

International Investment Agreements Under Scrutiny

Bilateral Investment Treaties, EU Investment Policy and International Development



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About BITs in Pieces

This project, also known by its full name *Making EU Investment Policy Work for Sustainable Development*, aims to promote an EU investment policy that is coherent with development policy and contributes to the achievement of the Millennium Development Goals of 2015, sustainable development, and the realisation of human rights in developing countries. In this project, more than 10 European civil society groups have come together to push for a critical review of European Bilateral Investment Treaties (BITs) in order to ensure that they do not limit the ability of governments to pursue public policy objectives.

About Traidcraft

Traidcraft Exchange is the UK's only development charity specialising in making trade work for the poor. In collaboration with local partners we work to create opportunities for poor people to harness the benefits of trade, helping them to develop sustainable livelihoods. Traidcraft also aims to use the experience of its sister trade company, Traidcraft plc, to improve wider trade practices. Traidcraft's Policy Unit conducts research and advocacy work to improve trade rules and the practice of companies. For the past few years, Traidcraft has been strengthening its work on investment and is developing its participation in networks and advocacy efforts about investment and development.

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Acronyms

BIPPA	Bilateral Investment Promotion and Protection Agreements
BITs	Bilateral Investment Treaties
CETA	Comprehensive Economic and Trade Agreement between EU and Canada
ECLAC	Economic Commission for Latin America and the Caribbean
FCN	Friendship, Commerce and Navigation (treaties)
FDI	Foreign Direct Investment
FET	Fair and equitable treatment
ICSID	International Centre for Settlement of Investment Disputes
IAs	International Investment Agreements
ISDS	Investor to State Dispute Settlement
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
TTIP	Transnational Trade and Investment Partnership
UNASUR	Union of South American Nations
UNCTAD	United Nations Conference on Trade and Investment

Executive Summary

International investment agreements (IIAs)¹ pose serious threats to democracy and the rule of law, important European values to which we are committed in our trade policy;² to public interests in social, environmental, health and consumer safety issues, and to the sovereign rights (and duties) of states to govern. Awareness of these risks is spreading. As concern around TTIP shows, both citizens and policy makers around the world are increasingly questioning this system, especially the investor-state dispute settlement mechanism (ISDS) that enables foreign investors to bypass the legal system of host states and sue governments before private tribunals for any policy, democratically passed law, or judgment of a court that adversely affects them.

High risk – dubious reward: IIAs’ development impact

Developing countries that sign IIAs with developed countries are taking a high risk gamble. In return for hoping to stimulate foreign direct investment (FDI) they severely restrict their policy space. But growing evidence proves that IIAs as such do not attract FDI – other determinants such as market size and the supply of natural resources are more important. When signing their first IIAs developing country negotiators were largely unaware of the risks posed by ISDS – a perception that only changed when they were hit with the first claims. Given that investment flows are increasingly global, European taxpayers will now more commonly have to foot the bill for claims from emerging market investors. For example, see the box on Ping An vs Belgium, below. The exponential rise in ISDS cases since the 1990s (see Figure 2) means that it is becoming more and more difficult for policy makers to continue to ignore the deficiencies of the process.

ISDS: violating the rule of law and undermining democracy

Investment arbitration takes place behind closed doors and does not adhere to basic public law principles. The regime has evolved into a business controlled by a few law firms and lawyers prone to conflicts of interest. Investment tribunals are composed of for-profit lawyers instead of independent judges – a system only foreign investors are allowed to use. Evidence shows that even the threat of claims deters government action, the so-called “regulatory chill”. The vague IIA rules provide arbitrators with interpretative leeway enabling them to challenge a broad range of public interest regulation. As IIAs delegate treaty interpretations to arbitrators, tribunals are effectively taking over state functions.

1. IIAs include Bilateral Investment Treaties and investment chapters in Free Trade Agreements.

2. Jean-Luc Demarty, Director-General, DG Trade, European Commission named “our values...open markets, democracy, the rule of law and respect for the individual” in The Parliament Magazine, 3 November 2014: <https://www.theparliamentmagazine.eu/articles/feature/ttip-worth-effort>

IIAs under scrutiny: reforms of the investment regime

The number of countries reviewing their investment frameworks is growing. Developing nations have made more fundamental changes. Ecuador, Venezuela, Bolivia, South Africa and Indonesia have terminated several IIAs; Bolivia, Ecuador and Venezuela have withdrawn from ICSID; India has frozen all investment negotiations; and UNASUR has created an alternative investment arbitration forum. Limited reforms in the EU, USA and Canada do not yet reflect the growing public concern.

Recommendations

- The EU and its Member States should refrain from pressuring developing countries to negotiate or sign IIAs.
- The EU and its Member States should drop ISDS from all EU and bilateral trade and investment agreements and explore alternative dispute resolution mechanisms.
- The EU and its Member States should initiate participatory reviews of their investment agreements, carry out Human Rights Impact Assessments of all IIAs, eliminate any inconsistencies of these treaties with international human rights obligations and include binding investor obligations in all investment agreements.



1. Introduction

The European Union took over competence for investment from the Member States in the 2009 Treaty of Lisbon. Trade Commissioner Malmström and her department, First Vice-President Timmermans, and members of the European Parliament share responsibility for investment policy with the Council. For Members of the European Parliament (MEPs) it is particularly important to develop a critical understanding of the risks of EU investment agreements. Due to the growing public concern, MEPs' positions on investment protection and ISDS have come under increasing public scrutiny.

Investment negotiations are ongoing between the EU and a range of developed and developing country partners (see box) and are sparking controversy and debate amongst the European public and policy makers. The stakes are high because international investment agreements affect consumers, citizens and tax payers around the world. They can threaten democracy and the rule of law, public goods like social, environmental,

health and consumer safety standards, and the sovereign rights (and duties) of states and the European institutions to govern.

These agreements have failed in their stated aim to foster inward investment³ and their social benefits in terms of jobs and growth are negligible.⁴ In investor-state dispute settlement (ISDS), the standard mechanism for enforcing investment agreements, three commercial lawyers are empowered to judge the legislative, executive and judicial acts of sovereign states. Unelected, unaccountable and largely unappealable, ISDS tribunals are increasingly popular with large multinational companies, on whom investment agreements bestow broad and ever more broadly interpreted rights.

To date, the European institutions have not signed and ratified an international investment agreement that contains ISDS, although some negotiations are well-advanced. So for European policy makers, there is still all to play for on the European approach.

