# ISDS: Spreading the disease instead of looking for a cure

## Why the Commission's alleged ISDS 'reforms' fail to address the key problems

*Analysis by the Seattle to Brussels Network*
*6 May 2015*

On 5 May 2015, the European Trade Commissioner Malmström presented a number of proposals to "further improve" investment protection standards and investor-state dispute settlement (ISDS) procedures in the proposed EU-US trade deal (Transatlantic Trade and Investment Partnership, TTIP)[1]. Several of these proposals were already mentioned in her speech before the European Parliament's international trade committee (INTA) on 18 March[2].

The Seattle to Brussels Network[3] is of the opinion that the Commission's proposals do not contribute to any meaningful reform of the ISDS system. They 1) ignore the outcome of the Commission's own public consultation on the issue; 2) do very little to address the fundamental problems of the ISDS system; 3) would dramatically expand the reach of ISDS, increasing the likelihood of claims against European governments; 4) are misleading in suggesting that the ISDS system was already meaningfully reformed in the recently concluded EU-Canada trade agreement (Comprehensive Economic and Trade Agreement, CETA) and would be significantly further improved in TTIP; and 5) ignore the elephant in the room: that there is no need for ISDS.

### 1. Commission dismisses public opinion on ISDS

In her announcement to the European Parliament and to Trade and Economics ministers of the EU member states on 18 March and in her paper of 5 May, Commissioner Malmström made it clear that she is of the opinion that *"we need to negotiate rules on investment protection and ISDS in TTIP".*

This contradicts economic reality: the enormous volume of transatlantic investments demonstrates that there is no "need" for any additional protection of foreign investors. It also runs counter to a global trend where more and more countries refuse to sign agreements that include ISDS or have started to terminate investment treaties that contain ISDS[4]. The most recent example is the country of Italy, which has announced to withdraw from the Energy Charter Treaty, which includes ISDS provisions, on the basis of which the country has already been sued over developments in the renewable energy sector.

What is more, the announcement is also a slap in the face of public opinion. In 2014 the Commission decided to organise a public consultation on its ISDS agenda – largely based on the alleged 'reforms' in the CETA investment chapter. The response from the public was massive with almost 150,000 people and organisations contributing, an absolute record for any EU consultation. But the response was also crystal clear: 97% of all respondents rejected

1 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

2 http://trade.ec.europa.eu/doclib/docs/2015/march/tradoc_153258.pdf

3 The S2B network was formed in the aftermath of the World Trade Organisation's (WTO) 1999 Seattle Ministerial to challenge the corporate-driven agenda of the European Union and other European governments for continued global trade and investment liberalisation. It has also developed as a response to the increasing need for European coordination among civil society organisations. The network includes development, environment, human rights, women and farmers organisations, trade unions, social movements as well as research institutes. http://www.s2bnetwork.org/

4 http://www.tni.org/pressrelease/after-south-africa-indonesia-takes-brave-decision-terminate-its-bilateral-investment

ISDS and the Commission's proposals to reform the system, amongst them business organisations and parts of government[5]. Despite such a strong 'No to ISDS' message and an overwhelming rejection of the alleged reforms outlined in the consultation, the Commission showed its disrespect for public opinion and decided to move ahead with its agenda, as illustrated by the statement of Commissioner Malmström on March 18.

## 2. The reform proposals do not address fundamental problems

Proposals presented to further 'reform' ISDS in TTIP include forcing investors to choose between national courts and ISDS, the establishment of an appeal mechanism, a fixed list of arbitrators, and new language on the right to regulate. These proposals do not address the fundamental problems of the investment protection system, most notably that:

- The current investment protection system grants special rights to foreign investors, rights that no one else in society has. Only foreign investors can circumvent existing courts and sue (or threaten to sue) states directly in private international tribunals that regularly impose large compensation sums on governments. And only they are being granted greater, and arguably excessive, private property rights than are enshrined in national constitutions or EU law. So while countering discrimination of investors is one of the key justifications for ISDS, the system itself is based on provisions that discriminate against domestic investors.
- ISDS surrenders the interpretation of investor rights; the judgment over whether legal and constitutional public policies are right or wrong and the order of large compensation sums to be paid from public budgets to for-profit arbitrators with a vested interest in this privatised judicial system. Arbitrators have effectively warded off attempts of governments to narrow their space for interpretation.
- ISDS is a purely one-sided tool as it only gives rights to investors without any obligations to contribute to public policy objectives or respect environmental, social, health and safety or other standards. It discriminates against regular citizens and local communities that are negatively affected by these investors, as they can't take them to international courts. EU member states and the Commission are currently even undermining proposals at the UN level to establish mechanisms that could give citizens access to international courts when their rights are violated by investors[6].

