the right one. Then, there are a separate set of questions to ask around the effectiveness of ISDS as a tool for those; and if they are effective, then to ask at what cost and who bears the costs and who reaps the benefits.

Let me unpack that a little bit. Just to illustrate, when thinking about ISDS as a tool for supporting outward investment, it is important to consider whether you want to use government resources negotiating, enforcing and monitoring treaties, and the subsidy that they are effectively providing, to promote all outward investment. Do you want to have a policy, for instance, of actively encouraging manufacturing or other processes to offshore? That might negatively affect jobs at home. Such investment can bring domestic benefits, but it can also cause different structural changes and economic dislocations that can have negative effects domestically on workers and communities, and that would need to be addressed.

Similarly, do you want to encourage offshore transactions done largely for the purpose of tax avoidance or do you want to affirmatively support outward investments, developing new fossil fuel reserves that experts say need to stay in the ground if we are going to meet the commitments of the Paris agreement? If we are using ISDS to affirmatively promote outward investment, it is a question of thinking about being more strategic in terms of what types of investment are being supported and ensuring that that outward investment is consistent with UK policies domestically, and also what the UK's hopes are for its trading and development partners.

Similar considerations apply for inward investment. If we are using ISDS to catalyse inward investment, it is important to think about whether or not you want it for all investments, such as acquisitions of existing companies or greenfield investments, or whether you might want to tailor it. Those are some thoughts about unpacking the aims of ISDS.

With respect to the rule of law point, I think that there is much more to address there. If the concern is that investors cannot get access to justice in domestic courts, then I am also not sure that ISDS is the right mechanism for addressing that problem, because it is also notoriously lengthy and costly. Rather than it causing countries to expend resources defending ISDS cases and paying liability, it might be an appropriate tool for international agreements to support co-operation, to understand what the bottlenecks are in domestic courts and to help overcome those bottlenecks so that all investors can benefit from that.

In terms of the effectiveness, at a systemic level, the evidence—and people have been looking for it—does not suggest that investors care much about investment protection when making their investment decisions. In a 2019 report by the House of Commons International Trade Committee on the UK's investment policy, the Minister for Investment himself told the Committee that investment treaties are not a top priority for business. He said, "I don't think a single business has ever raised that with me, which suggests that it is not that material". The lack of a connection between investment treaties and investment flows is something to keep in mind.

On a micro level, though, I think it is clear that IIAs and ISDS do provide powerful tools for investors who want to use the leverage that these tools provide in the context of specific disputes. Undoubtedly, there are possible benefits for specific individuals and companies that want to avail themselves of these tools. Covered investors get privileges that are not permitted under domestic law: they get better rights of access to justice, better substantive protections and a wider range of monetary remedies or higher monetary remedies. It sets up a privileged set of procedural and substantive protections for foreign investors. I think there are concerns that that system of unequal protection under the law imposes some costs that also need to be taken into account.

Lord Morris of Aberavon: Does anyone want to add to that?

Toby Landau: I would like to, if I may. I may have misunderstood, but I heard the question as concerning the concrete benefits, if any, to investors. If that is the question, it is important to think just from the perspective of an investor: what is the advantage of having protection in a treaty? There are at least three core points, in my view. The first is the availability of a forum to bring a claim and seek redress where there may be no realistic forum at all. That is because in many countries around the world where foreign direct investment is taking place, there is no local developed law on investor protection. There are not the sophisticated mechanisms that Jonathan Bonnitcha has described, which do exist, of course, in some countries. There is nowhere to go.

Secondly, investor-state dispute settlement brings a neutrality to dispute resolution. Even if you have a functioning and reliable local court, it is simply unrealistic in many cases that investors will go to that court with any confidence at all. That can be not just because the courts are slow, inexperienced or unreliable. It may just be because your dispute is

against the Government and is politicised or sensitive. The last thing you want to do is put it before a local bench.

The advantage of an investor-state dispute settlement is that it takes it out of the local territory, the local politics, and provides neutrality in the same way that arbitration provides neutrality in international commercial disputes, and has been incredibly successful for a long period of time for that very reason.