Current state of play - investment agreements in force and ongoing EU negotiations

The most widespread form of international investment agreements (IIA) are bilateral investment treaties (BITs). Globally, there are 3,196 IIAs, of which 2,857 are BITs.⁵ EU Member States have over 1,200 BITs with third countries in force. Apart from BITs, investment provisions are increasingly being integrated into free trade agreements. Since 2011, the European Commission has been mandated to integrate investment protection, including ISDS, into several free trade agreements currently being negotiated.

Overview of the Commission's investment mandates

June 2011:	India, Canada (CETA), Singapore
December 2011:	Egypt, Jordania, Morocco and Tunisia
November 2012:	Japan
June 2013:	United States of America (TTIP)
October 2013:	Malaysia, Vietnam and Thailand
October 2013	China (this is an investment-only agreement)
March 2014:	Myanmar (investment-only agreement)

3. UNCTAD 2014: Trade and Development Report 2014: Global governance and policy space for development, New York/Geneva.

4. Gallagher, Kevin P./Zarsky, Lyuba 2006: Rethinking Foreign Investment for Development, post-autistic economics review, Issue No. 37, 28 April 2006.

5. UNCTAD 2013: World Investment Report 2013 - Global Value Chains: Investment and Trade for Development, New York/Geneva, p. 102

Foresti vs South Africa: Investors challenge Black Economic Empowerment



In 2006, a group of Italian nationals and a Luxembourg-registered company sued South Africa before ICSID, a World Bank entity adjudicating investment disputes, over clauses of a new mining law stipulating support to Black Economic Empowerment. In order to redress injustices of the Apartheid regime, mining companies were required to transfer a portion of their shares to “historically disadvantaged South Africans”. The investors claimed that this law amounted to expropriation and a breach of the “fair and equitable treatment” standard. In 2010 both parties agreed on a settlement greatly reducing the requirement to divest shares to South Africans.⁶

This short report aims to highlight problematic elements of the current investment protection regime, including impacts in the developing world; critically discuss the ongoing reform efforts underway around the world; and propose a way forward for European policy makers in line with their commitments to Policy Coherence for Development.

In Chapter 1 we evaluate the success of international investment agreements in their stated aim of stimulating flows of foreign direct investment into developing countries. In Chapter 2 we examine the impacts of ISDS on the rule of law. In Chapter 3 we critically review global efforts to reform the system. And in Chapter 4 we make recommendations for European policy makers on the way forward for European investment policy.

Awareness of the enormous risks posed by international investment agreements is beginning to spread. In the developing world South Africa, India, Indonesia and Bolivia are re-evaluating investment agreements, and some countries have terminated IIAs that proved detrimental. About three quarters of known investor-state disputes to date have been brought against developing and transition economies.⁷

In the European Union, which took direct competence for investment with the 2009 Treaty of Lisbon, growing numbers of legislators are concerned about investment provisions in negotiations with the United States (TTIP), Canada (CETA) and Singapore (EUSFTA). The European public is increasingly alarmed: 150,000 responses, mostly from citizens, were submitted to the European Commission’s public consultation on ISDS in TTIP.

Costs of defending an ISDS case

Costs of defending an ISDS case average US\$8 million. Tribunals’ ability to award almost unlimited damages poses a particular threat to developing countries and can cause ‘regulatory chill’. In 2012 an ISDS tribunal ordered Ecuador to pay \$1.77 billion in compensation to US company Occidental Petroleum. Interest and legal costs increased the total penalty to \$2.4 billion, a sum equivalent to Ecuador’s annual spend on health care for seven million people.⁸

6. Foresti vs South Africa, ICSID Case No ARB(AF)/07/1, Award, 4 August 2010

7. UNCTAD 2014: Recent Developments in Investor-State Dispute Settlement (ISDS), IIA Issues Note, No. 1, April 1, 2014

8. Wallach, Lori/Beachy, Ben 2012: Occidental v. Ecuador Award Spotlights Perils of Investor-State System, Public Citizen, Memorandum, November 21, 2012

2. Do IIAs increase investment?

Chapter 2: Summary of key points

- Developed countries were the driving forces behind IIAs.
- Developing countries signing IIAs entered into a risky bargain: They severely restricted their policy space in exchange for the prospect of higher FDI inflows.
- IIAs do not attract FDI – other determinants (market size, natural resources, infrastructure, labour force) are more important.
- When signing their first IIAs developing country negotiators were largely unaware of the risks of investment arbitration.
- This perception only changed when the number of disputes began to rise and the staggering costs of compensation payments and legal defence became apparent.

In the post-war era, Europe drove the negotiation of IIAs, conceived as protective instruments against expropriations and nationalisations of European companies' assets overseas. Developed countries initially claimed that international law obliged states to accord foreign investors minimum standards of protection, and to pay "prompt, adequate and effective" compensation for expropriations (the so-called Hull rule). This view was opposed by developing nations defending their sovereign right to intervene in the economy.⁹ Jeswald Salacuse, Professor of Law at Tufts University, describes developing country governments' reservations towards an international economic order dominated by the old colonial powers:

"With the advent of decolonization after World War II, many newly independent countries, asserting that they had played no part in the development of Western conceptions of international law and believing that existing international rules served only to maintain their poverty, also challenged Western views of international investment law."¹⁰

As these conflicting views proved impossible to reconcile, developed countries started to push developing countries into signing investment agreements. In 1959, West Germany and Pakistan were the first countries to sign an IIA. In the next decades, France, Italy and Sweden followed Germany's example. The first USA IIA was signed with Egypt in 1982.¹¹

9. Neumayer, Eric/Spess, Laura 2005: Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?, *World Development*, Vol. 33, No. 10, pp. 1567-1585, 2005

10. Salacuse, Jeswald W. 2010: The Emerging Global Regime for Investment, *Harvard International Law Journal*, Volume 51, Number 2, Summer 2010, pp. 427-473

11. Alschner, Wolfgang 2013: Americanization of the BIT Universe: The Influence of Friendship, Commerce and Navigation (FCN) Treaties on Modern Investment Treaty Law, *Goettingen Journal of International Law* 5 (2013) 2, pp. 455-486

Formally, IIAs apply equally to both parties. But as investments flowed almost exclusively from developed to developing nations, there was no real reciprocity: “BITs were designed to cover an asymmetrical relationship between developed, capital exporting countries and developing, capital importing countries.”¹² Consequently, the regulatory burdens fell almost entirely on developing countries. Due to the perceived nonreciprocal nature of the treaties and the enduring scepticism of developing countries, the network of IIAs increased only slowly during the first three decades. From 1959 until 1989, 386 IIAs were concluded.¹³

The 1990s witnessed a rapid increase in the number of IIAs, with about 1,600 treaties concluded throughout the decade. Debt crises in developing countries and extensive borrowing by the U.S. administration under Reagan led to a drying up of private bank lending to developing countries, exacerbated by a reduction of development assistance.

