Seattle to Brussels Network

Seattle to Brussels Network refutes European Commission's defense of controversial investor-to-state dispute settlement

Short Version

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The European Commission recently issued two papers to address growing concerns among civil society and the wider general public over inclusion of the increasingly controversial investor-state dispute settlement mechanism (ISDS) in the EU-US Transatlantic Trade and Investment Protection agreement (TTIP) and other trade and investment agreements. [1] *The Seattle to Brussels Network responds to the arguments and the Commission's proposals to amend the flaws in the ISDS system.*

The Commission justifies ISDS by referring to the legal barriers foreign investors face, but gives no concrete examples. Critiques that ISDS subverts democracy by allowing foreign investors to bypass national courts and challenge regulations introduced by sovereign states before ad hoc international tribunals are met with the circular argument that "healthy, vibrant democracies sign into ISDS". The EC repeats the argument that ISDS can only order states to pay out compensations, but cannot force public authorities to repeal a specific policy. The Commission chooses to disregard how even the threat of claims from large transnational corporations running into tens if not hundreds of millions of dollars can weigh on public budgets and force policy-makers to reconsider proposed legislation.

However, the Commission could not completely ignore the problems associated with ISDS. It was forced to acknowledge the conflicts of interests in the current system, with arbitrators having a financial incentive to favour foreign investors as the only party that can bring an ISDS claim. It was also forced to recognize how the broad legal phrasing of investment protections gives foreign investors scope to abuse ISDS. Similarly, the Commission has had to admit that there is lack of consistency in the awards, that ISDS is costly and biased in the sense that the system is only open to claims from transnational corporations, that it is non-transparent and that claims may also impact on EU budget.

The Commission states that they are "solving" these problems. The Seattle to Brussels Network refutes the Commission's claims. While in recent trade negotiations, the EC has been tightening up some of the expansive legal phrasing commonly used in investment chapters, it has yet to

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[1] Factsheet on Investor-to-State Dispute Settlements, at http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151791.pdf and Incorrect Claims about Investor-to-State Dispute Settlements, at http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151790.pdf

develop its announced proposals for rules on mediation and a code of conduct for arbitrators. The basic flaws of the system remain unchanged: ISDS arbitrators remain private lawyers, presiding over cases that only investors can initial; taking broad interpretations of the scope and meaning of the investment agreements; issuing awards against which no appeal is possible. The recently concluded trade and investment agreement with Canada (CETA) introduces a sole arbitrator tribunal which, if anything, serves to make ISDS cheaper and more accessible. The investor bias in the system, the discrimination against domestic investors, the absence of investor obligations (for example in relation to the observance of human rights) and the challenge to democracy remain unaddressed.

Incorrect claims?

A closer look at the Commission’s responses to growing concerns regarding Investor-State Dispute Settlement (ISDS)

Civil society critique #1:
Investor- state dispute settlement subverts democracy by allowing companies to go outside national legal systems.

EC response: *The EC argues that democracy is not subverted as many ‘healthy, vibrant democracies ‘have signed on to investor state’; relying on national courts to enforce obligations in investment agreement can be hard; those courts might be biased or lack independence; they may not be accessible to foreign investors at all; and countries might not incorporate investment agreement rules into national law.*

The broader picture: Most international investment agreements do not contain provisions to exhaust local remedies before reverting to international arbitration. National legal (democratic) systems are by definition bypassed when international investors – mostly transnational corporations – are enabled to challenge democratic policies for interfering with their profits before ad hoc and intransparent investment tribunals. That many ‘healthy, vibrant democracies ‘have signed on to investor state’ committed to ISDS does not change this. At the same time, the EC has never substantiated its argument that ISDS is needed as a counterbalance for inaccessible and biased national courts – not even when pressed by the European Parliament. In relation to the necessity of including ISDS in TTIP, the Commission has failed to come up with any evidence of discrimination against foreign firms in US courts.

