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What greater rights for investors really means

EU-US trade: the myths behind the investor-state dispute settlement mechanism

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Introduction

Negotiations for a trade deal between the European Union and the United States started in July 2013. If agreed, the deal will be the biggest bilateral free trade agreement in history. It is known as the Transatlantic Trade and Investment Partnership (TTIP) or the Transatlantic Free Trade Agreement (TAFTA).

The talks cover a huge range of issues and sectors, many related to our environment and health, with unclear outcomes for the rules about food safety including genetically modified products, toxic chemicals, highly polluting fuels, data protection among many other things.

Officially, the aim of the talks is to reach an agreement to make trade easier by addressing the so-called 'barriers' to trade. But in reality, they threaten to weaken safeguards put in place to protect the environment and citizens, while those who will benefit will be powerful companies, making more money and getting privileges that no other part of society has.

Under discussion are proposals to include an investor-state dispute settlement (ISDS) mechanism. This is a controversial tool that allows companies to use trade agreements to file expensive private lawsuits against host states when democratically-agreed regulatory changes are deemed to affect their investment potential, including their profits.

Among other shortcomings, the system has been criticised for fully relying on three individual arbitrators to interpret the provisions of trade agreements and issue rulings behind closed doors that the signatory states have to comply with. Arbitrators are mostly corporate lawyers, paid by the hour, who have a financial interest in keeping the system alive. They are not bound by case law and their rulings cannot be appealed, which makes the system highly unpredictable for both society and investors[1].

Following widespread public concern, a public consultation was launched on the investor-state dispute settlement mechanism[2]. The European Commission announced its intention to reform the mechanism. This briefing shows that the proposed reforms will do little to appease civil society fears, and little to prevent harmful corporate lawsuits against state regulations that protect people and the environment[3].

Friends of the Earth Europe do believe however, that it is important for citizens to use this opportunity to signal opposition to the system as a whole, and for civil society to further raise public awareness about the harmful potential of the system. Even with reforms, ISDS remains unacceptable in trade agreements, including TTIP and the Canada –EU Comprehensive Economic Trade Agreement (CETA).

[1] http://www.foeeurope.org/sites/default/files/publications/foee_factsheet_isds_oct13.pdf
[2] http://trade.ec.europa.eu/doclib/press/index.cfm?id=1052
[3] The public consultation features extracts of the proposed investment chapter of the EU-Canada trade agreement: http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

The European Commission consultation on ISDS in TTIP

Following mounting public criticism of the investor-state dispute settlement mechanism, the European Commission announced in January this year that it would hold a public consultation to allow critics to voice concerns. The consultation was launched on 27th March and closed on July 13th 2014. The Commission has stated that the negotiations on the investment chapter of the TTIP have been put on hold for the duration of the consultation.

Opening the controversial issue of investor-state dispute settlement to participation from the public is a good thing. However, the Commission's consultation falls short of meeting civil society expectations. In particular, it does not address the fundamental question about whether the ISDS mechanism should be included in the transatlantic trade agreement in the first place, rather only asking for opinions on the proposed Commission reforms.

It is only in the last question of the 44-page technical document that the respondent has the chance to express their view on the inclusion of ISDS in the trade deal.

The questions: *"What is your overall assessment of the proposed approach on substantive standards of protection and ISDS as a basis for investment negotiations between the EU and US?", "Do you see other ways for the EU to improve the investment system?"*, and *"Are there any other issues related to the topics covered by the questionnaire that you would like to address?"*.

The Commission also doesn't accept email contributions, a significant barrier for citizens who want to express their opinion on ISDS. The consultation's format and structure show the lack of genuine openness to civil society and citizen criticism of the ISDS system as a whole. Rather the Commission seems set on using it to justify their plans of introducing a reform that will not address the fundamental flaws.

The consultation can be found here. Over 23,000 individuals have already expressed their opposition to the ISDS mechanism as part of the 'No 2 ISDS' campaign: http://www.no2isds.eu/en

Myth #1: Investor-state dispute settlement is not biased in favour of (foreign) investors

According to the European Commission, investor-state dispute settlement is necessary to protect investors abroad, and there is little evidence that it is biased in favour of investors. They back up their arguments by referring to the UNCTAD statistics on the topic. According to the 2014 UNCTAD figures, of all the cases concluded by 2013, 43% were found to be in favour of the state, 31% in favour of the investor, and 26% cases resulted in settlements[4].

