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LEGAL STUDIES RESEARCH PAPER SERIES

Research Paper No. 16

Volume 12, Issue 4, 2016

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Osgoode Legal Studies Research Paper No. 16
Vol. 12/ Issue. 4/ (2016)

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for foreign investor protection in TTIP**

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Abstract:

In November 2015, the European Commission released a proposed text on foreign investor protection in the EU-US Transatlantic Trade and Investment Partnership (TTIP). In this paper, I outline key flaws in this proposal, including language buried in the text that seriously undermines the EC's proposed provisions on the "investment court system" (ICS) and on the right to regulate.

Keywords:

European Commission, TTIP, investor-state dispute settlement, investment court system (ICS), right to regulate

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Key flaws in the European Commission's proposals for foreign investor protection in TTIP

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18 November 2015

In November 2015, the European Commission released a proposed text on foreign investor protection in the EU-US Transatlantic Trade and Investment Partnership (TTIP).¹ The EC's proposal has various flaws arising from concerns about the foreign investor protection system but also detailed aspects of the proposed text. The flaws cast doubt on the EC's claims, in particular, that it has reformed investor-state dispute settlement (ISDS) and that it has safeguarded the right to regulate. They also return us to weaknesses in the EC's proposals for foreign investor protection in agreements like the TTIP. In this paper, I outline six key flaws.

1. ISDS is alive in the EC's proposals

From the start, the EC's approach to foreign investor protection has been based on the widely and rightly criticized process of investor-state dispute settlement.² In its new TTIP proposal, the EC introduces a new acronym to describe ISDS: ICS, which stands for "investment court system".³

Despite my initial enthusiasm about ICS when I read the EC's press release on the topic, and although the details do have positive elements, after a study of the text it became clear that ICS is mainly a re-branding exercise for ISDS. Too many flawed elements of ISDS remain – including elements that give rise to unacceptable appearances of bias among ICS "judges" – to use terms like court and judge without being misleading to the uninitiated.

Most importantly, ICS "judges" would continue to have a financial interest in future claims because they are still paid a (lucrative) daily fee in a context where only one side

¹ European Union, *Transatlantic Trade and Investment Partnership – Trade in Services, Investment and E-Commerce (Chapter II – Investment)*, Draft document tabled for discussion with the U.S. (released 12 November 2015), online: http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf (last visited 17 November 2015) (EC Proposal). The proposal may affect other pending agreements including the EU-Canada Comprehensive and Economic Trade Agreement (CETA) and the EU-Singapore Free Trade Agreement (FTA).

² ISDS is rightly criticized because of its inappropriate reliance on arbitration to make final decisions about public law and policy and about the award of public funds to private actors. Most ISDS cases involve challenges to laws, regulations, judicial decisions, or other sovereign decisions that affect a range of constituencies in society. In this public law context, the use of arbitration conflicts with basic principles of democratic and public accountability, regulatory capacity, budgetary flexibility, judicial independence, and procedural fairness. For a discussion, see G Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: OUP, 2007) ch 7; G Van Harten, *Sovereign Choices and Sovereign Constraints* (Oxford: OUP, 2013) ch 1 and 4.

³ European Commission, "Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations", Press release (16 September 2015).

– foreign investors – can bring claims,⁴ they would continue to operate under the usual ISDS arbitration rules,⁵ they would not have to meet the requirements for judicial appointment in any country,⁶ and they would not even be barred from working on the side as ISDS arbitrators.⁷ I am prompted to say that, if ISDS is “dead”, as some officials have claimed,⁸ then the EC’s ICS proposal reminds me of a zombie movie.

There is one very promising signal in the EC’s proposals – an apparent commitment to establish a proper international court to replace ISDS in existing treaties⁹ – yet this aspect of the proposal unfortunately is put in doubt by the EC’s choices about sequencing, as I discuss below.