Civil society critique #2:
Investor-state dispute settlement gives too many rights to companies

EC response*: The commission says that rights are restricted to "generally accepted principles of international law," explicitly mentioning protection against discrimination, protection against unlawful expropriation and a requirement to treat investors fairly and equitably.*

The broader picture: What the Commission fails to mention, is that the standard clauses and definitions in investment treaties - in particular those relating to non-discrimination, compensation in the case of direct or indirect expropriation and fair and equitable treatment standards - have been broadly formulated and interpreted by

tribunals in a vague, incoherent and potentially unlimited manner.[2]
Civil society and a growing number of states point out that investment protection agreements favour foreign investors by giving them access to a parallel and exclusive legal system that is not open to domestic investors and that allows them to refer to the broadly phrased protections mentioned above that in many instances would fail if brought under the domestic legal systems of the countries concerned.

Civil society critique #3:
Investor - state allows companies to sue just because they might lose profits

EC response*: The Commission argues that a loss of profits resulting from a change of laws is not in itself sufficient to sue a host state and claim damages. A breach of a standard in the investment treaty by the host state is a necessary pre-condition.*

The broader picture: To the letter the Commission is right, investment agreements do not say "companies can sue governments just because they may lose profits" so that "a loss of profits is in itself not sufficient to sue a host state". But nevertheless this is what it comes down too. When foreign investors find that government measures or changes of law frustrate their operations, intentions or plans and therefore their expectations about profits, they can invoke the vaguely formulated standards on "fair and equitable treatment" or "indirect expropriation" (or "regulatory taking") to sue governments even if the government measures or changes of law were undertaken to protect the environment or social or other public interests.

The vague standards in investment treaties, the incoherence in their application by investment tribunals and the absence of an appeal mechanism make it very difficult for host states and companies to predict their rights and respective obligations with certainty.[3] The imprecise language has led investment tribunals to reach entirely contradictory interpretations of the same obligations, so that foregone benefits as a result of government regulation can qualify for compensation. This encourages investors to attempt to present profit losses as an "indirect expropriation" or "unfair treatment".

Civil society critique #4:
Investor - state dispute settlement cases take place behind closed doors

[2] Bernasconi, N. (2012). Investment treaties and why they matter to sustainable development. International Institute for Sustainable Development
[3] http://www.iisd.org/pdf/2010/eu_parliament_hearing_investment.pdf

EC Response: *The European Commission admits this point and advocates more transparency at the international level, including by making submissions public, hearings open, all decisions public and enabling interested parties to make their views known.*

The broader picture: The EC's commitment to enhance transparency is limited and will continue to allow arbitral tribunals to keep hearings private and withhold information not just to protect the "integrity of the arbitral process" or "confidential business information", but also for "logistical reasons". In addition, the new transparency rules would apply only to cases based on the EU's future agreements. Secrecy can be maintained in all cases arising from the approximately 1200 EU member states BITS that are currently in force, as EU member states will be able to exclude existing agreements from the new UNCITRAL transparency rules.

Civil society critique #5:

Investor- state dispute settlement undermines public choices (e.g. Vattenfall challenging the German moratorium on nuclear power, Philip Morris challenging Australia's plain packaging regime for cigarettes)

EC response: *The fact that a policy has been challenged does not mean that the challenge will be successful. The EU will negotiate in such a way so as to ensure that legislation reflecting legitimate public choices e.g. on the environment, cannot be undermined through investor state dispute settlement. Experience with investor state dispute settlement up until now confirms that tribunals do not consider it appropriate to undermine public choices. Also, ISDS cannot place states under obligation to change their legislation, only to pay out compensation.*

The broader picture: Companies use the investor-state arbitration system to challenge public policies they dislike. Measures such as tax collection, health insurance regulation, water supply and transportation policy have all been subject to successful challenge by investors[4], who can argue that policy changes violate the right to a stable regulatory environment.

The high cost of compensation for enacting any public policy against the will of corporations undermines the ability of states to make public policy choices. In the Philip Morris case, Australia may have to pay millions in compensation for making a public policy choice to protect the health of its citizens. Often the threat of a claim against a state means that the state does not proceed with a policy change. This limitation of policy space is termed "regulatory freeze".