The figures need to be examined in more detail. "Settled" cases refer to situations in which states agree to negotiate with the companies suing them, with a view to resolve the dispute. Exact terms of the settlement process remain secret in most of the cases, but they result in the state either compromising over the policy change that originally triggered the dispute

[4] http://unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf

and/or agreeing to pay a significant compensation to the company in an effort to resolve the dispute. So, in the end, 57% of the known cases at the end of 2013 ended up being totally or partially in favour of the investors – regardless of whether the state loses the case or agrees to the settlement, it gives in to company pressure.

Investor-state arbitration also introduces discrimination against domestic investors as they get fewer rights than foreign investors. If domestic investors disagree with a governmental action, they need to rely on the normal court system, while foreign investors can turn to investment biased private courts.

Furthermore the system is discriminatory against citizens, as they are not in a position to take corporations to such tribunals if their rights are affected by an investor or if damage is caused. Citizens also have to rely on the regular court systems.

Myth #2: ISDS is needed to protect investors in the context of the EU-US trade talks, particularly because EU companies cannot access US courts

The European Commission is going to great length to justify why the arbitration mechanism is needed in the context of the TTIP. The Commission argues that: "relying on the national courts of the host country to enforce obligations in an investment agreement is not always easy"; "investors might not be able to access the local courts in the host country". However, in both cases, the Commission fails to give concrete examples of such situations occurring[5].

The European Commission claims that European companies are facing specific barriers in accessing US courts, but this also lacks concrete evidence. In fact, the Commission statement is not correct. Foreign investors can have access to courts in the US in a case of violation of US or state law. It is recognised that the US generally has a strong court system with high protection of investments, which can be used by local and foreign investors alike.

A recent London School of Economics' study looked at the legal arguments used by the European Commission to justify the inclusion of investor-state arbitration in the TTIP[6], including US cases that would show deficiencies of the US judicial system that would need to be overcome by ISDS.

Also discussed is whether ISDS would be necessary to overcome legal obstacles to ensure that US courts give effect to the substantive investor protection provisions of TTIP. The paper concludes that: *"There is no evidence for any broader problem with the US judicial system. Whereas some few cases may have been unfortunate, they do not reveal any systemic deficiency capable of proper remediation. On the contrary, those cases cited by the Commission, if anything, rather suggest weaknesses of investor-state arbitration as well as a lack of efficiency of ISDS mechanisms to overcome the foreign investors' problem. International commitments by the US to European investors can very well be made applicable in US courts and even confer right of action to individuals".*

When the Commission was asked for proof that investors are being treated unfairly in Canada by a Member of the European Parliament, it could only provide two specific examples. Experts who have looked into these cases found that – contrary to the

[5] http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151790.pdf
[6] http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2410188

Commission's claims – the companies were offered compensation or had access to Canadian courts. So, the Commission did not provide any credible argument supporting the need for ISDS[7].

Finally, several serious academic studies[8] have challenged the arguments according to which there is a correlation between international investment protection and the promotion of foreign direct investments. In fact, the arguments that investment protection under the form of investor-state arbitration encourages foreign direct investment are misleading at best. This puts in to question the Commission's call for including an investor-state dispute settlement mechanism in the TTIP.

Myth #3: ISDS does not harm states' right to regulate

The European Commission keeps on repeating that investor-state arbitration can "only" force states to pay compensation to investors when the latter wins a case. It states that *"experience with investor-state dispute settlement up until now confirms that tribunals do not consider it appropriate to undermine public choices"* and that it could not happen that a country would have to change their legislation under an ISDS case. This is not factually correct (see box below).

ISDS and the negative impact on regulatory standards: Vattenfall and Ethyl cases

Vattenfall vs. Germany: In 2009, Swedish energy company Vattenfall initiated an ISDS procedure against Germany under the Energy Charter Treaty. Vattenfall had engaged in the construction of a coal fired power plant in Hamburg-Moorburg, located on the Elbe river.

When Hamburg's Environmental Authority issued a licence imposing quality standards for the waste waters released by the power plant, Vattenfall claimed that those standards made the investment project unviable. Using ISDS provisions, the company asked Germany for compensation amounting to €1.4 billion.

Vattenfall and the city of Hamburg eventually settled the case with an agreement that foresaw the issuing of a modified water use permit, which lowered the environmental requirements previously set by the Hamburg Environmental Authority.

Ethyl vs Canada: Using NAFTA's investment chapter, Ethyl sued Canada using ISDS to challenge the introduction of a ban by Canada on toxic chemical MMT. Canada agreed on a settlement, which resulted in reversing its ban and agreeing on a 13-million USD payment to the company. Incidentally, the same chemical happened to be banned in the US.