## 3. Including ISDS in TTIP significantly expands its scope

An inclusion of ISDS in TTIP would dramatically expand the investment flows covered by ISDS and therefore increase the likelihood of European governments being sued through ISDS. Currently only 8% of the US-owned firms operating in the EU are covered by ISDS, through existing bilateral agreements between mainly Central and Eastern European member states and the US. If ISDS is included in TTIP, all investment flows would be covered and more than 47,000 U.S.-owned firms would be newly empowered to launch ISDS attacks on European policies and government actions[7]. This will undoubtedly result in many more ISDS cases against EU member states. While currently investors have already claimed at least 30 billion Euro compensation from EU member states[8] this amount will increase drastically, with EU tax payers footing the bill.

---

5 http://corporateeurope.org/international-trade/2015/02/ttip-investor-rights-many-voices-ignored-commission

6 The UN Human Rights Council is discussing a proposal for a Treaty on business and human rights. EU member states have voted against this proposal and are boycotting the negotiations.

7 https://www.citizen.org/documents/EU-ISDS-liability.pdf

8 http://foeeurope.org/hidden-cost-eu-trade-deals

4. **Proposed reforms in CETA and TTIP make no meaningful difference in investor protection regime**

Commissioner Malmström's reference[9] to the recently concluded EU-Canada trade agreement CETA as the "baseline" for reforms of investment protection in TTIP inspires little confidence. As the Seattle to Brussels Network has pointed out several times[10], there are no meaningful reforms in the CETA text, despite the Commission claiming otherwise. Also the proposals for reforming ISDS in TTIP, largely build on the CETA arrangements, will not result in significant changes.

- The Commission claims to have protected the right to regulate in CETA but now recognises that this is not enough and proposes to go further in TTIP through *"an operational provision (an article) which will refer to the right of Governments to take measures to achieve legitimate public policy objectives, on the basis of the level of protection that they deem appropriate"*[11]. But if one looks at CETA, a mention of the right to regulate is notably absent in CETA's investment chapter. It is only referred to in the preamble and the labour and environment chapter (in very weak and to some extent, contradictory language). The fact that it is mentioned in other chapters but not in the investment chapter could even be interpreted by the arbitrators against the right to regulate. During a public debate in March 2014, Rupert Schlegelmilch from DG Trade admitted that the formulation on the right to regulate in CETA will "not make any difference" in investor-state disputes. Therefore, similar clauses in existing treaties have failed to prevent, in practice, lawsuits from investors against public interest standards. An operational provision in the investment chapter itself as the Commissioner now proposes would also not help. Protecting the right to regulate can only be effectively achieved by narrowing the protection standards.

- The Commission claims to have narrowed key concepts like "fair and equitable treatment" which have been used most widely by investors to attack public interest policies in ISDS claims. But CETA arguably widens the concept's scope by explicitly protecting investors' "legitimate expectations". So if companies claim that government officials did something that created a specific expectation on their side, for instance regarding special incentives granted, lack of plans for stronger labour or environmental rules, exemptions being provided, this can be used by arbitrators in future CETA-based ISDS cases against the EU and its member states to award compensation payments. This provides companies with a powerful weapon to fight tighter rules. Not surprisingly, investment lawyers who are constantly encouraging investors to sue countries in ISDS tribunals, have praised the fact that CETA explicitly lists new rights for investors under concepts such as fair and equitable treatment.[12]

- The Commission claims to have "obliged investors to drop cases in national courts if they want to pursue ISDS"[13] in CETA. However, cases like the Vattenfall vs. Germany – where the Swedish energy company challenges the constitutionality of Germany's exit from nuclear power in the German constitutional court and demands €4,7 bn in compensation

