
Response to the European Commission’s Investor-State Dispute Settlement “Reform” Proposal

Introduction

In 2013, Transatlantic Consumer Dialogue (TACD) published a position paper opposing the inclusion of investor-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP). TACD noted: *“Investors should not be empowered to sue governments to enforce the agreement in secretive private tribunals, and to skirt the well-functioning domestic court systems and robust property rights protections in the United States and European Union.”*¹

Since TACD made its initial recommendation to exclude ISDS from TTIP, the political backlash against ISDS in Europe grew to such an extent that in 2014 the European Commission (EC) initiated a pause in investment negotiations while undertaking a public consultation and internal review of the European investment position. The response to the public consultation², which was based on the EC’s investment text for the Canada-EU Trade Agreement (CETA), was overwhelming. Nearly 150,000 responses were filed, 97 percent of which rejected the inclusion of ISDS in TTIP altogether. At the same time, European Union member-state governments and major political groups in the European Parliament voiced their opposition to the inclusion of ISDS in the TTIP. Meanwhile, in the United States, serious concern against ISDS has continued to grow among members of Congress, legal experts - including some of the nation’s most prominent law professors - state-level officials and others. For instance, in August 2015, the bipartisan National Conference of State Legislatures reaffirmed its longstanding opposition to ISDS.³

In September 2015, the European Commission published a new textual proposal⁴ which includes “reforms” of the ISDS system it seeks to have included in TTIP and renames ISDS as an “Investment Court System.” On the one hand, the Commission’s ISDS reform proposals demonstrate its recognition that the status quo ISDS is politically untenable. Unfortunately, however, the Commission’s proposal

¹ TACD’s 2013 Position on Investor-State: <http://test.tacd.org/wp-content/uploads/2014/01/TACD-TTIP-Resolution-on-Investor-State-Dispute-Resolution-in-the-Transatlantic-Trade-and-Investment-Partnership.pdf>

² TACD’s submission to the Commission’s Public Consultation: <http://tacd.org/wp-content/uploads/2014/07/TACD-Response-to-EU-Consultation-on-ISDS-FINAL-2.pdf>

³ From the National Conference of State Legislatures’ Policy Directive on Free Trade and Federalism: “NCSL will not support Bilateral Investment Treaties (BITs) or Free Trade Agreements (FTAs) with investment chapters that provide greater substantive or procedural rights to foreign companies than U.S. companies enjoy under the U.S. Constitution. Specifically, NCSL will not support any BIT or FTA that provides for investor/state dispute resolution.” <http://www.ncsl.org/ncsl-in-dc/task-forces/policies-labor-and-economic-development.aspx>

⁴ European Commission, September 2015: http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf

fails to address the fundamental concerns that TACD and others have raised. Rather, the proposal merely suggests some changes on the margins to address some of the issues that have been raised by ISDS's many critics.

TACD Recommendation

The Commission's proposal would leave foreign corporations and foreign investors empowered to challenge extra judicially U.S. and EU policies related to all of the issues about which TACD is most concerned, including food safety and labelling, regulation of emerging technologies, financial protections for consumers, protecting consumers' privacy rights, ensuring affordable access to medicines, the safety of drug and medical devices, affordable quality services, control of toxic products and substances and tobacco regulation. Simply renaming a system that allows one class of interests – foreign investors – to attack in extrajudicial tribunals consumer protections that apply to domestic and foreign entities alike does not remedy the fundamental structural problems of the EU's proposal or any other ISDS regime. Critical consumer safeguards simply should not be vulnerable to such challenges.

TACD recommends that the U.S. and EU exclude investor-state dispute settlement in any form – whether it is based on the U.S. Model Bilateral Investment Treaty or the European Commission's "Investment Court System" (ICS) proposal –from any trade agreement. Existing levels of protection in the EU and the US are surely enough to guarantee legal security for investors.

ISDS systems have proven harmful to consumers, as powerful commercial interests from tobacco companies to corporate polluters have used investor-state dispute settlement provisions around the world to challenge and undermine consumer protections. An ISDS regime in TTIP poses unprecedented risks in this regard, as it would newly empower approximately 80,000 corporations and subsidiaries on both sides of the Atlantic to attack consumer safeguards in the U.S.-EU context.⁵

There is no legitimate rationale to take such a risk with our consumer standards. More than €3.7 or \$4 trillion in transatlantic investment provides ample evidence that U.S. and EU investors have sufficient confidence to invest without the creation of a foreign-investor-only tribunal system in the TTIP. The robust judicial systems and property rights protections on both sides of the Atlantic are sufficient to resolve any claim of unfair treatment of investors by States⁶. And, state-state dispute resolution is a sufficient mechanism for resolving legitimate trade-related disputes.