[7] Franziska Keller, Parliamentary question, http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2012-011230&language=EN

[8] Examples include: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1594887 ; http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1685876

Additionally, and even more importantly, the mere threat of multi-million claims by large companies is no small thing for public finances of states: it can be a significant threat for public budgets and therefore it can have a significant chilling effect on regulatory choices.

According to Peter Kirby from the law firm Fasken Martineau, *"it's a lobbying tool in the sense that you can go in and say, 'Ok, if you do this, we will be suing you for compensation.' It does change behaviour in certain cases."*

A clear example of the chilling effect of arbitration is the announcement by New Zealand's Health Minister that the enactment of tobacco plain packaging legislation will be put on hold until Philip Morris' claim against Australia's tobacco rules has been resolved.[9]

Myth #4: The Commission's proposed reforms will address existing problems and make the system acceptable

We welcome that the Commission has acknowledged a certain number of flaws in the way the system has worked so far. During the launch of the consultation on ISDS, Commissioner De Gucht himself stated: *"We will include a new ISDS that will address loopholes and abuses […] I fully agree with critiques that argue that ISDS has resulted in worrying examples.[10]"*

These include: conflicts of interest with arbitrators, the risk of abuse of the system because of the vague phrasing of investment protection clauses, the lack of consistency of the awards, the significant costs of the mechanism for public budgets, and the lack of transparency around it, making it impossible for companies to use mailboxes to sue states[11].

In relation to the EU-Canada trade deal (CETA), the Commission has announced reforms to partly address the lack of transparency, the problems of conflicts of interest, or issues such as companies using mailboxes to sue states. The proposed reforms also include clarifications of the rules in relation to indirect expropriation and fair and equitable treatment.

However, the propositions will only apply to future trade agreements, not impacting the already existing 1,400 trade agreements that EU member states have, and they remain highly insufficient.

Here are the key reasons why:

- The definitions of an investment and an investor remain too broad. In particular the text mentions what types of investments "may" be included but it does not provide a closed list of these.[12] Likewise the definition of an investor allows companies to use the mechanism very loosely. This is particularly problematic because definitions are the cornerstone of the system. The broader they are the more uncertainty there is, as arbitrators will have to interpret them in each and every case, making it more likely to allow companies to misuse the system against states.

[9] http://corporateeurope.org/printpdf/1802
[10] http://ec.europa.eu/avservices/video/player.cfm?ref=I087684
[11] http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151791.pdf ; http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151790.pdf
[12] http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf

- Although a welcome addition, the new rules for appointing the arbitrators (subject to agreement by both parties, use of a roster in case of disagreement between both parties), fail to address the fundamental conflicts of interest of arbitrators. Contrary to judges in existing court systems, arbitrators are mostly corporate lawyers paid by the hour; they are both judges and parties depending on the cases. They have an interest in awarding claims because that might result in more claims and thus more income for themselves or their law firms. They are also not bound to serve the public interest but instead the interest of their clients, which are usually large corporations. The roster system proposed by the Commission is not an innovation; it already exists under ICSID, which has not helped mitigate concerns of impartiality and independence of arbitrators[13]. Furthermore, the proposed roster only comes into play when both sides fail to agree on the presiding arbitrator; it does not require that all arbitrators working on the case fulfil the same criteria, experience, independence or impartiality.

- The introduction of a code of conduct for arbitrators is a welcome announcement, but what it will look like and when exactly it will be introduced has not yet been announced. It also remains to be seen how and by whom its implementation will be monitored. According to the Commission, arbitrators will have the choice between following this code of conduct, or the guidelines of the International Bar Association (IBA) – which already exist and appear too general and therefore not appropriate to address the problem. This alternative between the two systems questions the efficiency of the proposed code before its creation. In addition, Friends of the Earth Europe's experience working with the European Commission's codes of conduct and guidelines for European Commissioners and staff ethics regulation has been unsatisfactory. Civil society complaints have raised serious problems of implementation of the Commission's own ethics rules and unchecked potential conflicts of interest[14]. Once ethics rules are agreed on, their effectiveness depends on strict implementation of the rules and close monitoring. The European Commission has not performed well in these areas previously.

- Transparency: The stated objective to make investor-state arbitration more transparent is in reality limited in scope. It will be up for the arbitrators to *"determine that there is a need to protect confidential or protected information"* and to hold hearings in private in certain situations. The confidentiality argument is used all too often by companies and even the Commission itself to limit transparency, so it is very likely that key information will remain secret. While the EU-Canada text refers to the new transparency rules under UNCITRAL, these also show limits. For instance the tribunal can invoke *"logistical reasons"* or the argument that disclosing information would *"jeopardize the integrity of the arbitral process"* to limit openness and public access.