The third point is that this is a form of dispute resolution that is binding and enforceable, so it is effective. That itself is incredibly important for investors. They may be able to go to a local court and get a local judgment, but if they cannot enforce the judgment, then the process is of no worth at all.

Just to step back from that, I will state the obvious: for any investor, the ability to exit the project, the investment, or resolve a dispute is as important as the initial decision of making the investment. If you get into an investment and you get stuck, then you need to have some resolution and you have to find some exit. That is what ISDS is providing.

Chair, I do not want to go on too long, but may I circle back just to cover one other area? I would not advocate to this committee that ISDS is without its problems. It has a lot of problems and many detractors, but this is not a binary policy issue of: do you have ISDS or not? The question is more nuanced than that. The question is: what form of ISDS you want? It is not, in my view, as simple as saying, "Countries are feeling the exposure now and are thereby taking steps to get rid of ISDS". Some countries are doing that, but many are not.

One can identify five categories now, five models of ISDS. I will quickly list them and we can talk about them further if it is of any interest. There is of course the traditional model, which is full ad hoc or institutional international arbitration. There is a second form, which is no ISDS at all—that is, no mechanism in the treaty whatsoever. The third is a standing ISDS tribunal, much like a court structure, and that is replacing party-appointed arbitrators with standing adjudicators. Fourthly, there is a limited ISDS.

We now have plenty of experience of treaties that are making ISDS much more limited in its ambit in order to answer all these criticisms: for example, requiring local remedies to be exhausted first, having carve-outs for certain areas of policy, imposing time limits and increasing the role of states to make their views known. Lastly, there are procedures that are focused very specifically on improving the arbitrators, the efficiency of the process and transparency.

I have listed those in order to say this debate should not, in my view—with all due respect to the people who are very against ISDS—be about whether we have ISDS or not. I think there is a discernible need for something, and there is a question then as to how the craft the best solution.

Lord Morris of Aberavon: Is it a fall-back mechanism, and is it likely to be used substantially or is it marginal? What type of investor is likely to use it?

Toby Landau: It is used all the time. When you have an ISDS mechanism in a treaty, we have seen over the last 50 years an exponential increase in cases. People resort all the time to ISDS. It is not a fall-back, as such. It may be a fall-back to, for example, negotiation or mediation. Sometimes, of course, people try to see if they have remedies before local courts, but it has become a primary form of dispute resolution, and that is for any type of investor.

The Chair: I want to move on. I am conscious we have not given Dr Bonnitcha a chance to talk on this question, but it might be sensible to move to the Earl of Sandwich's question, which is in a similar area, and perhaps takes us into some of the risks of ISDS. John, perhaps you would be kind enough to direct that to Dr Bonnitcha in the first instance.

Q5 **The Earl of Sandwich:** I am delighted to do that. My question is again about the benefits versus the risks, and regulatory chill. Quite a few witnesses are concerned about the implications for domestic policies and say that ISDS provisions can interfere with the Government's ability to introduce their own public interest regulatory measures. What evidence do you have of that? I know that Lord Kerr will also be mentioning this in relation to the CPTPP, the Trans-Pacific Partnership, so perhaps that can all be put together. If Lise has a comment afterwards, that would be splendid.

Dr Jonathan Bonnitcha: It is an important question because, as you say, this is an issue that has had a lot of attention. We know that there is some risk of regulatory chill. For example, in a study published I think last year in one of the top international relations journals *International Studies Quarterly*, a scholar looked into the impact of ISDS claims on tobacco control measures, because ISDS has famously been used to challenge tobacco control measures in Australia and Uruguay.[1] She found that in both cases of ISDS, a challenge to the tobacco control measures was unsuccessful, but the findings of the study were interesting because they suggested some different effects of regulatory chill in different countries.

What seemed to be happening is that in developed countries, the ISDS claims discouraged Governments from going ahead with their tobacco control regulations so long as the cases were pending. So, they encouraged delay and caution and there is a public health cost to that, but when those cases were resolved in favour of the two states in question, many developed countries went ahead with their own tobacco plain packaging laws, for example.