2. The case still has not been made for foreign investor protection in the TTIP

The foreign investor protection system gives a special status and, in effect, a public subsidy to foreign investors faced the usual risks of democracy and regulation. In the case of the TTIP, the EC is proposing to expand this system to countries whose courts are reliable, accessible, independent, and indeed much superior to ISDS itself.

Various assertions have been made to justify the expansion of ISDS in this unorthodox context. Yet they are never, in my experience, accompanied by any real evidence to show that European or U.S. courts have systemic failings to justify giving such an extraordinary international remedy to foreign investors alone.

For example, the EC has said that ISDS is needed to protect small and medium enterprises (SMEs). However, the EC does not provide evidence of actual benefits of ISDS for SMEs nor does it address the extensive evidence of significant costs. As an illustration of the latter, SMEs have recovered only a tiny fraction of compensation ordered by ISDS tribunals in known cases and, for the vast majority of SMEs that have brought ISDS claims, the legal and arbitration costs of doing so appear to have exceeded

⁴ EC Proposal, above note 1, Section 3, Article 9(14) (linking financial remuneration to frequency of claims by incorporating generous daily rates paid to ISDS arbitrators under the ICSID regulations).

⁵ EC Proposal, above note 1, Section 3, Article 6(2) (allowing for foreign investor claims under the ICSID Rules, ICSID Additional Facility Rules, and UNCITRAL Rules, all of which are commonly-used arbitration rules in ISDS).

⁶ EC Proposal, above note 1, Section 3, Articles 9(4) and 10(7) (facilitating the appointment of the non-judges who currently dominate ISDS by adding the flexible category of “jurists of recognised competence”).

⁷ EC Proposal, above note 1, Section 4, Article 11(1) (omitting the word “arbitrator” from the list of prohibited side roles of ICS “judges”).

⁸ e.g. D Vicenti, “Pittella: ISDS is dead, EU-Canada trade deal must be reopened” *EurActiv.com* (3 July 2015).

⁹ European Commission, above note 3 (“... the Commission will start work, together with other countries, on setting up a permanent International Investment Court. The objective is that over time the International Investment Court would replace all investment dispute resolution mechanisms provided in EU agreements, EU Member States’ agreements with third countries and in trade and investment treaties concluded between non-EU countries. This would further increase the efficiency, consistency and legitimacy of the international investment dispute resolution system.”) (emphasis added).

any compensation received.¹⁰ Worse, domestic investors and citizens have no right whatsoever to protection in ISDS, while ISDS can be used to pressure governments to appease large multinationals and extremely wealthy foreigners. In short, ISDS skews decision-making and the marketplace in favour of bigger foreign players at the expense of smaller and domestic ones.

Any proposal to give special privileges or public subsidies to any economic actor – here, the largest and wealthiest in the world – calls for a strong justification based on clear evidence of the public benefit. The absence of such a justification and evidence has been a serious omission in the EC’s proposals for foreign investor protection from the very start.¹¹

3. The EC’s proposals are fundamentally imbalanced

The EC is proposing exceptionally powerful rights and privileges, without any actionable responsibilities, for foreign investors.¹² Again, the EC gives no serious justification for this discrimination in favour of foreign investors over domestic investors and citizens.

If the EC was committed to balance, it would ensure at least that ISDS could be used to hold foreign investors to account if they flaunt labour, environmental, consumer, or other standards in situations where domestic or European institutions do not offer an effective remedy.¹³ The EC’s proposal takes no steps at all toward such a balance.

The way forward on this issue is clear, I suggest. The EC should establish actionable responsibilities for foreign investors by allowing a host country or affected third party, such as a trade union or a local community, to bring a claim (or, more modestly, a counter-claim) against a foreign investor *in the very same process* that is used to enforce foreign investor protections.¹⁴ That is a basic test for evaluating balance in the EC’s proposals. At present, the EC’s proposals are the opposite of balanced.

