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From the Experts

Dispute Resolution After the TPP Trade Agreement

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The recently concluded Trans-Pacific Partnership (TPP) trade agreement stands to open vast new markets to foreign investors. Now legislators in each of the 12 participating countries—collectively representing 40 percent of the world's economy—must decide whether to sign the accord into law. In the meantime, private investors would be well-advised to consider the implications of pursuing compensation, should new investments go awry, through the TPP's Investor-State Dispute Settlement (ISDS) mechanism.

ISDS has been part of the international economic landscape since 1959, and currently exists in over 3,000 trade agreements, including the North American Free Trade Agreement (NAFTA) and several US-EU bilateral investment treaties. Under ISDS, investors would be able to challenge actions by a host country that are—or appear to be—in violation of their property rights. While this can be viewed as encouraging investment into newly opened markets, companies initiating actions perceived by the media or other public commentators to be unfair to the host country may suffer considerable financial and reputational fallout as a result.

To avoid the need for ISDS in the first place, a thorough understanding of the host country's political, economic and social dynamics should be part of any pre-investment plan. Advance understanding of these issues can also help to inform any subsequent legal strategy initiated under ISDS.

Avoiding the ISDS Rabbit Hole

Although ISDS stands to offer investors some protection against local discrimination or expropriation, investors should proceed with caution. In controversial cases involving heated disputes between corporate and state interests, protracted legal proceedings could stoke resentment and severely damage a company's public image, not to mention increase the costs associated with doing business in a new market. ISDS has been sharply criticized for allowing large multinational companies to circumvent domestic legal processes, threaten the sovereignty of host governments, and offer foreign companies access to privileges not available to domestic investors.

Rather than relying on the availability of ISDS, companies seeking to invest in TPP member

countries should exercise increased vigilance as to the underlying risk factors that might lead to adverse action against an investor in the first place, and evaluate whether any potential ISDS suit would be worth the financial and/or reputational cost. Targeted intelligence gathering can help companies identify and fill existing information gaps as well as develop precise questions to bear in mind during subsequent phases of investment and/or litigation. Such intelligence may also include an assessment of political risk factors, environmental sensitivities, indications of civil unrest, and even the identification of potential allies and foes.

Understanding the Risks

The final text of the TPP accord may not be available for several more weeks. However, according to the Office of the U.S. Trade Representative (USTR), the TPP's ISDS provisions are expected to have extensive protections for member governments, entitling them to "protect against legitimate public welfare objectives such as public health, safety, the environment, and the conservation of living or non-living exhaustible natural resources." Given such broad parameters, investors would be wise to consider the myriad ways in which their planned projects might be viewed as impinging on such factors.

An ongoing suit in the World Bank's International Centre for Settlement of Investment Disputes (ICSID) exemplifies the importance of assessing risk factors early on. Pacific Rim, a Canadian-Australian mining company, has been in an investor-state dispute with the government of El Salvador for the past six years. Although it claims that the government's refusal to grant it a mining permit cost the company US\$301 million in potential lost revenue, headlines have broadly demonized the company for attempting to secure mining rights in a country where 90 percent of its limited surface water supply is contaminated, and for seeking damages amounting to approximately 1.5 percent of El Salvador's annual GDP in 2009, according to World Bank data. In recent years, press reports and blog posts show that Pacific Rim's legal efforts have generated a significant activist response in the country and rallied critics against both the company's actions and investor-state tribunals in general.

Reactions to the Pacific Rim suit are not anomalous. In recent years, criticism of the ISDS mechanism has highlighted the perceived imbalance of power between wealthy corporations with seemingly limitless resources and the cash-strapped governments on the other side of the table. Figures from the United Nations Conference on Trade and Development (UNCTAD) show that of the known ISDS cases (those not governed by confidentiality agreements) over the past 25 years, the majority of the actions appear to have been initiated by investors from developed countries, and that less-developed economies have faced a larger proportion of lawsuits than their wealthier counterparts.

Streamlining the Process

According to a report on ISDS published by the Center for Strategic and International Studies (CSIS), employing the mechanism can be just as costly and time-consuming as any complex litigation proceeding. As noted above, the Pacific Rim suit has been active for six years, costing both parties significant legal fees (approximately US\$13 million, to date, for El Salvador alone), and, for Pacific Rim, accusations of corporate irresponsibility and even complicity in human rights abuses.

It is therefore in any investor's best interest to obtain critical intelligence of a new market early, rather than to rely on ISDS as an end-game silver bullet. Because tribunals tend to define what constitutes "fair and equitable" treatment of foreign investment quite broadly, such intelligence

can also help to identify otherwise subtle contextual facts and issues, which can be leveraged to strengthen an investor's claims and expedite settlement talks.

Indeed, despite the reputational risks, payoffs associated with ISDS can be substantial. To cite two recent examples, in 2012 ICSID ordered Ecuador to pay US\$1.77 billion to Occidental Petroleum for canceling its contract with the company, and in 2014 the tribunal directed Venezuela to pay US\$1.6 billion to Exxon Mobil for nationalizing its oil projects.

An Informed Path Forward

The Trans-Pacific Partnership agreement creates vast new opportunities for foreign investors, but with a significant caveat: Without thorough knowledge of a given jurisdiction, investors could find themselves embroiled in a legal dispute that may damage their reputation and lead to fallout with the host government. Because the majority of ISDS cases have been initiated by large corporations against developing countries, investors should be mindful of the financial and reputational consequences associated with any potential suit, and arm themselves with information beyond that which can be gleaned from a financial prospectus alone.

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