As a consequence, foreign direct investment (FDI) appeared as an alternative source of capital to dwindling private credit. Structural adjustment programmes, trade liberalisation and market deregulations were increasingly coupled with policies expected to attract FDI, amongst which IIAs featured prominently.

In its Trade and Development Report 2014, UNCTAD presents the outcomes of an econometric exercise analyzing whether IIAs fostered FDI flows from developed to developing countries over the period 1985-2012. Having applied a new, rigorous methodology the research comes to the sobering conclusion that “IIAs appear to have no effect on bilateral North-South FDI flows”. The report’s advice to developing country policy makers is straightforward: “Indeed, they should remain cautious about any kind of recommendation to actively pursue IIAs.”¹⁴

“BITs appear to have no effect on bilateral North-South FDI flows”

UNCTAD Trade and Development Report 2014, p.159.

12. Ibid., p. 465

13. Vandeveldt 2005, see FN

14. UNCTAD 2014: Trade and Development Report 2014: Global governance and policy space for development, New York/Geneva, p. 159

15. UNCTAD 2009: The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries, UNCTAD Series on International Investment Policies for Development, New York/Geneva 2009

16. Tobin, Jennifer L./Rose-Ackerman, Susan 2011: When BITs have some bite: the political-economic environment for bilateral investment treaties, *The Review of International Organizations*, March 2011, Volume 6, Issue 1, p. 2

17. Hallward-Driemeier, Mary 2003: Do Bilateral Investment Treaties Attract FDI? Only a bit...and they could bite. World Bank, DECRG, June 2003, <http://dx.doi.org/10.1596/1813-9450-3121>

In an earlier analysis, UNCTAD explains that IIAs are of minor importance compared to other factors directly determining FDI inflows: “Key among them is the economic attractiveness of host countries concerning the size and growth of the market, and the availability and costs of natural resources, as well as inputs such as skills, infrastructure services, or intermediate goods.”¹⁵

IIAs will not compensate potential investors for the lack of these endowments. As Jennifer Tobin and Susan Rose-Ackerman argue, “these treaties cannot substitute for an otherwise weak investment environment”.¹⁶ As a result, countries potentially reaping benefits from IIAs may, if at all, only be found among the more advanced economies. World Bank economist Mary Hallward-Driemeier concedes that “those

that are benefiting from them are arguably the least in need of a BIT to signal the quality of their property rights.”¹⁷

What is more, the weak prospect of receiving FDI through IIAs must also be compared with the risk of costly investment disputes. Development experts Kevin P. Gallagher and Elen Shrestha found that “relative to government budgets and in per capita terms developing countries pay significantly more in damages than developed nations do.”¹⁸ States cannot bring claims against companies, and pay heavily to defend themselves. Damages of US\$ 50 billion were recently ordered against Russia,¹⁹ the highest figure yet, and there is an upward trend in the scale of damages.

Brazil: No IIAs and the largest FDI recipient in the region



A good case in point illustrating the weak link between IIAs and FDI is Brazil. Although the government negotiated 14 IIAs in the 1990s, the Brazilian Congress rejected them as unconstitutional. Yet a negative impact on FDI flows has never been detected. Quite to the contrary: Brazil is number five *globally* in the 2014 list of countries where corporate executives say they are most likely to direct their foreign investment dollars.²⁰ Brazil continues to be the largest recipient of FDI inflows in Latin America, significantly higher than those of Mexico (which has many IIAs). In a recent report, the Economic Commission for Latin America and the Caribbean (ECLAC) finds that the “volume of investment [...] is substantial even for an economy as large as Brazil’s. It is equivalent to 2.9% of the country’s GDP”.²¹ Brazil’s example convincingly proves that IIAs are no precondition for attracting FDI.

18. Gallagher, Kevin P./Shrestha, Elen 2011: Investment Treaty Arbitration and Developing Countries: A Re-Appraisal, Tufts University, Global Development and Environment Institute, Working Paper No. 11-01, May 2011
19. Former Yukos shareholders awarded \$50bn in damages against Russia, Financial Times, 28 July 2014: <http://www.ft.com/cms/s/0/f5824afa-1623-11e4-8210-00144feabdc0.html#axzz316BnmRVY>
20. AT Kearney’s Foreign Direct Investment (FDI) Confidence Index®, established in 1998, ranks countries based on how changes in their political, economic, and regulatory systems are likely to affect foreign direct investment inflows in the coming years. <http://www.atkearney.com/research-studies/foreign-direct-investment-confidence-index#sthash.kdtI0pvB.dpuf>
21. ECLAC 2013: Foreign Direct Investment in Latin America and the Caribbean 2012, Santiago, June 2013

At the beginning of the 1990s, only about 10 known investor-state dispute settlement cases were registered. It was only after the turn of the century that arbitrations multiplied, reaching 568 ISDS cases by the end of 2013 (see next section).²² Due to the low number of disputes and lacking expertise, negotiators had only limited understanding of the potential consequences when negotiating their first IIAs.²³

A South African government commission reviewing the country's IIAs signed in the post-apartheid era concluded that the government "had no history of negotiating IIAs and the risks posed by such treaties were not fully appreciated at that time. [...] As a result the Executive entered into agreements that were heavily stacked in favour of investors without the necessary safeguards to preserve flexibility in a number of critical policy areas."²⁴

South Africa's experience is not an isolated case, as interviews among government officials concerned with IIA negotiations in 13 developing countries revealed. Researchers Lauge Poulsen and Emma Aisbett, responsible for this survey, conclude: "Practically all officials – including stakeholders – noted that they were unaware of the far-reaching scope and implications of IIAs during the 1990s, when the treaties proliferated."²⁵ This perception only changed when countries were hit by their first investment claims.

22. UNCTAD 2014: Recent Developments in Investor-State Dispute Settlement (ISDS), IIA Issues Note, No. 1, April 1, 2014

23. Van Harten, Gus 2010: Five Justifications for Investment Treaties: A Critical Discussion, Trade, Law and Development, Volume II, No. 1, Special Issue: International Investment Law, pp. 19-58

24. Republic of South Africa 2009: IIA Policy Framework Review, Government Position Paper, Pretoria, June 2009

25. Poulsen, Lauge N. Skovgaard/Aisbett, Emma 2013: When the claim hits: bilateral investment treaties and bounded rational learning, World Politics, Volume 65, Issue 02, April 2013, pp 273-313

3. ISDS and the Rule of Law

Chapter 3: Summary of key points

- Investor State Dispute Settlement (ISDS) allows investors to challenge states through investment tribunals which lack transparency and circumvent international legal standards.
- Investment tribunals are dominated by a few large law firms and a small group of lawyers. This makes them prone to conflicts of interest.
- Investment cases are mainly decided by for-profit lawyers instead of independent judges.
- There is no equality before the law as only foreign investors are allowed to sue.
- Arbitrators have considerable interpretative leeway enabling them to challenge a broad range of state measures taken in the public interest.
- By delegating treaty interpretations to arbitrators, investment tribunals effectively take over state functions usually reserved to democratically legitimate policy makers.
- As investment tribunals treat cases from the perspective of commercial law, they tend to ignore the broader public welfare aspects of disputes.
- Even the threat of filing investment claims may deter government action – a chilling effect particularly problematic for countries whose regulations are still evolving.