[4] IISD, 2012:7.

Civil society critique #6:
Investor-state dispute settlement is biased in favour of investors - they can threaten to bring expensive cases against governments and so scare them away from policies that the investors do not like.

EC response: *The EC states that UN statistics on investor-state-dispute cases show that a majority of cases, around 42%, were decided in the state's favour and 30% in favour of the investor. The rest were settled.*

The broader picture: It is in the interest of arbitrators who make a lot of money on the back of the ISDS system to rule in the interest of investors as the only party who can bring claims. In addition, it is likely that many of the settled cases – 30% of known decisions – involve payments or other concessions for the investor. When settlements contain benefits for the investor, the above statistics look very pro-investor. Plus, investment arbitration is non-reciprocal and investors cannot be sued, for example, when they violate human rights. They might not win every case, but only states can lose in the sense that only states have to pay compensation. The system also allows arbitral tribunals to resolve contested legal issues in investment treaty law with expansive interpretations of ambiguous treaty texts, enhancing the risk of liability for respondent states. At the same time, the threats of claims against governments have become ever more important and occur more frequently than actual claims. There is clear evidence that proposed and even adopted laws on public health and environmental protection have been abandoned or watered down because of the threat of corporate claims for damages. The European Commission's solution that as a deterrent for investors to bringing tactical or spurious claims the costs of litigation should be borne by the losing party, is countervailed by two trends that reduce or even remove the financial risk of an expensive claim, making investment disputes more attractive for investors: Contingency fee arrangements and the emergence of third-party funders financing (parts of the) costs of investment disputes in the hope of sharing in the spoils if a payout is awarded.

Civil society critique #7:
Investor- state dispute settlement cases are decided by a small clique of lawyers, with considerable conflicts of interest, who seek to cream off public money.

EC response: *The EC acknowledges the potential conflict of interest when lawyers combine roles as arbitrators, but points out that at the same time the number of true specialist lawyers in this field is limited. The EC proposes a code of conduct and appointment of presiding arbitrators by agreement of both disputing parties.*

The broader picture: There are real concerns about the neutrality of investment arbitration. The ISDS system itself is demonstrably biased in favour of corporations. And arbitrators often have close links to business or to law firms which encourage investors to claim against states. Just 15 arbitrators, nearly all from Europe, the US or Canada, have decided 55% of all known investment-treaty disputes. This small group of lawyers sits on the same arbitration panels, acts as both arbitrators and counsels and even calls on each other as witnesses in arbitration cases.[5] Arbitrators and investment lawyers earn big money from the boom in arbitration cases. Legal and arbitration costs average over US$8 million per investor-state dispute, exceeding US$30 million in some cases. Elite law firms charge as much as US$1,000 per hour, per lawyer – with whole teams handling cases. Arbitrators also earn hefty salaries, amounting up to almost US$1 million in one reported case. The cost of investment arbitration is borne by taxpayers, including in countries where people do not even have access to basic services.

Civil society critique #8:
Investors should not be allowed to challenge governments directly in international law. Only governments should be able to act against each other, via state-to-state dispute settlement.

EC response: *Governments (including the EU) need to pursue the general interest, and that means that they have neither the time nor the resources to follow-up each individual alleged breach of the agreement.*

The broader picture: With trade disputes, states rely on state-state settlement. There is no clear reason to treat foreign investment differently. Foreign investors do not need a parallel legal system to enforce their superior rights. Even governments with less robust legal systems will generally be keen to maintain a good reputation with foreign investors and refrain from arbitrary expropriations or systematically discriminating against foreign investors. Meanwhile, through regulatory chill effects and the cost of arbitration and awards, ISDS provisions constitute a considerable and growing policy and financial risk. The exponential growth in the number of ISDS cases spurred on by international trade lawyers; frivolous claims; and pressures to shelve regulation under threat of investment claims are systemic flaws. Political risk insurance constitutes a more appropriate mechanism for dealing with political risk than ISDS.

[5] http://www.tni.org/briefing/profiting-injustice

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