9 http://europa.eu/rapid/press-release_SPEECH-15-4624_en.htm

10 http://eu-secretdeals.info/upload/2014/03/S2B-Marc-Maes-CETA-Investment_Response-to-DG-Trade-claims-March-7-2014_v2.pdf; see also the annex here: http://corporateeurope.org/sites/default/files/trading-away-democracy.pdf

11 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

12 In his comments at "The Investor-State Dispute Settlement Mechanism: An Examination of Benefits and Costs," CATO Institute, May 20, 2014, investment lawyer Todd Weiler said: "I love it, the new Canadian-EU treaty…we used to have to argue about all of those [foreign investor rights]…And now we have this great list. I just love it when they try to explain things." Available at: http://www.cato.org/events/investor-state-dispute-settlement-mechanism-examination-benefits-costs.

13 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

from Germany for the same measure in a parallel ISDS dispute – would still be possible under CETA rules. Because all that CETA does is prevent investors from parallel *compensation* claims in two different fora, while having the constitutionality of a measure reviewed in one forum and using another to claim compensation will still be possible.

- For TTIP, Commissioner Malmström now proposes "*to make a definitive choice between ISDS and domestic courts at the very beginning of any legal proceedings ("fork-in-the-road").* Another proposal of hers is to "*request investors to waive their right to go to domestic courts once they submit a claim to ISDS ("no u-turn")*"[14]. Both proposals miss the point completely as they continue to allow investors to choose for private tribunals and circumvent the national court systems.

- Claiming to have guaranteed arbitrator independence through a code of conduct in CETA falls very short of real reforms to ensure their independence and impartiality, such as security of tenure and fixed salaries. Existing codes of conduct for arbitrators have not prevented a small club of arbitrators from deciding the majority of investor-state disputes, allowing them to encourage claims and grow the arbitration business with expansive, investor-friendly interpretations of the law. The code of conduct which CETA refers to does not even define what a conflict of interest is, let alone ban blatant ones such as situations in which arbitrators work on the side as lawyers.

- The Commission's proposal to "ensure" arbitrators independence in TTIP is also deficient. Malmström proposes: "*A requirement that all arbitrators are chosen from a roster pre-established by the Parties to the Agreement*"[15]. However, such a system already exists to a certain extend with the ICSID roster of arbitrators. But that did not prevent that the EU and the US nominate 'pro-investor' arbitrators[16]. So this proposal is re-launching an old idea that proofed unsuccessful in the past. The additional proposal to require "*certain qualifications of the arbitrators, in particular that they are qualified to hold judicial office in their home country*"[17] provides no guarantee at all that for-profit investment lawyers would be excluded from being arbitrators. They only need to have a qualification for being a judge, they don't need to be a functioning judge. Commissioner Malmström herself seems to think of the arbitrators on the list as for-profit arbitrators with an interest in growing their own business by keeping the system claimant- and thereby investor-friendly when she admits: "*Of course, this does not go the whole way to creating a permanent investment court, with permanent judges who would have no temptation to think about future business opportunities.*"[18] This suggests, that the Commission does not really want to tackle the problem of arbitrator bias in TTIP.

- The Commission claims that governments - and not arbitrators - were given ultimate control over CETA's investment rules by allowing States to issue binding joint statements of how to interpret the provisions in the treaty and that the same would be granted in TTIP. However, the NAFTA experience (where this feature was already included decades ago) shows that it does not make much of a difference. In the history of NAFTA, binding interpretations have only being used twice and not very successfully. Furthermore, governments always have had the possibility to issue authoritative interpretations of the

14 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

15 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

16 For example, Germany nominated Karl-Heinz Böckstiegel; France nominated Emmanuel Gaillard; the UK nominated Sir Franklin Berman; The Netherlands nominated Albert Jan Van Den Berg; Spain nominated Juan Fernández-Armesto, Prof. Bernardo M. Cremades and Dr. Andrés Rigo Sureda; Belgium nominated Bernard Hanotiau and Sweden nominated Kaj Hobér. On its part, the US has nominated William W. Park and Daniel M. Price.

17 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

18 http://trade.ec.europa.eu/doclib/docs/2015/march/tradoc_153258.pdf

agreement as established by the Articles 31 and 32 of the Vienna Convention on the Law of Treaties (VCLT), so this is not a new feature that couldn't have been used before. What is more, the NAFTA experience shows that arbitrators are willing to ignore what the treaties' party intended by their interpretations – it is quite naïve to believe that they will treat the EU any better.