¹⁰ G Van Harten and P Malysheuski, “Ordered financial transfers due to ISDS: Size and wealth of beneficiaries”, Draft study prepared for the University of Oslo’s PluriCourts project (forthcoming). In the EC’s proposal, the minor changes to ISDS for SMEs do little to address the core issues that the disputed amounts at stake for SMEs would rarely justify the cost of bringing an ISDS claim, that the relative availability of ISDS for large multinationals puts SMEs and domestic investors at a competitive disadvantage, and that the financial dependence of ISDS arbitrators (and ICS “judges”) on future claimants works in favour of large multinationals that are more likely to be repeat players in ISDS. If the EC wanted to protect SMEs from mistreatment abroad, there are much better options than ISDS. For example, the EC could establish an SME political risk insurance program that entailed the redirection of money from ISDS lawyers and arbitrators to actual compensation for the most seriously harmed SMEs.

¹¹ G Van Harten, “Comments on the European Commission’s Approach to Investor-State Arbitration in TTIP and CETA”, Osgoode Legal Studies Research Paper No 59/2014 (3 July 2014), online: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2466688.

¹² Ibid.

¹³ In its proposals, the EC has questioning the effectiveness of domestic institutions in all countries to protect foreign investors. Yet, if we accept the EC’s concern about domestic institutions, it follows that domestic institutions may fail to enforce foreign investors’ responsibilities too. There is a basic imbalance in establishing powerful and highly-enforceable rights, but not responsibilities, for foreign investors.

¹⁴ It is especially important that the process be the same so that awards for or against foreign investors are both internationally enforceable.

4. The EC's proposals put poison pills into the "right to regulate"¹⁵

The EC has proposed to put a right to regulate into the TTIP text.¹⁶ However, the EC has included poison pills in the relevant text that appear designed to kill the right to regulate in future ISDS cases. The key poison pills are as follows.

- i. The wording of the right to regulate in Article 2(1) includes a "necessity test" for state decisions that are protected by the right to regulate. While this test might sound reasonable on its face, it has been applied in exceedingly strict ways by a large majority of ISDS tribunals faced with the issue.¹⁷ One who knows the record of ISDS tribunals therefore should also know that a necessity test is the surest way to make it very hard for a challenged law, regulation, or other decision to qualify for protection under the right to regulate.¹⁸
- ii. The wording of the right to regulate in Article 2(1) – when interpreted in the context of the express prohibition any requirement for states "to compensate the investor" that is included in Article 2(4) but not in Article 2(1)¹⁹ – makes it clear that compensation orders by ISDS tribunals for new laws, regulations, or other decisions are not precluded or limited by the right to regulate in Article 2(1). This discrepancy creates a big gap in the EC's proposal because compensation orders, and the potentially huge price tag they put on future state decisions,²⁰ are at the heart of the concerns about ISDS and the right to regulate.

¹⁵ The "right to regulate" in foreign investor protection system is a euphemism for decision-making by institutions of democracy, regulation, government, and courts in countries. Using the term reduces these institutions to a position of equality with foreign investor protection in the priorities of the state. Keeping that in mind, it is remarkable that, to date, the EC did not even include a statement on the right to regulate in the investment chapters it proposed in the CETA with Canada or FTA with Singapore.

¹⁶ EC Proposal, above n 1, Section 2, Articles 2(1) and 2(2). The problematic language in Article 2(1) is underlined in the following text of Article 2(1): "The provisions of this section shall not affect the right of the Parties to regulate within their territories through measures necessary to achieve legitimate policy objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity." For stronger language that precludes ISDS compensation orders and that does not apply a necessity test, albeit only to protect certain types of subsidies, see Articles 2(3) and 2(4).

¹⁷ G Van Harten, *Sovereign Choices and Sovereign Constraints* (Oxford: OUP, 2013), p 66-68.