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[1] Carolina Moehlecke, 'The Chilling Effect of International Investment Disputes: Limited Challenges to State Sovereignty'*, International Studies Quarterly*, (March 2020), pp1-12: https://academic.oup.com/isq/article/64/1/1/5568076?login=true

What she found in developing countries was different. The regulatory chilling effect was ongoing, so even after the successful defence of these ISDS cases by the Governments in question, developing countries—whether because of risk aversion or more difficulty in assessing the extent of legal risks associated with certain sorts of policies—were still reluctant to adopt these tobacco control policies, even after those cases were resolved. Some chilling effect was observed and clearly documented in that study, which I can share after the event.

More generally, one of the bigger concerns—I do not know if this is exactly a regulatory chill issue, although it is adjacent to it—is the possibility of unknown unknowns: categories of cases that people have not fully thought through yet coming about in the future and surprising Governments because of the broad interpretations and non-specificity of the protection standards in these investment treaties.

Even 10 years ago, if someone had said that there were going to be 40 claims against Spain, running into tens of billions of euros, relating to a change in the tariff regime in the solar energy industry where those changes to the tariff structure had been supported and indeed actively encouraged by both the IMF and the European Union, I think people would have thought that that was very unlikely. We are not talking about Venezuela here—we are not talking about expropriation or seizure of assets; we are talking about quite complex regulatory disputes around pricing arrangements in utilities. But that is one of the big sets of claims we have seen in this decade.

Things that maybe have not been thought through yet are risks relating to subnational government action. Of course the state, the UK, is responsible for all its organs and subnational entities. What are the risks to the UK, and to the political settlement in the UK, for example, if the Scottish Government were to take regulatory action that was supported by a strong democratic mandate in Scotland that was then subject to an ISDS claim brought against the UK Government as the relevant state actor? There may be some sense within the UK Government that the claim should be settled by regulatory amendment or paying the investor out. These kinds of questions have not been fully worked through in the system yet; they are future sites of regulatory chill, rather than just the classic examples of public health and environmental regulation, which tend to get more attention from the NGOs and activists in this space.

The Earl of Sandwich: Thank you very much. That brings us very close to home. If we may, could we have a copy of that earlier paper, please?

The Chair: Ms Johnson, did you want to add to that? If you are happy I will move on.

Lise Johnson: Maybe just briefly. The OECD's work on public integrity has also highlighted the use of litigation as a threat for unduly securing influence over law and policy-makers. It says that interest groups can abuse justice to harass public officials by initiating litigation, aiming to show illegality or administrative incompetence and that faced with these

threats, even honest public decision-makers may make biased policy choices. I think it is important for buttressing this theory of regulatory chill and the policy considerations behind it, especially given the high stakes of ISDS.

The issues of chill were recognised by the former US trade representative, Robert Lighthizer, who had said in testimony before Congress that the US has had situations where real regulation, which should be in place, which is bipartisan and in everybody's interests, has not been put in place because of fears of ISDS. He said that it is something we have to think about very carefully.

Another study—it is in a different publication to the one Jonathan was referring to—also looked in depth at the tobacco litigation measures and similarly found evidence of regulatory chill in a number of countries. I can send that to, as well, you after this.

The Earl of Sandwich: Thank you so much.

Q6 **Lord Foster of Bath:** I was going to ask whether or not we need ISDS mechanisms between two developed economies where they both have robust legal systems. However, we have already heard Dr Bonnitcha point out that many investor disputes—for instance, between the UK and Australia—are handled in the courts, and he went on to suggest that ISDS is neither necessary nor appropriate.

Ms Johnson has told us that lots of effort seems to have to go into finding a way of doing it, none of it very satisfactory, so that, for instance, the US and Canada have now dropped doing it. She suggested that the efforts should be put into sorting the bottleneck in the court system.

On the other hand, Mr Landau, working at the grubby end—as he puts it—says that you need a place to have your rights enforced. Even in the conditions I am describing, the availability might be there but it is not going to provide the neutrality or the binding enforceable exit that he says ISDS mechanisms can give. That summarises the three positions, I hope. I would be grateful if you can confirm that I have it right, because then we can move on.