One of the key concerns in relation to IIAs is the Investor State Dispute Settlement (ISDS) clause, which is routinely included in treaties. The clause enables companies to enforce their rights and seek compensation for alleged breaches of IIAs. The majority of cases have been brought under ICSID (International Centre for Settlement of Investment Disputes), part of the World Bank group based in Washington.²⁶ Cases are decided by a panel of three commercial lawyers, sitting in private session.

At the beginning of the 1990s, only about 10 known investor-state dispute settlement (ISDS) cases were registered. However, after the turn of the century arbitrations multiplied (see figure 1).²⁷

Shortcomings of the ISDS process start with the opacity of the system – even the number of cases brought before tribunals is not in the public domain. Various forums administer investment arbitrations but due to their confidentiality rules many do not provide data on the cases they are handling. Unlike ICSID, most forums do not maintain public registries of claims. For example, files initiated under the rules of UNCITRAL (United Nations Commission on International

Trade Law), the Stockholm Chamber of Commerce or the International Chamber of Commerce may remain undisclosed for years or even forever.²⁸ For this reason, UNCTAD is only able to count the known cases while the actual number might be considerably higher.

Recent research has shown that investment arbitration has evolved into a lucrative business dominated by a handful of international law firms with a small club of lawyers deciding the majority of cases (see box).

An investment tribunal typically consists of three arbitrators, one appointed by each of the disputing parties, and the third mutually agreed by the parties. But unlike an ordinary court composed of independent judges, the majority of arbitrators are private lawyers with a commercial interest in attracting as many cases as possible. Due to their changing roles, sometimes acting as counsels and sometimes as arbitrators, there is potential for severe conflicts of interests. An advocate may act as arbitrator in investment disputes involving companies his or her law firm may have represented in earlier cases, thus raising serious doubts about impartiality.

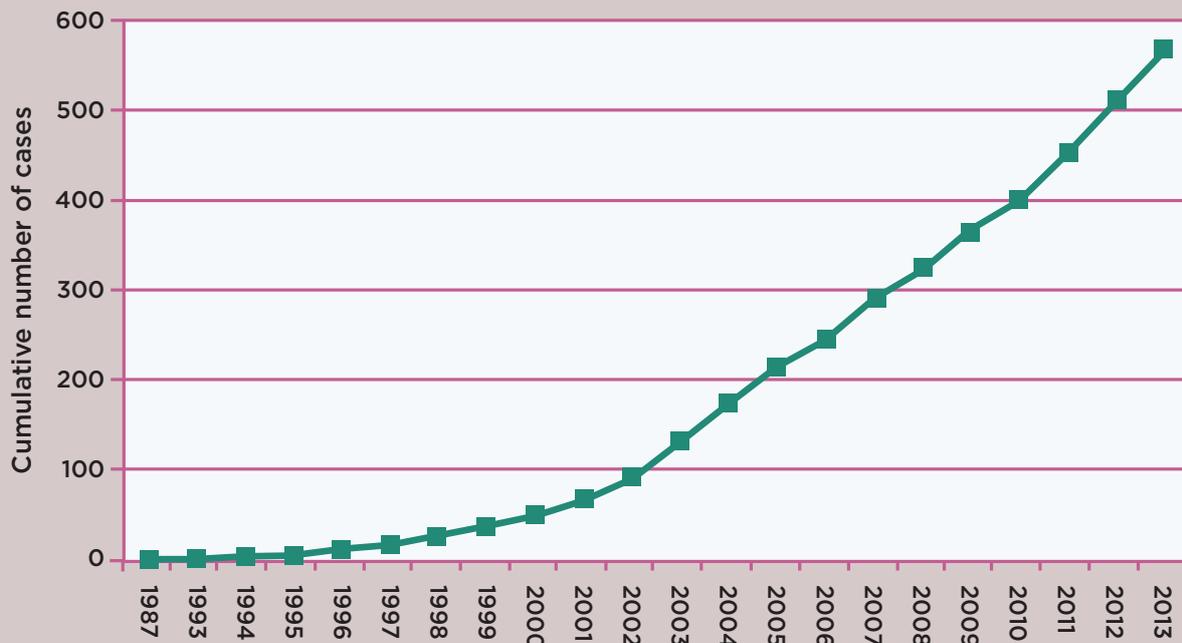
Problems with ISDS

- Grants foreign investors the exclusive right to bypass national courts and sue governments before international tribunals, thus undermining democratically legitimate legal systems.
- Discriminates against all domestic actors whose claims can only be brought before domestic courts – in breach of the principle of equality before the law.
- The same lawyers involved in treaty-based investment tribunals can wear ‘multiple hats’ acting as counsel or expert witness in one case and arbitrator in another, creating potential conflicts of interest.
- Does not provide for effective safeguards eliminating arbitrators’ financial dependence on corporate clients.

26. UNCTAD 2014, see FN

27. UNCTAD 2014: Recent Developments in Investor-State Dispute Settlement (ISDS), IIA Issues Note, No. 1, April 1, 2014

28. <http://www.iareporter.com/articles/20140512>

Figure 1: Known ISDS cases (total as of end 2013)

Source: UNCTAD 2014: Recent Developments in Investor-State Dispute Settlement (ISDS)

As Gus Van Harten, Associate Professor of Law at York University, argues, “Investment treaty arbitration is, in institutional terms, inconsistent with the rule of law.”²⁹ Unlike judges, whose independence is safeguarded by the security of their tenure, a set salary, and bars on outside remuneration, “arbitrators can earn incomes beyond their adjudicative role” by advising claimants and respondents. They are also influencing the rules of the game by promoting arbitration clauses in investment contracts and agreements tailored to the needs of their corporate clients.

The risk for states is that they open themselves up to more and more grounds for claims through the ISDS process, with its high risk of conflicts of interest.