The European Commission's new proposal would address some specific criticisms of the current system's mode of operation, by increasing the transparency of investor-state proceedings, setting a specific roster of arbitrators randomly assigned to cases, and establishing an appeals process.

⁵ See <http://www.citizen.org/TAFTA-investment-map>

⁶ This is the conclusion of the opinion on the 2015 TTIP resolution of the Legal Affairs committee of the European Parliament, the committee responsible for the interpretation of EU and international law.
See : <http://bit.ly/1ZX1rxf>

However, these proposed changes do not address TACD's fundamental concerns with ISDS.⁷ The EC proposal would massively expand an extrajudicial tribunal system -- open only to foreign investors, not domestic citizens -- that formally prioritizes corporate rights over the right of governments to regulate on behalf of citizens.

Background

TACD, academics, legal experts, civil society, and elected officials have all raised a series of criticisms related to investor-state dispute settlement that are elaborated in TACD's October 2013 position paper and our submission to the European Commission's consultation in 2014. The European Commission's September 2015 "reform" proposal does not address TACD's core concerns with the ISDS regime and only partially addresses some of TACD's specific concerns with elements of the regime's current modes of operation.

Criticism: **ISDS empowers foreign investors alone to bypass domestic courts and go before extrajudicial tribunals**, or to re-litigate issues already decided in domestic courts before extrajudicial tribunals. This undermines the rule of law and creates a discriminatory structure in which foreign investors enjoy greater procedural rights than domestic businesses and citizens.

The EC proposal does not address this concern. Under the EC proposal, the extrajudicial tribunals are rebranded as "investment courts." But these so-called investment courts remain available only to foreign investors; foreign investors are not required to exhaust domestic remedies before appealing to the extrajudicial tribunal; and foreign firms would retain the power to re-litigate matters decided in domestic courts, so long as the domestic case concluded before the ISDS case began. (And the Commission proposal would allow a foreign firm to simultaneously pursue their claim in domestic courts and in a tribunal if they asked for injunctive relief in the domestic court and monetary compensation in the tribunal.)

Criticism: The right to regulate is not protected, **non-discriminatory public interest policies** may be subject to successful ISDS challenge.

The EC proposal does not address this concern in a meaningful way. The Commission proposal specifies that the broad substantive rights granted to foreign investors "shall not affect the right of the Parties to regulate..." for a series of public interest reasons. On careful inspection, this "right to regulate" turns out to be illusory. First, the EC proposal specifies that regulatory purpose must be "legitimate," a matter left to determination of an ISDS tribunal. There is a long history in international trade and investment jurisprudence of tribunals adopting a very narrow construction of what constitutes a legitimate objective. Second, the EU proposals says that any challenged policy must be "necessary to achieve" public interest objectives. The "necessity" standard in international trade and investment law is typically an extremely difficult test to meet, with the availability of other mechanisms to achieve an objective -- no matter how politically or practically unlikely -- sufficient reason to find a particular regulation is not "necessary." Finally, under ICS, what is at stake in a technical, legal sense is not a party's "right to

⁷ We note as well that so-called ISDS "reforms" included in the Trans-Pacific Partnership fall short even of the inadequate European Commission proposals.

regulate,” but whether it will be required to pay compensation to maintain regulations found to conflict with ICS rules. Thus, under the EC proposal, a tribunal might hold that its ruling against even a concededly “legitimate” policy does not affect the right of parties to regulate.

Criticism: The definition of investment is extremely broad, enabling challenges to a wide array of public interest policies and allowing for firms that have made no real “investment” to launch a case.

The EC proposal does not address this concern. The definition of investment includes the broad language of past ISDS pacts.

Criticism: The definition of investor and the denial of benefits language allow for the possibility that firms located outside of a pact’s signatory countries can launch ISDS cases under the pact, and that domestic firms can use foreign subsidiaries to launch cases against their home government.

The EC proposal does not address this concern. The denial of benefits language in the Commission’s proposal is even weaker than the U.S. Model Bilateral Investment Treaty (BIT). Standard U.S. language allows a Party (e.g. the United States) to deny the pact’s foreign investor rights to an “investor” if it has “no substantial business activities” in the claimed home country (e.g. Germany) and is controlled by a firm in a country that’s not a signatory to the pact (e.g. China). But the EC proposal omits this language, allowing for firms based in non-TTIP countries with no investments in the claimed TTIP home country to launch ISDS cases under TTIP. The text also would allow firms to launch ISDS cases against their own home governments via a subsidiary stationed on the other side of the Atlantic.