Toby Landau: That was a brilliant summary, and I can confirm that. The only thing I would add is that I think my perspective has some support from commercial arbitration, which is sort of the sister of investor-state arbitration. In international commercial arbitration, undoubtedly we have an incredibly successful mechanism that for cross-border trade has become the first choice. One must ask the question: why is that, if indeed there is equal confidence in developed legal systems and their courts? The answer is, neutrality.

Neutrality is such a vital point that it is not an answer to neutrality to say, "We have great judges, very efficient courts and a very sophisticated law". We know from the commercial world that that is not enough. People very often will only be satisfied and comfortable with dispute resolution in a third neutral country before neutral courts, the courts of a third state,

or international arbitration. That same dynamic is, I think, active and even more important in investor-state arbitration, just because of the sensitivity of many of the issues in play.

The Chair: Thank you. Before we move on to the CPTPP, David Watts, please.

Q7 **Lord Watts:** Thank you, Chair. The House of Commons International Trade Committee suggested that the Government should consider using the provisions in the international investment agreements to counterbalance investor rights, such as enshrining investor obligations allowing for state counterclaims or carve-outs from investment protection. Is this a practical solution to deal with the concerns that are being raised about standard ISDS clauses? If Jonathan could address that, that would be appreciated.

Dr Jonathan Bonnitcha: Thank you very much for the question. Again, this is an issue that has received some discussion. It depends what you think the problems with ISDS are, because if you share my view that ISDS provisions are neither necessary nor appropriate in treaties between developed democracies, then the question of counterclaims and carve-outs does not arise as such. I guess we can think of these as tweaks or minor adjustments within the existing structure of rights and obligations and dispute settlement mechanisms that aim to slightly rebalance or adjust the rights between the parties within that same basic structure. The basic structure, the basic content of the investment protection obligations and the basic ISDS mechanism, remains more or less unchanged.

My view is that those are not a solution to the problems that I see with the ISDS mechanism, although they are an improvement on the status quo. Investor obligations are a little bit different because it would depend on exactly how that is done—whether that is incorporated just by way of a counterclaim, in which case it would be relevant only if the investor has first initiated a claim against the state, or whether it is something more sweeping. I will not get too much into the detail there, as much as I would love to talk about it.

Just stepping back out again to the bigger point about what the problems are here and what we are trying to solve, and I guess answering to some extent Toby's point about neutrality, it is important to understand—and I think this is uncontentious, just as a matter of factual background—that ISDS largely does not apply between developed democracies at the moment. In a recent paper, for example, with co-authors we looked at Germany's 10 largest bilateral investment relationships. Germany has the largest network of investment treaties in the world and only one of those 10 largest relationships is covered by an investment treaty. That is the relationship between Germany and China, leaving aside the partial sectoral coverage of the Energy Charter Treaty.

The picture in the US is the same. Only one of the US's 10 largest bilateral investment relationships is currently covered by an investment

treaty that contains ISDS. That is because the world's largest investment relationships are bilateral relationships between developed democracies and they are, for the most part, not covered by ISDS. That is one way to answer Toby's point about whether a neutral mechanism is necessary. Trillions of dollars of global investment currently goes ahead without the coverage of ISDS mechanisms.

The Chair: Thank you very much, Jonathan. May I ask Lord Kerr to take us into the issues relating to CPTPP, please?

Q8 **Lord Kerr of Kinlochard:** Yes, thank you, Chair. I am now very encouraged by this discussion, because I spent my career in the Foreign Office encouraging investment treaties with developing countries and I spent 10 years on the boards of Rio Tinto and Shell. I can remember no dispute in Australia or New Zealand where an ISDS provision in a treaty would have been remotely helpful or relevant. It seems to me that Mr Landau's five-category taxonomy has to be right and that we are talking horses for courses.

With CPTPP, here we have a whole lot of horses of different kinds and I am not quite sure what approach we should be taking to the ISDS provisions in CPTPP. Our Government have announced that we would like to join CPTPP. This committee is doing an inquiry into what that should mean. Could our witnesses describe the CPTPP provisions on ISDS and could Mr Landau explain where he thinks the British Government should take a stand? Which of his five categories applies to CPTPP? Perhaps we should start with Mr Landau.