Another feature violating the rule of law relates to the one-way process enshrined in the investment arbitration system. As Van Harten explains, “The ability to bring claims is non-reciprocal”.³⁰ It is only one class of parties – investors – which is allowed to bring claims, while only the other class – states – is liable for paying compensations in case of alleged treaty violations. As only investors trigger the use of the system, arbitrators have a strong incentive to encourage business claims and to interpret IIAs in favour of future corporate clients.

In fact, the secrecy surrounding investment treaty disputes as well as the vague rules contained in IIAs allows arbitrators expansive interpretations of individual clauses, turning many public

29. Van Harten, Gus 2010, see FN, p. 39

30. Ibid, p. 37

Money makers: the emerging arbitration industry

A report by Corporate Europe Observatory and the Transnational Institute exposed the high degree of concentration in the investment arbitration industry. A large proportion of the cases go to a handful of international law firms such as Freshfields Bruckhaus Deringer (UK), White & Case (U.S.) or King & Spalding (U.S.), while a small group of 15 elite lawyers has decided 55 percent of the known disputes.³¹

Their services are extremely costly. According to the OECD, the billing rates for specialised arbitration lawyers are around \$1,000 an hour. In recent ISDS cases the overall costs for legal counsel and arbitrators have averaged \$8 million, in some cases even exceeding \$30 million.³² Elite lawyers' intimate acquaintance with colleagues serving as arbitrators and with the rules governing ISDS procedures provides them a valuable advantage. Governments who cannot afford their expensive expertise have significantly lower chances of successfully defending their case. Consequently, the profit-driven arbitration market puts cash-strapped developing countries at a systematic disadvantage.

regulations into alleged treaty breaches. Their interpretative leeway enables arbitrators to challenge a broad range of state measures taken in the public interest, such as policies to promote social equity, public health, and environmental protection, or measures to cope with the impacts of financial crises (see box).

The arbitral decisions, as far as they have been made public, expose many deficiencies of the system. UNCTAD has found that the large room for interpretation led to "recurring episodes of inconsistent findings" and "erroneous decisions" taken by investment tribunals, including "divergent legal interpretations of similar or identical treaty provisions".³³

Unlike any other legal process, investment arbitration does not include an appeal mechanism. Once a decision is made, awards take immediate effect and the state cannot appeal on points of law or fact.

The main IIA clauses open for wide interpretations and regularly invoked by claimants are the standards of "fair and equitable treatment" and "indirect expropriation".

Fair and equitable treatment (FET) has emerged as "the most relied upon and successful basis for IIA claims by investors".³⁴ Several tribunals identified investors' "legitimate expectations" as a key element of the FET standard. Regulatory changes, such as new laws or taxes diminishing private profits, may be seen as breaches of an investor's "legitimate expectations" justifying compensation. Some awards even interpreted the FET standard as a state obligation to maintain a "stable and predictable business environment".³⁵

The second important standard, "indirect expropriation", refers to state measures depriving investors of the economic value of their assets by limiting the ability to profit from their property. Unlike direct expropriations, this standard does

31. Eberhardt, Pia/Olivet, Cecilia 2012: Profiting from injustice – How law firms, arbitrators and financiers are fuelling an investment arbitration boom, Corporate Europe Observatory/Transnational Institute, Brussels/Amsterdam, November 2012

32. Gaukrodger, D./Gordon, K. 2012, Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community, OECD Working Papers on International Investment, 2012/03, OECD Publishing

33. UNCTAD 2013: Reform of Investor-State Dispute Settlement: In Search of a Roadmap, IIA Issue Note, No. 2, June 2013, p. 3

Investment arbitration: threatening public policy



Veolia vs Egypt: Investors challenge minimum wage

In 2012, French company Veolia Propreté filed an ICSID claim against Egypt over the introduction of a new minimum wage. In 2000, Veolia had signed a contract to provide waste management services in the port city of Alexandria. But a few years later, Veolia tried to adapt the contract to compensate for increasing costs. Inflation had devalued the Egyptian currency and the government had introduced a new labour law including a minimum wage. After the government refused to adapt Veolia's contract, the company submitted its claim to an ICSID tribunal.³⁶



Suez vs Argentina: Investors challenge cost controls for basic services

In reaction to Argentina's 2001 crisis, the Argentinian government devalued the country's currency and froze rates for basic services such as water and energy. French water company Suez, which led a consortium operating a water concession in Buenos Aires, sued Argentina over the rate cap. In 2010, an ICSID tribunal ruled that the government's refusal to allow tariff adjustments breached the "fair and equitable treatment" obligation. The tribunal has not yet decided on the compensation payment. However, Suez announced the consortium would seek €1.2 billion.³⁷



Ping An vs Belgium: Investors challenge bank restructurings

In 2012, China's second biggest insurance company, Ping An, sued Belgium before ICSID on the basis of the Belgium-China IIA over the collapse of Fortis Bank. The insurer lost \$2 billion in 2008, when Belgian-Dutch Fortis was nationalised and dismantled. Against Ping An's will the Belgian government sold part of the Fortis assets to French bank BNP Paribas. The insurer argues, the nationalisation process and the asset sale violated its rights. This is the first time a Chinese investor has brought a claim before ICSID.³⁸

34. UNCTAD 2012: Fair and Equitable Treatment: A sequel, UNCTAD Series on Issues in International Investment Agreements II, New York and Geneva, 2012

35. *Ibid*, p. 66

36. <http://economie.jeuneafrique.com/entreprises/entreprises/btp-a-infrastructures/11868-veolia-assigne-legypte-au-tribunal.html>

37. http://www.iareporter.com/articles/20100818_9

38. Financial Times 2012: Ping An in arbitration claim over Fortis, 24 September 2012

not involve an outright seizure of property as, for example, in the case of nationalizations. However, tribunals already denounced many public interest regulations as measures “tantamount” or “equivalent” to expropriation.³⁹

By interpreting the extremely vague IIA standards, arbitral tribunals are taking on the role of lawmakers transforming these broad clauses into more precise rules prescribing how governments have to treat foreign investors. By doing so, they are in effect taking over functions belonging to the state, functions which rightly belong to democratically elected law makers or to regulatory bodies accountable to the public.

Delegating these state functions to investment arbitration is particularly dangerous because “these tribunals tend to treat the cases from the point of view of commercial arbitration”, as UNCTAD warns.⁴⁰ Investment tribunals cannot be expected to adequately take into account the public welfare aspects of these disputes such as governments’ obligation to guarantee financial stability, to control corporate conduct, to foster social inclusion and to protect the environment.

This system compromises the EU’s established democracy, human rights and the rule of law.

It undermines the commitment to these values in European foreign affairs, and is inconsistent with the goal of policy coherence for development.