Criticism: Foreign investors are granted **vague, broadly-interpreted substantive rights** such as “Minimum Standard of Treatment (MST), including “fair and equitable treatment” (FET) and a prohibition of “indirect expropriation.” These standards have proven dangerously elastic and favorable to foreign investors in a series of ISDS decisions in which governments have been ordered to pay compensation for non-discriminatory public interest policies.

The EC proposal does not address this concern. The FET definition in the Commission’s proposal is very broad, allowing for challenges of a wide array of non-discriminatory public interest policies. For example, lawyers that represent investors in ISDS cases have praised the inclusion of language that makes explicit what formerly investors had to convince a tribunal on a case by case basis: a tribunal can take into account whether the investor’s expectations were frustrated. While the text states that such broad foreign investor rights “shall not be interpreted” as committing a Party to freeze policies in place, it does not say that Parties cannot be made to pay for making such changes; and, in any case, the ISDS track record provides extensive evidence that tribunalists ignore such caveats.

The EC’s expropriation definition, in combination with the broad definition of investment, would allow for findings of expropriation violations that would not pass muster in many domestic courts. As in the standard U.S. FTA text, in its annex on expropriation, the EC allows for non-discriminatory public interest policies to constitute expropriation violations in “the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive.” This “rare circumstance” language gives the tribunal of three private lawyers undue discretion in this area.

Criticism: ISDS tribunals enjoy wide discretion – they are not bound by a system of legal precedent or any substantive appeal.

The EC proposal partially addresses this concern. The EC proposes an appeal system, with wider grounds for appeal than are currently allowed to initiate “annulment” proceedings under existing ISDS pacts. However, there is no requirement for tribunalists to adhere to a system of legal precedent, either in the initial claims process or in the appeals process, unless a “Services and Investment Committee” issues a binding interpretation at its own discretion.

Criticism: ISDS incentivizes a pro-investor bias among tribunalists and drawn-out proceedings that mean higher costs to tax-payers. Only foreign investors are able to initiate cases and thus create business opportunities for tribunalists. Tribunalists are paid on an hourly basis, meaning that lengthy cases generate more income than those dismissed at an early stage. These structural problems are exacerbated by the fact that the initiating investor is empowered to select one of three tribunalists and must consent to the chair.

The EC proposal partially addresses this concern, but does not address the structural problem. Under the EC proposal, tribunalists would be assigned randomly from a roster of appointed ISDS arbitrators. However, foreign investors would remain exclusively empowered to launch cases. Despite the EC’s suggestion that the tribunalists receive a € 2,000 per month “retainer fee”, to ensure their availability on short notice, the tribunalists would still be paid by the parties of each dispute, and according to the fee schedule of the World Bank’s International Center for Settlement of Investment Disputes (ICSID) that is referenced in the proposal, tribunalists earn \$3,000 (€ 2,760) per day with no cap to what they can earn in total per case. As a result, the EC proposal would preserve the incentives for ISDS tribunalists to rule in favor of investors, as doing so would boost the likelihood that more foreign investors would launch cases, leading to more award-hinged payments for tribunalists. And, while the proposal says that provisional awards should be concluded within 18 months, it allows the tribunal to easily exceed that “deadline” by simply stating their reasons for doing so.

Criticism: ISDS tribunals are rife with conflicts of interest, as tribunalists commonly serve as attorneys for investors in other ISDS cases, and/or have ties to the investors in the cases they are deciding.

The EC proposal partially addresses this concern. The EC proposal prohibits tribunalists from participating in cases presenting conflicts of interest or serving as counsel in investment disputes. It establishes a process for Parties to challenge perceived conflicts of interest. Such challenges, however, are heard by the “president” of the tribunal (a la UNCITRAL rules). The “president,” chosen at random from the third-Party “judges” not deciding the case, enjoys broad discretion to keep tribunalists with conflicts of interest, as they are not bound by enforceable criteria. Moreover, given the investor arbitration bar is a relatively insular and self-protective community that has dubbed itself “The Club,” the means that the Commission proposal uses to try to address the conflict of specific conflict of interest problems is unlikely to result in meaningful change. In addition, members of the tribunal will still be allowed to work as corporate lawyers. The code of conduct and ethics provisions of the ICS proposal are not solid enough. It is, for example, not acceptable that a judge can be linked directly or indirectly to one of the parties in a dispute for a certain period of time surrounding a dispute.