Toby Landau: I am happy to answer that. On the structure of the CPTPP, for our purposes we are looking at chapter 9, on investment. In a sense, it is state of the art as to where treaties have got to in response to all the criticisms. Jonathan mentioned earlier the unknown unknowns, and I think that is right. The way that treaties have developed in this field year on year has been reactive. I think that that does leave risks regarding things that we do not yet know—that is absolutely right. But for things that we do know, this treaty, this draft, reacts rather well, to my mind.

If I may, I will split it into two: first, the substantive protections; and secondly ISDS, the actual dispute resolution provisions. I will do this very quickly, but it is a complex document. I will just pick up the highlights that I think are important. On the substantive protections, the risk of standards that are too ambiguous has been addressed. On the key standards that are regularly deployed or implemented, they are very narrowly drawn, in line with current best practice. That includes the minimum standard of treatment in article 9.6, which ties back fair and equitable treatment to the customary international law minimum standard and specifies, with sufficient detail, in my view, why that is a narrow, high threshold.

On expropriation and compensation, article 9.8 is a detailed provision by reference to annex 9-B. It draws back expropriation from a much broader category that has often been found and criticised in other cases.

Along the way there are specific provisions to reduce the risk of regulatory chill. I think this may be the subject of a subsequent question, but there are at least three specific provisions—article 9.6, article 9.8 and annex 9-B, and article 9.16—which preserve regulatory freedom on the part of each Government, so that the risk of the chill is greatly reduced.

When one gets to the ISDS provisions, it is a very tightly drawn treaty, in my view. It falls into, in my taxonomy, the last two categories, which is limited ISDS; it is the fourth and fifth of my categories because it is restricting ISDS in two ways. First, it restricts it in terms of carve-outs, so the coverage is restricted, together with time limits. Secondly, the procedure is greatly improved by, first, enhancing the role of the state to provide binding determinations and interpretations for non-disputing parties to participate in the process. There are codes of conduct for the arbitrators, provisions for early dismissal of frivolous claims, consolidation of claims and transparency, as well as restrictions on the remedies that can be provided.

In my view, this is a responsive treaty at the moment. It meets the more frequent challenges and criticisms of ISDS, but I do take on board Jonathan's point that it may not meet the points that we do yet know about.

The Chair: Thank you. Lord Kerr, did you want to follow up?

Lord Kerr of Kinlochard: I would have asked about the extent to which regulatory chill comes in, but I think Toby Landau has answered that. Perhaps the only thing I should do is ask if either of our other witnesses believes that the regulatory chill factor would be larger than Toby has suggested.

Lise Johnson: I do think that it would be larger. I agree with Toby that the treaty is reactive to developments in case law, but with respect to the legally relevant parts of fair and equitable treatment and the national treatment provision, it has codified the approach taken in Bilcon v Canada, which is a dispute where an investor successfully challenged an environmental review of a mining project. That is notable, because the dissenting arbitrator in that case commented that, given the tribunal's majority decision that a chill would be imposed on environmental review, in this respect the decision of the majority would be seen as a remarkable step backward in environmental protection.

The standard that the tribunal applied in that case is the standard for FET and national treatment that is codified in the TTP. I do not think that the TPP reacted appropriately to that case. It could have been related to the timing of that decision and also the timing of the negotiation of the CPTPP.

Also, with expropriation, there have been recent decisions, such as Bear Creek v Peru, showing that the narrowing that maybe parties had not intended through the annexes that seek to clarify that provision has not been that effective.

Finally, with respect to the "right to regulate" provisions that are inserted there, there is this qualifier that Governments have a right to regulate as long as that regulation is consistent with the treaty. As we have seen in over 20 years of practice under the NAFTA, at first those provisions were cited by the investor in support of its position, saying, "It has to be consistent with the treaty". The state cited it, saying, "We have tried to protect our environmental regulations". Neither side won. Essentially, both sides stopped referring to the provision in cases over the past 20 years and it did not have an impact on an outcome, including cases involving environmental disputes. I think those "right to regulate" provisions have not in fact been impactful in terms of the outcomes of decisions.