Defenders of the ISDS process sometimes point to the fact that the presence of this option does not mean that it will necessarily be used. However, for many developing and even developed countries, the threat of investment arbitration has a powerful influence on policy making. Governments may be deterred from taking necessary measures, a phenomenon called “regulatory chill” (see box).

In some cases governments have succeeded in avoiding a costly award by entering into a settlement agreement with the investors. But the terms of the agreements, which are generally not published, may oblige them to modify or abandon planned social or environmental regulations and pay compensation.

This ‘chilling’ effect is particularly problematic for developing countries whose laws and regulations may still be evolving. Discouraging them from the implementation of adequate supervisory and regulatory frameworks may thwart their development plans and undermine poverty eradication and environmental protection.

Freezing government action – the threat of regulatory chill



Newmont vs Indonesia: Investors challenge industrial policy

In order to boost domestic processing and employment and increase the value of its exports, Indonesia proposed banning exports of unprocessed minerals. As an interim measure until the ban comes into effect in 2017, export taxes on unprocessed minerals have been increased. US-based mining company Newmont filed for arbitration with ICSID over the ban and rising taxes. Only after Indonesia agreed to significantly lower its export tax, did Newmont agree to withdraw its arbitration claim. Newmont used the fact that its Dutch entity is the majority shareholder in the Indonesian subsidiary to bring the claim under the Netherlands – Indonesia IIA.

39. UNCTAD 2012: Expropriation: A sequel, UNCTAD Series on Issues in International Investment Agreements II, New York and Geneva, 2012

40. UNCTAD 2014: Trade and Development Report 2014: Global governance and policy space for development, New York/Geneva, p. 138

4. IIAs going forward: European competence and reform

Chapter 4: Summary of key points

- More and more countries are undertaking reviews of their investment frameworks.
- The NAFTA members, the U.S., Canada and Mexico, have undertaken modest reforms redefining some treaty clauses to widen their policy space.
- The Australian government treats ISDS in FTAs on a case-by-case basis.
- Ecuador, Venezuela, Bolivia, South Africa and Indonesia have terminated several IIAs.
- Bolivia, Ecuador and Venezuela have withdrawn from ICSID.
- The Union of South American Nations UNASUR has created a regional investment arbitration centre as an alternative to ICSID.
- India has frozen all negotiations on bilateral investment agreements.
- The European Commission has carried out a public consultation on ISDS in TTIP.
- The EU has integrated novel, but largely insufficient reforms into CETA's investment chapter.

The boom in ISDS claims and growing understanding of their threats have led governments around the world to question their IIA frameworks. Both developed and developing countries are initiating reviews and reforms of varying scope.

Having witnessed a sharp rise of investment claims under the investment chapter of the North American Free Trade Agreement (NAFTA), the U.S., Canada and Mexico embarked on some modest reforms aimed at clarifying the meaning of some treaty provisions. Yet, this attempt to limit the interpretative discretion of arbitrators largely failed as tribunals continued to issue expansive interpretations of these provisions.⁴¹

In 2007, an attempt by the Norwegian government to introduce a new IIA policy caused civil society protests and led to a broad public debate. It was particularly criticised for privileging investor interests. Finally, in 2009, the government withdrew the proposed new model.⁴²

A number of developing countries have embarked on even more fundamental reforms of their investment policies. Bolivia (2007), Ecuador (2009) and Venezuela (2012) have withdrawn from ICSID in an attempt to limit the enforceability of ISDS rulings. Bolivia has notified the USA of its intention to terminate their IIA.

41. Porterfield, Matthew C. 2013: A Distinction Without a Difference? The Interpretation of Fair and Equitable Treatment Under Customary International Law by Investment Tribunals, IISD, Investment Treaty News, March 22, 2013

42. Seattle to Brussels Network 2010: EU Investment Agreements in the Lisbon Treaty Era: A reader, Amsterdam, July 2010

Ecuador is reviewing all its IIAs in light of the cases brought, their links to FDI flows, and their relevance to its development aspirations. To date, Ecuador has terminated nine IIAs. Venezuela terminated its Dutch IIA in 2008 following a string of claims by US firms with 'shell companies' set up in the Netherlands to benefit from Treaty protection.⁴³ In 2010, the 12 members of the Union of South American Nations (UNASUR) started negotiations on a regional investment arbitration centre as an alternative to ICSID,⁴⁴ expected to be operational in 2015.⁴⁵ The 9 member states of the ALBA group (Alianza Bolivariana para los Pueblos de Nuestra América) established an "Observatory of the South on Investments and Transnationals" in September 2014 to monitor the international arbitration

system and to assist developing country governments targeted by investor claims.⁴⁶

Over three years South Africa critically reviewed its investment framework and the 23 IIAs in force.⁴⁷ The scrutiny had been provoked by the 2006 Foresti case challenging South Africa's Black Economic Empowerment legislation (see Chapter 1). The Department of Trade and Industry concluded in 2009 that: "BITs extend far into developing countries' policy space, imposing damaging binding investment rules with far-reaching consequences for sustainable development."⁴⁸ Investment rules preventing governments from requiring investors to transfer technology, train local workers, or source inputs locally were failing to foster development.



43. Van Os, Roos/Knottnerus, Roeline 2011: Dutch Bilateral Investment Treaties – A gateway to 'treaty shopping' for investment protection by multinational companies, SOMO, Amsterdam, October 2011

44. <http://www.iisd.org/itn/2012/01/12/unasur/>

45. <http://www.eluniverso.com/noticias/2014/09/26/nota/4032781/centro-resolver-controversias-sobre-inversiones-unasur-estaria>

46. <http://cancilleria.gob.ec/estados-del-sur-ponen-en-marcha-observatorio-sobre-inversiones-transnacionales/>; <http://portaldelsur.info/2014/09/proponen-la-creacion-de-un-observatorio-del-sur/>

47. According to UNCTAD, South Africa signed 46 BITs, of which 23 came into by June 2013. See http://unctad.org/sections/dite_pcbb/docs/IIAs_south_africa.pdf

48. Republic of South Africa 2009: Bilateral Investment Treaty Policy Framework Review, Government Position Paper, Pretoria, June 2009

In 2010, South Africa decided to refrain from entering into new IIAs “unless there are compelling political or economic reasons to do so”. It announced that it would terminate existing investment treaties but “offer partners the possibility to re-negotiate IIAs on the basis of a new model”.⁴⁹ In addition, the cabinet planned to develop a new investment act and establish a ministerial committee charged with overseeing this work.