¹⁸ For example, the necessity test has been applied to require that a country made no contribution to the state of affairs requiring the passage of the law or regulation and that the country selected the policy option that would have the least impact on the foreign investor (in circumstances where the state often cannot know with reasonable certainty how an ISDS tribunal will assess its past policy options in an ISDS proceeding and a team of lawyers for a multinational will be attacking whatever policy option the state did choose to adopt). *Ibid.*

¹⁹ The explicit override, which is missing from Articles 2(1) and 2(2), is underlined in the following text of Article 2(4): "For greater certainty, nothing in this Section shall be construed as preventing a Party from discontinuing the granting of a subsidy and/or requesting its reimbursement, or as requiring that Party to compensate the investor therefor, where such action has been ordered by one of its competent authorities listed in Annex III." EC Proposal, above n 1, Section 2, Articles 2(1) and 2(2).

²⁰ See G Van Harten, *Sold Down the Yangtze: Canada's Lopsided Investment Deal with China* (Toronto: Lorimer, 2015), p 96-100.

- iii. Similarly, in Article 2(2), the wording of the state’s right to “change the legal and regulatory framework”, read again in the context of Article 2(4), makes it clear that compensation orders for legal or regulatory changes are also not precluded or limited by the state’s right in Article 2(2).
- iv. Although Article 2(2) appears to block awards of expected profits, the compensation orders mentioned in items ii. and iii. above would typically include reasonable-expected lost profits for foreign investors.²¹ As I explained above, Article 2(2) does not apply to compensation orders by ISDS tribunals. As a result, the language in Article 2(2) on expected profits would not apply to compensation orders. Rather, the arbitrators’ general power to award monetary compensation, which is used regularly to award lost profits, takes over. In the EC’s proposal, this general power is found in Article 28(1).²²

These textual details greatly undermine the EC’s proposal on the right to regulate and the right to change the legal and regulatory framework. Indeed, they suggest that the EC is pretending to protect the right to regulate, while leaving catches in the text that return us to the usual concerns about ISDS. The text on this point is a good case study for how legal language can be written in ways that may give a false impression of security to the uninitiated.

Under the EC’s proposal, foreign investors can still use ISDS – as they have in most ISDS cases so far – to attack state decisions in areas of agriculture, consumer protection, culture, energy, environment, financial security, intellectual property, land use, mining, public health, taxation, or transportation.²³ Likewise, ISDS tribunals can still order vast amounts of public compensation for foreign investors in any of these areas.²⁴ The EC’s proposal does not alter this situation.

²¹ The language in Article 2(2), with the weaker language underlined, is as follows: “For greater certainty, the provisions of this section shall not be interpreted as a commitment from a Party that it will not change the legal and regulatory framework, including in a manner that may negatively affect the operation of covered investments or the investor’s expectations of profits.” EC Proposal, above n 1, Section 2, Article 2(2).

²² This assessment is based on the regular practice of ISDS tribunals to award reasonably-expected lost profits to foreign investors under the tribunals’ general power to award damages under Article 28(1). I do not see this general power as being limited by the language in Article 2(2) that refers to expected profits in the context of how foreign investors’ protections are “interpreted”. The interpretation of the substantive obligations of foreign investor protection is a separate step from the award of damages under Article 28(1). EC Proposal, above n 1, Section 3, Article 28(1).

²³ G Van Harten, *Sovereign Choices and Sovereign Constraints* (Oxford: OUP, 2013), p 10-14 and 82-89.

²⁴ Instead, the relevance of the new substantive language in the EC’s proposal is to the likelihood of success of future ISDS claims. On this issue, the proposal as a whole does not make a clear difference either way when compared to the text of the CETA with Canada, for example. If pressed, I would say that the EC’s TTIP proposal increases the overall likelihood of success for foreign investors due to the inclusion of a (dangerous) umbrella clause, which outweighs any benefit from the Article 2 language on the right to regulate and on changes to the regulatory framework due to the poison pills in Article 2.

5. The EC's proposal remains disrespectful of domestic institutions, including domestic and European courts

The EC's proposal is still premised on an assumption that EU and US courts are so flawed that foreign investors should be able to bring an ISDS claim without having to demonstrate that it would be unreasonable for the foreign investor to seek relief first in the courts.