The Chair: Thank you. Dr Bonnitcha, is there anything you want to add?

Dr Jonathan Bonnitcha: Just briefly to echo Lise's point. I do not want to go too deeply into the legal detail, but if we look at article 9.16, which is the one that Toby mentioned, as Lise has said, it is very important to recognise that this article just restates something that would in any case be self-evident: that a state is entitled to regulate in a way that is not inconsistent with the agreement, so it is entitled to take measures that are otherwise consistent with the agreement. That is not a clarification; that is just a restatement of what is obvious.

In the case of the remedies provision, which Toby also mentioned, that is also just a restatement of existing practice. I think we all agree that this is a reactive document. It is longer than investment treaties have been in the past. It seeks to address some of the criticisms and concerns of past investment treaties largely through minor and textual tweaks, but the basic structure of the ISDS mechanism and of protections—the reference to fair and equitable treatment, for example, which we know is the key standard under which these treaties are litigated—remains intact. So, the basic structure is intact.

The Chair: Thank you very much. Let us zero in a bit. Lord Astor, you were going to ask additionally about not just CPTPP but New Zealand.

Q9 **Lord Astor of Hever:** Lord Lansley, thank you very much. This is a question initially for Jonathan and Toby. New Zealand has signed a number of side-letters with CPTPP members to curtail ISDS. Should the UK be pursuing side-letters with specific CPTPP members? If so, which ones?

The Chair: Jonathan, would you be kind enough to take that first?

Dr Jonathan Bonnitcha: Of course; I would be delighted to. That is exactly right. That reflects the nature of the CPTPP as a multi-issue and very complex deal. When states are coming to this treaty looking to

accede, possibly like the UK is, the investment chapter will not necessarily be the highest priority or the most salient issue, so a decision on whether to join the treaty or not obviously involves consideration of a wide range of questions that are well beyond this chapter. The negotiation of side-letters is one way to manage the position for a state that has decided that the treaty as a whole, for any number of possible reasons, is worth being a party to, but that the ISDS mechanism poses risks. Yes, that is what New Zealand's policy has been. I believe they would negotiate side-letters with any of the CPTPP parties who would be willing to agree to one with them.

It is also consistent with past bipartisan Australian policy. When Australia signed a free trade agreement with the US in 2004, for example, ISDS was excluded from that agreement at Australia's request, because Australia has largely had a policy of not including ISDS mechanisms in treaties with other developed democracies.

Part of the question was, should the UK seek to negotiate similar side-letters if it were to join the CPTPP? Yes, in my view. With which states? Potentially, with all of them, although there would be a clear order of priority and also an important question about looking at existing treaties in force. For example, Singapore is party to the CPTPP, but the UK is already bound by an investment treaty with Singapore that contains an ISDS clause, I believe. Toby will correct me if I have that wrong.

There is also a question about the potential overlay of these treaties. The CPTPP, for the reasons we have all discussed, is probably an improvement on the existing Singapore-UK bilateral investment treaty, but this question of the way the agreements fit together would also need to be considered.

The Chair: Thank you. Mr Landau, do you want to add to that?

Toby Landau: Yes, very briefly. I agree with much of what Jonathan has said. There is certainly the scope to adapt by using side-letters. If one looks at New Zealand's practice, it is rather complicated and it is not clear—at least, to the outsider—what has motivated the different side-letters. There are two different groups of side-letters that New Zealand has concluded. First, with Peru and Australia they have side-letters that fully exclude ISDS. That is understandable with Australia, because that reflects bilateral policy previously, so the ASEAN-Australia-New Zealand FTA likewise does not have ISDS.

It is not readily understandable with Peru because there is no previous investment treaty between them, so quite what has motivated that I do not know. Following on from my previous contributions and my previous evidence to this committee, I would have thought that Peru would be a prime candidate for ISDS, because of the lack of available alternatives in that forum as a host state for investment.