In 2012, South Africa terminated its IIA with Belgium and Luxemburg, the treaty that had been invoked in the *Foresti* case. Subsequently, the government gave notice to terminate the IIAs with Spain, Germany, Switzerland, and the Netherlands (all in 2013).⁵⁰

Karel De Gucht, former EU trade commissioner, reacted angrily to the terminations, alleging this would negatively impact on investment flows between South Africa and the EU.⁵¹

In November 2013, the South African government published a draft investment law, the “Promotion and Protection of Investment Bill”.⁵² The bill provides a new legislative framework aimed at promoting and protecting investment, while preserving the sovereign right to regulate. It applies to all investors, foreign and domestic alike.

Yet, unlike current IIAs, its protections do not include the controversial standard of “fair and equitable treatment”, and compensation for expropriation is not guaranteed to be at “market value”. Instead, the bill stipulates that compensation “must reflect an equitable balance between the public interest and the interests of those affected”. Finally, and most notably, the draft act provides no general right to refer investment disputes to international arbitration: investment disputes are to be settled in domestic courts.

South Africa isn’t alone in questioning ISDS. Australia assesses ISDS on a case-by-case basis⁵³ and recently agreed an IIA with the Pacific Islands that excludes ISDS. Instead this agreement provides for dispute resolution in national courts or through a mechanism mutually agreed by the parties.⁵⁴

In March 2014, the Indonesian government decided not to renew the Netherlands-Indonesia IIA, as part of a wider review of the appropriateness of its outdated ‘first generation’ IIAs to its current developmental status and aspirations. Indonesia had been the target of a spate of investment disputes brought under various IIAs, each involving compensation claims of hundreds of millions of dollars, amongst which were the claims of Newmont (see chapter 3) and Churchill Mining (below).⁵⁵

Churchill Mining vs Indonesia: Investors challenge revocation of licences

In 2012, British company Churchill Mining took Indonesia to ICSID claiming that the government violated the UK-Indonesia IIA when a local government revoked its coal concession in the East Kutai district of East Kalimantan over allegations of corruption. Churchill Mining is seeking more than \$1 billion in compensation. In February 2014, an ICSID tribunal rejected the Indonesian government’s attempt to challenge ICSID’s authority to adjudicate over Churchill’s claim. The tribunal confirmed that it did have the jurisdiction to sit over the case.⁵⁶

49. Carim, Xavier 2013: Lessons from South Africa’s BITs review, Vale Columbia Center on Sustainable International Investment, Columbia FDI perspectives, No. 109, November 25, 2013

50. <http://www.moneyweb.co.za/moneyweb-south-africa/investors-are-protected-government-argues>

51. <http://www.bdlive.co.za/business/trade/2013/11/12/eu-steps-up-fight-to-have-treaties-with-sa-retained>

52. Republic of South Africa 2013, Promotion and Protection of Investment Bill, Government Gazette, 1 November 2013, No. 36995

53. <http://www.eastasiaforum.org/2014/04/09/why-no-investor-state-arbitration-in-the-australia-japan-fta/>

54. Evidence of Mr Edwini Kessie, Chief Trade Adviser Pacific Islands Countries, UNCTAD World Investment Forum, 16 October 2014: <http://unctad-worldinvestmentforum.org/wp-content/uploads/2014/10/Kessie.pdf>

55. <http://kluwerarbitrationblog.com/blog/2014/08/21/indonesias-termination-of-the-netherlands-indonesia-ii-a-broader-implications-in-the-asia-pacific/>

56. <http://www.thejakartapost.com/news/2014/02/27/ri-risks-loss-churchill-legal-battle.html>

India has also adopted a more critical attitude towards investment treaties. In January 2013, the former Congress-led government ordered a freeze of all negotiations on “Bilateral Investment Promotion and Protection Agreements” (BIPAs) until a review of a new model investment treaty is completed.⁵⁷ Under the new BJP-led government, ministries are debating the model text and “Certain departments of the government are not in favour of these pacts” according to officials.⁵⁸

Developing countries are also at the forefront of international efforts aimed at requiring investors to respect human rights. While trade and investment agreements offer businesses far-reaching rights there are no comparable international instruments addressing their obligations. In part, in order to fill this gap, Ecuador and South Africa sponsored a resolution of the United Nations’ Human Rights Council calling for a “legally binding instrument on Transnational Corporations and Other Business Enterprises with respect to human rights”, which was adopted in June 2014.⁵⁹ Among the supporters were China, India, Indonesia, Kenya, Philippines and Russia, while developed countries including France, Germany, UK, Japan and USA voted against it.⁶⁰

In the European Union, civil society campaigns challenging trade agreements with Canada (CETA) and the United States (TTIP) have stimulated a broader debate on the Union’s investment policy. In early 2014, the European Commission suspended negotiations on the planned investment chapter in TTIP and launched a three month public consultation on some limited policy reforms, which received about 150,000 replies.⁶¹

CETA, whose consolidated text has recently been published, or the EU Singapore FTA would be the first EU trade agreements with a comprehensive investment chapter including ISDS. The agreement with Canada is widely seen as a blueprint for TTIP. The Commission claims that the “important innovations” introduced in CETA would preserve the right to regulate, while the ISDS provisions represent “the most progressive system to date”.⁶² However, the reforms introduced in CETA do not eliminate core threats posed by the current investment regime (see appendix).

The numbers of EU policy makers critical of the Commission’s investment approach are rising. In September 2014, the Austrian Parliament adopted a resolution openly questioning the rationale of including ISDS in agreements among countries with “developed legal systems” such as the EU, the USA and Canada. Similarly, Germany’s economics ministry stated that investment protection should not be included in TTIP. However, other Member States such as Britain, Spain and Sweden continue to defend ISDS in the EU-U.S. agreement.

Still, these divergent views illustrate an important shift in the European debate: The former consensus among EU policy makers on the inclusion of ISDS in TTIP, CETA, and IIAs more generally has been lost.⁶³ Various political groupings in the European Parliament have also questioned ISDS, including S&D, ALDE, Greens and GUE.