This assumption is inherent in the EC proposal not to include the standard duty of all individuals to go first to a country's courts, where they offer justice, before pursuing an international remedy.²⁵ Foreign investors alone have been excused from this duty, thus exacerbating the imbalances created by ISDS.

Instead of including a standard duty to exhaust local remedies, the EC has introduced a complicated "U-turn" clause. This clause prevents foreign investors from turning back from ISDS, once they have resorted to ISDS. Yet it does nothing to require foreign investors to use the courts first or to explain why they are going to ISDS instead of to the courts. Foreign investors can choose to avoid the courts, they can turn back from the courts at any point to pursue ISDS instead, and they can use ISDS to seek compensation for a court's decisions at any level.

This arrangement is an extraordinary gift for foreign investors, not available to anyone else who might need international protection. In turn, domestic investors and citizens in general are disadvantaged. They must deal with the usual risks of democracy and regulation in the usual ways: by taking part in the democratic process, by buying insurance, by bargaining for strong dispute settlement clauses in their contracts with government, or by relying – like everyone else – on the courts.

6. If the EC is serious about an international investment court, why is it proposing to expand ISDS in the TTIP?

I worry that the EC is using the language of an international investment court to give cover for a huge expansion of ISDS.²⁶

²⁵ The duty to resort to domestic courts before seeking an international remedy is important for many reasons. It creates an intermediary between domestic institutions and international review; it allows an international tribunal to see how domestic courts characterize and resolve a dispute in the context of domestic law; it respects domestic institutions by giving them an opportunity to resolve a dispute; it checks undesirable legal maneuvering; it supports the principles of sanctity of contract and free markets by requiring foreign investors to resort to any contractually-agreed remedies; and it creates an incentive for foreign investors to consider carefully the reliability of a country's institutions when deciding whether to enter the country.

²⁶ If the TTIP is concluded, it would roughly triple the scope of the foreign investor protection system beyond all existing ISDS treaties. It would also expand greatly the exposure of the United States and Western European governments to ISDS. Other trade agreements – such as the CETA with Canada or the FTA with Singapore – would also expand the scope of foreign investor protection significantly. Finally, like the TTIP, they would make it practically impossible for countries to withdraw from ISDS by terminating the hundreds of bilateral investment treaties that allow for ISDS. Instead, ISDS would be

As noted earlier, the EC's ICS proposal falls well short of establishing a court with independent judges. And, while the EC has signalled that it will work toward an full-blown international court to replace ISDS, if this is the goal then the EC's sequencing appears backwards. Logically, the EC should be pushing to transform existing treaties so that ISDS is replaced with an international court before the EC goes to the U.S. with its proposals. In past, the U.S. government has not welcomed the idea of new international courts. The fact that the EC has done the opposite – by floating a version of ISDS with the U.S. before pursuing a proper court with other countries – seems to undermine the EC's credibility on the issue of an international investment court.

Conclusion

For six reasons, the EC's proposal for foreign investor protection in TTIP are flawed:

1. ISDS lives on in the details of the EC's proposal.
2. There is still no evidence-based justification for including extraordinary protections for foreign investors in the TTIP and similar agreements.
3. The proposal does not include any responsibilities for foreign investors that can be enforced in the same process as foreign investors' elaborate rights and protections.
4. The EC has buried poison pills inside the details of the "right to regulate".
5. The proposal remains disrespectful of domestic institutions, including domestic and European courts.
6. The EC's proposal for an international investment court lack credibility because the EC has proceeded first with a proposal for ISDS in the TTIP.

There is a viable alternative to this state of affairs. The EC could decline to pursue new treaties based on ISDS. It could work to establish an international judicial process that replaces ISDS in existing treaties. It could ensure that the law of foreign investment is balanced by permitting foreign investor rights and responsibilities to be enforced in the same process. It could ensure that this area of law is respectful of domestic institutions based on longstanding principles of international legal protection for all individuals. The EC could do all of these things, and it should.

embedded in a larger trade agreement on which broad sectors of a country's economy would become dependent over time.