The second category of side-letter from New Zealand concerns Malaysia, Brunei and Vietnam. Here, it is not a side-letter that removes ISDS

altogether. It imposes a six-month period for consultation and thereafter—that is, after a dispute has arisen—it allows for ISDS provided that the state consents. So, it imposes a further threshold whereby you can go to ISDS as long as your counterparty state is going to consent at that point, which is another compromise, in a sense. That allows the state that is going to be subject to a claim to decide whether or not it wants to be in arbitration. That might well resolve a lot of the concerns that Jonathan and Lise have articulated.

Interestingly, it may not make much difference because Brunei, Malaysia, Vietnam and New Zealand still have access to ISDS under other agreements that still apply, so they still have access to the ISDS: for example, the ASEAN-Australia-New Zealand FTA, which, according to article 1.2 of the CPTPP, will still apply. Therefore, there is still an active mechanism.

At the same time, New Zealand concluded a joint declaration with Chile and Canada to say that they will consider the evolving international practice and evolution of ISDS, so they have left it hanging as to whether they may well want to change this in the future. All that is to say that if this committee is concerned with the risks and problems that have been articulated, then side-letters would be a very good way of dealing with them.

The Chair: Thank you for that; that is very helpful. Let me come to Baroness Liddell. I see Lord Gold has his hand up and I want to come back to Lord Kerr well, but we are nearly out of time.

Lord Gold: Lord Chair, I am sorry to interrupt you, but my question goes to side-letters. Very quickly, what is the legal effect of a side-letter?

Toby Landau: It will have effect as if it is part of the treaty with respect to the signatories to the side-letter. That means that where New Zealand, for example, and Peru have agreed that there is no ISDS, that side-letter is an effective international agreement between them, which means that there can be no arbitration commenced by an investor.

Q10 **Baroness Liddell of Coatdyke:** I am looking for a bit of informed speculation, particularly on Jonathan's part. Negotiations on bilateral trade agreements between the UK and Australia, and the UK and New Zealand, are going ahead apace now. In your view, what will Australia and New Zealand push for on investment protection generally and ISDS specifically? Could their asks present any risks to the UK, other than the one you speculated about earlier about the nature of the union between Scotland and the United Kingdom? Over to you.

Dr Jonathan Bonnitcha: I am happy to reassure you, at least in a speculative sense, that I think it is unlikely that Australia and New Zealand would specifically present risks to the UK, because it is unlikely that either state would be pushing for ISDS in a treaty with the UK. In the case of New Zealand that is quite clear, given the current stated

policy of the Labour Government in New Zealand and the practice of side-letters under the CPTPP we have just been talking about.

In Australia, I think it is less clear under the current Government because the stated policy is that ISDS is considered on a case-by-case basis. But as I have alluded to before, Australia has a relatively small investment treaty network and has historically had a bipartisan practice whereby it has not sought the inclusion, and has sometimes actively requested the exclusion, of ISDS mechanisms in treaties with other developed democracies. The Australia-US FTA was an example of that.

It is very unlikely that Australia would push for that, but if you were interested in Australia's most recent bilateral investment treaty to see what they might request if they were to push for something, the recent treaty negotiated with Uruguay would give you a rough example of the Australian position at the moment—particularly looking at the question of the actual content of the substantive investment protections, leaving ISDS aside.

The Chair: Thank you. I think we have time for two short additional questions. John Kerr first, please.

Q11 **Lord Kerr of Kinlochard:** I would like to come back to Lord Gold's exchange with Mr Landau about India. Our Government are contemplating a trade agreement with India. In the context of ISDS, is there anything that our Government should learn from the difficulties that companies like Cairn and Vodafone have had over long period of time with the Indian tax authorities?

Toby Landau: Is that a question for me?

Lord Kerr of Kinlochard: Yes, please.

Toby Landau: I have to declare before I say anything that I am counsel to Vodafone against India. I have been representing Vodafone for some time, so I will not say anything specifically about that case, which is still live at the moment in the Singapore courts.

What I can say more generally is that that kind of case is an interesting example of the utility of ISDS, because the collection of cases, Cairn, Vodafone and Vedanta—there are a trio of them, and now a couple of others have surfaced—are all focused on the tax policy of the Indian Government. They show the attempts that have been made through the Indian court system and tax regulatory system to get recourse with respect to conduct that was challenged, and the inability to do so.