[13] http://www.iisd.org/pdf/2014/reponse_eu_ceta.pdf
[14] http://www.alter-eu.org/press-releases/2013/02/14/ombudsman-investigates-conflicts-of-interest-via-revolving-door
http://www.alter-eu.org/sites/default/files/AlterEU_revolving_doors_report_0.pdf
http://www.alter-eu.org/sites/default/files/revolving_door_provides_privileged_access.pdf
http://www.alter-eu.org/documents/2011/01/new-commission-code-not-enough-to-close-revolving-doors
http://www.transparencyinternational.eu/european-union-integrity-system-study/the-euis-report-latest-news/

- Right to regulate: The Commission has announced that the proposed improvements *"will address the concerns raised that investment protection rules may negatively impact states' right to regulate. They should, amongst other things, ensure that companies cannot successfully bring claims against states' regulatory policies when these are taken for public policy reasons*[15]*."* The Commission has particularly stressed that the "new" investor-state dispute settlement system will mention the right to regulate.

On the one hand, the leaked EU negotiating mandate on TTIP shows that the right to regulate is conditioned by a necessity test: governments need to prove that regulations they want to introduce or have already introduced are/were necessary and the policy objective could not be achieved by other means.

Furthermore, the text mentions: *"without prejudice to the right of the EU and the Member States to adopt and enforce, in accordance with their respective competences, measures necessary to pursue legitimate public policy objectives such as social, environmental, security, public health and safety in a non-discriminatory manner"*[16]. This leaves it up to an arbitrator to decide what is a *"legitimate"* public policy objective, thus also potentially limiting states' right to regulate in cases that the arbitrator concludes that the objective was not legitimate.

On the other hand, available documents in relation to the EU-Canada agreement also seem to indicate that the right to regulate is not yet fully protected. Specific mention of the right to regulate only appears in the preamble in the CETA agreement, which is not binding on the parties. So this sentence has no legal meaning and thus provides no protection.

- In the context of CETA, the Commission has argued that the risks of misuse of the *"fair and equitable treatment"* clause by investors have been closed. This is misleading. In fact, the clause combines a closed list of conditions together with vague and open-ended formulations. This leaves excessive freedom for arbitrators to interpret the clause and its possible breaches in a way that could limit governments' right to regulate in the public interest. In addition the text foresees that the "fair and equitable treatment" obligations can be viewed and amended every year, which leaves the door wide open for weakening in the future.
- In the context of CETA, the dangerous *"Most Favoured Nation"* clause remains. This concept allows investors to use any right that is given to investors in other trade agreements by the EU or Canada. Therefore, this provision is nullifying improvements made in CETA, especially on key issues such as Fair and Equitable Treatment and Indirect Expropriation.
- While the Commission mentions the introduction of an appeal mechanism, there is no concrete commitment in CETA to do so.

[15] http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151916.pdf
[16] http://eu-secretdeals.info/upload/TTIP-mandate_M-Schaake_website.pdf

Conclusion:

Despite the European Commission myths, the proposed reforms on investor-state dispute settlement will not address the fundamental flaws of the system, nor alleviate civil society concerns about its misuse by companies eager to sue states for millions of euros in compensation for lost profits. The Commission fails to provide credible arguments for replacing a far superior legal system with a highly biased system of corporate courts. It is essential that civil society groups and citizens continue to send a very clear "No to ISDS" signal to the European Commission.

Further reading:

Friends of the Earth Europe's response to the European Commission consultation on ISDS
http://www.foeeurope.org/sites/default/files/news/foee-isds-consultation-submitted-30062014.pdf

The website set up by Friends of the Earth Europe, AK Europa and ÖGB Europa to take part in the European Commission on ISDS – including detailed arguments about what is wrong with ISDS - can still be accessed at: www.no2isds.eu

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More resources on what is wrong with ISDS and the European Commission's proposals to reform the system

Corporate Europe Observatory
10 reasons to oppose ISDS
http://corporateeurope.org/international-trade/2014/04/still-not-loving-isds-10-reasons-oppose-investors-super-rights-eu-trade

International Institute for Sustainable Development: Response to the European Commission consultation on ISDS: http://www.iisd.org/publications/reply-european-commission-public-consultation-investment-protection-and-investor

Friends of the Earth Europe

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Friends of the Earth Europe campaigns for sustainable and just societies and for the protection of the environment, unites more than 30 national organisations with thousands of local groups and is part of the world's largest grassroots environmental network, Friends of the Earth International.

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