- The Commission suggests "*to include a bilateral appellate mechanism for ISDS… modelled largely on the institutional set-up of the WTO Appellate Body"*[19], with permanent members, directly within TTIP. This may improve the functioning of ISDS but does not address the fundamental problems mentioned above (privileging of foreign investors, transfer of powers from independent courts to private tribunals, one-sidedness of the system). Also, the Commission said numerous times that they wanted an appeal body within CETA but this has not happened. Similarly, the US has included a reference to the possible creation of an appellate mechanism in its agreements since 2002 but in reality it has never introduced any appeal mechanism. So again this may be nothing more than an empty promise that will not be kept.

- The proposal of creating an international court was also raised by Commissioner Mälmstrom: *"The EU should pursue the creation of one permanent court. This court would apply to multiple agreements and between different trading partners, also on the basis of an opt – in system*"[20]. This proposal has nothing to do with CETA and TTIP – even if there was the political will on all sides, it would simply take years to establish such a court. So while the Commission verbally supports a multilateral court, it makes no concrete commitments at all to integrate such a court proposal in TTIP (or CETA). The principles of such a court as outlined by its proponents – independence, balance, fairness – are in stark contradiction to what the Commission negotiated in CETA and intends to do in TTIP. This suggests that Malmström's reference to the court is nothing but hot air, meant to divert the discussions from what ISDS in TTIP is really about: a massive power grab from foreign investors and a dramatic transfer of powers from independent courts to private, for profit arbitrators.

The fact that Commissioner Malmström has categorically stated that the proposed reforms for TTIP would not apply to the Canada-EU free trade agreement and that the CETA text will not be opened up again are a further indication of the Commission's unwillingness to seriously consider a meaningful reform of investment protection. The current CETA text would leave European governments at risk of being sued, including through US investors who could sue through their Canadian subsidiaries, if they structure their investment accordingly, allowing them to circumvent any potentially more far-reaching changes in TTIP.[21] European governments have already been forced to pay out upwards of €3.5 billion though ISDS mechanisms in other trade deals.[22]

**5. There are no convincing reasons for ISDS**

The EC proposals ignore the elephant in the room: the fact that EU-US investments have taken place for decades and have grown to over €3,000 billion without ISDS and that ISDS is clearly not needed.

None of the arguments made by the European Commission on why ISDS should be included in TTIP in the first place hold against the evidence:

19 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

20 http://trade.ec.europa.eu/doclib/docs/2015/may/tradoc_153408.PDF

21 http://citizen.org/documents/EU-ISDS-liability.pdf

22 https://www.foeeurope.org/how-taxpayers-footing-bill-europes-trade-deals-041214

- The EC argues that “the US does not accept trade deals without ISDS”. However, the US-Australia free trade agreement (FTA) from 2004 does not contain ISDS.
- The EC argues that “if there is no ISDS in TTIP, other countries will not accept it either”. However, the EU is currently negotiating bilateral investment treaties (BITs) and FTAs which include ISDS with other countries like China, Vietnam, Malaysia, and none have subjected its inclusion to whether it is also present in TTIP. Also, the fact that the US-Australia FTA from 2004 does not contain ISDS, while the more recent Australia-China FTA from 2014 does include ISDS indicates that countries like China do accept that their partners negotiate agreements according to different standards.
- The EC argues that “No US law prohibits discrimination”. However, the two cases that the Commission brings forward as proof are highly controversial[23] and the Commission’s claims are strongly rejected. But even if they were true, this is not a reason to establish a complete parallel arbitration system. If the US can accept ISDS, it can also and without less far-reaching consequences prohibit discrimination of foreign investors via other means.

**To summarise:**

- None of the EC proposals for reform addresses the fundamental flaws of ISDS. Instead they are mainly cosmetic and serve as a lubricant to make ISDS more acceptable in an attempt to increase the coverage of ISDS threefold.
- There is no one single solid argument that justifies the inclusion of ISDS in TTIP in the first place.

*This briefing paper has been written by Cecilia Olivet and Lyda Fernanda (Transnational Institute), Marc Maes (11.11.11), Pia Eberhardt (Corporate Europe Observatory) and Paul de Clerck (Friends of the Earth Europe).*

23 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2410188