In terms of the facts of the Vodafone case, without commenting on it too much, it is rather instructive, because the Indian Government imposed a withholding tax on the investor in India. That was challenged by the investor over a number of years, all the way up to the Indian Supreme Court, which was a huge undertaking. In the Indian Supreme Court, Vodafone was successful and the court ruled that the tax had been improperly imposed. Thereafter, the Indian legislature passed retroactive

legislation to, in a sense, reverse the effect of the Supreme Court judgment and to impose tax by a change in the law. At that point, an investor does not have anywhere else to go. So, that was the genesis of the Vodafone bilateral investment treaty case. That is an instructive example of where ISDS has a very important role to play.

The Chair: Thank you very much. Lord Goldsmith, you have your hand raised.

Lord Goldsmith: Thank you. It is interesting, because Toby Landau has just dealt with the point I wanted to raise. In the discussion that has taken place—I have listened to it with great interest—one point that did not come out was the difference between an international standard of protection and a standard of protection that is dependent upon what the local legislature decides it wants to have in place. Is there any comment on that? I think what Toby Landau has just talked about demonstrates that issue. That may be an additional one for the committee to take into account, but perhaps he could comment on that, and if others want to, please do so.

The Chair: Thank you. Ms Johnson or Dr Bonnitcha, did you want to comment specifically on that?

Q12 I will just move to the final question, if I may, which is for Ms Johnson. Just thinking about Mr Landau's taxonomy, one was the question of a standing tribunal. In that territory, of course, there are a number of proposals coming forward. We have the EU's multilateral investment court proposal, and we have seen a little more flesh on those bones. We also have the work that is taking place under UNCITRAL. Looking more generally at the way the United Kingdom should address these issues, would you advise the UK to pick up and prioritise any of those?

Lise Johnson: On the disparate levels of protection between domestic and foreign investors, it is also important to highlight that one issue of concern that a number of developed states have raised is that investment treaties are providing unequal protections to foreign investors as compared to domestic, that there is no good justification for that regulatory distortion and that if you are going to create a distortion in the regulatory framework, then you want to understand the policy reasons behind it. That is a good thing to flag up, and there are concerns around creating that.

With respect to the Vodafone decision, the Cairn cases and the implications for domestic states, it is a big challenge to tax offshore capital gains transactions. It is a question of thinking about the signals that these decisions are sending not only to states about the way that they adopt tax measures, but also to investors about their ability to structure transactions in a way that is designed to avoid taxes. Again, what is the role of our international treaties and what signals do we want them to send? Those are important questions to ask.

With respect to the issue of reform, I participated in the UNCITRAL negotiations and have been following them closely. It is important for the UK to play a leadership role there. The multilateral investment court is very similar to ISDS in many of its structural design features—it is the private right of action against the state without exhaustion of remedies. That being said, there could be broader reforms that are integrated within the UNCITRAL process, such as tools for exhaustion or the protection of the rights of non-parties, which is an issue that currently has not yet addressed. The issue of damages is also potentially on the agenda. Those are all things that the UK Government could pick up.

Also, having had a robust financial services industry, the UK could consider the role of the private sector and private risk insurance in order to help investors deal with some of the risks in the places where they are investing, along with a public risk insurance backstop to help provide risk insurance or mitigate risk in the areas where the private sector is not willing to insure, or willing to insure only at a cost that is too high for investors to purchase. There are a number of areas for the UK to be a leader in.

The Chair: Thank you very much. We have overrun our time, but principally because we have had such excellent material from our three witnesses. We are very grateful to each of you. Thank you very much for giving your time and your expertise. I fear we may call on you, not least regarding the references you have made during the course of your evidence and the additional material—and, indeed, as we scrutinise some of the agreements the UK is planning to enter into and its approach to the CPTPP.

You have advanced considerably our ability to scrutinise those agreements when they come forward and set them into a much better context, and we are most grateful to you for your participation. I know our secretariat would be very grateful if there is any additional material that you want to add, and which we can take account of as well. With that, may I say thank you to our witnesses? The public evidence session is now concluded.