57. <http://www.thehindu.com/business/Economy/bipa-talks-put-on-hold/article4329332.ece>

58. http://articles.economictimes.indiatimes.com/2014-06-23/news/50798470_1_investment-protection-bipas-protection-agreement

59. United Nations, General Assembly, Human Rights Council: Elaboration of an international legally binding instrument on transnational corporations and other business enterprises with respect to human rights, A/HRC/26/L.22/Rev.1, 25 June 2014

60. Mohamadieh, Kinda, 2014: Human Rights Council: Historic resolution adopted for a legally binding instrument on TNCs, TWN Info Service on Climate Change, 30 June 2014

61. For a thorough analysis of the European Commission’s consultation document see: Nathalie Bernasconi-Osterwalder 2014: Reply to the European Commission’s Public Consultation on Investment Protection and Investor-to-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP), IISD Report, June 2014

62. European Commission 2014: Investment Provisions in the EU-Canada Free Trade Agreement (CETA), 26 September 2014

63. http://www.parlament.gv.at/PAKT/VHG/XXV/UEA/UEA_00245/index.shtml; <http://www.bmwi.de/DE/Themen/ausenwirtschaft,did=655140.html>; <http://blogs.ft.com/brusselsblog/2014/10/23/leaked-letter-14-ministers-take-on-juncker-over-trade/?hubRefSrc=permalink>

5. Recommendations

Foreign direct investment has to be effectively regulated in order to contribute to economic development, social progress and environmental sustainability.

At present international investment agreements are actively impeding Governments around the world from pursuing policies which are in the public interest and there is a growing movement questioning their usefulness and effectiveness.

Based on the evidence contained in this report we make the following recommendations:

- **The EU and its Members States should refrain from pressuring developing countries to negotiate or sign IIAs.**
 - **The EU and its Member States should drop ISDS from all EU and bilateral trade and investment agreements and explore alternative dispute resolution mechanisms:**
 - ◆ Using domestic legal remedies should become the norm where possible.
 - ◆ Appropriate multilateral state-state dispute mechanisms could be created, guaranteeing transparency, broad stakeholder participation, and the right to regulate.
 - ◆ Such mechanisms should be composed of independent and impartial judges free from conflicts of interest.
 - **The EU and its Member States should initiate participatory reviews of their investment agreements, carry out Human Rights Impact Assessments of all IIAs, eliminate any inconsistencies of these treaties with international human rights obligations and include binding investor obligations in all investment agreements.**
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Appendix

CETA Reality Check: EU reforms fall short

CETA “reforms” neither achieve their stated objective of “clearer and more precise” rules, nor do they overcome the fundamental deficiencies of ISDS.

EUROPEAN COMMISSION CLAIM	REALITY CHECK
<p>1. Right to regulate <i>“CETA makes clear from the outset that the EU and Canada preserve their right to regulate”</i></p>	<p>To prove this claim, the EC refers to CETA’s preamble where the parties simply recognize “that the provisions of this Agreement preserve the right to regulate”.⁶⁴ But unlike the treaty’s body text, the preamble is non-binding. In contrast, CETA’s binding investment chapter makes no mention of the right to regulate.</p> <p>Further references can only be found in the chapters on labour and the environment, but these, too, do not contain an unequivocal statement confirming the right to regulate. In fact, the environment chapter effectively limits this right by requiring that environmental policies be implemented “in a manner consistent [...] with this Agreement”.</p>
<p>2. “Fair and equitable treatment” (FET) <i>“A clear, closed text defines precisely the standard of treatment without leaving unwelcome discretion to arbitrators”.</i></p>	<p>CETA’s drafting does not explicitly close this list. Previous similar attempts under NAFTA largely failed.⁶⁵ Moreover, many investors are basing their claims on precisely the same incidents listed in CETA as potential FET violations, particularly the perceived “arbitrariness” and “discrimination”. For instance, Philipp Morris’ suit against Australia’s plain packing law as well as Lone Pine’s suit against Canada following Quebec’s fracking moratorium have been based on the alleged “arbitrariness” of these government measures.⁶⁶ In addition, CETA explicitly refers to investors’ “legitimate expectation” which governments might have created through “specific representations”, thus deliberately opening the door to expansive FET interpretations such as those assuming a state obligation to maintain a “stable” business environment.</p>

64. CETA Consolidated text, 1 August 2014, 1. Preamble

65. Porterfield, Matthew C. 2013: A Distinction Without a Difference? The Interpretation of Fair and Equitable Treatment Under Customary International Law by Investment Tribunals, IISD, Investment Treaty News, March 22, 2013

66. CEO 2014: Still not loving ISDS: 10 reasons to oppose investors’ super-rights in EU trade deals, Annex 1

EUROPEAN COMMISSION CLAIM	REALITY CHECK
<p>3. Code of conduct <i>“CETA is the first agreement that has a binding code of conduct for arbitrators acting in an ISDS dispute. The code is based on the ethical rules of the International Bar Association, subject to further revision. It prevents conflicts of interest.”</i></p>	<p>CETA does not contain a binding code of conduct for ISDS arbitrators. Instead, the text merely states that arbitrators “shall comply” with the guidelines of the International Bar Association (IBA), which may be replaced or supplemented by a proper code of conduct to be elaborated up until two years after CETA’s entry into force.⁶⁷ However, the IBA Guidelines on Conflicts of Interest in International Arbitration represent a non-binding and largely ineffective tool of voluntary self-regulation developed by and for the arbitration industry. They did not prevent the emergence of the elite club of law firms and lawyers concentrating a large part of the investment arbitration business. As the contents of the envisaged code of conduct intended to replace or supplement the IBA guidelines are still unknown, it is impossible to maintain that they will avoid conflicts of interest.</p>
<p>4. Shell companies <i>“CETA does not protect so-called “shell” or “mailbox” companies. To be qualified as an investor, it is necessary to have real business operations in the territory of one of the Parties.”</i></p>	<p>Under CETA, only enterprises with “substantial business activities” in their home country are deemed to be investors covered by the agreement’s standards of protection. This provision apparently intends to restrict treaty shopping, i.e., setting up shell companies with the purpose of gaining access to international arbitration. Nevertheless, this clause is likely to be ineffective due to CETA’s extremely broad investment definition including, inter alia, shares, stocks, bonds and loans.⁶⁸ Consequently, a shell company set up in Canada and holding a few shares of a British company would qualify as an investor with “substantial business activities” eligible to sue the UK before an international tribunal.</p>
<p>5. Appellate mechanism <i>“The agreement also provides for the possible creation of an Appeal Mechanism”</i></p>	<p>Similar to the envisaged code of conduct, the option of an appellate mechanism has been shifted to later consultations by a special committee to be created under CETA. This committee shall debate “whether, and if so, under what conditions an appellate mechanism could be created”.⁶⁹ Accordingly, there is no obligation to set up such a mechanism. And it appears unlikely that this will ever happen given negotiators’ failure to agree on an appeals body after years of negotiations.</p>

67. CETA Consolidated text, 1 August 2014, 10. Investment, Article X.25 (Constitution of the Tribunal) and Article X.42 (Committee)

68. CETA Consolidated text, 1 August 2014, 10. Investment, Article X.3 (Definitions)

69. CETA Consolidated text, 1 August 2014, 10. Investment, Article X.42 (Committee)

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