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A Summary of Public Concerns on Investment Treaties and Investor-State Dispute Settlement

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NOTE

This paper is a new, expanded version of an article by the author published in his Global Trends column in Malaysian daily *The Star*, and the introductory chapter of the book *Investment Treaties: Views and Experiences from Developing Countries* published by the South Centre.

1 Introduction

IN recent years there has been a great amount of discussion on the problems surrounding international investment treaties, specifically bilateral investment treaties (BITs) as well as the investment chapter in many free trade agreements (FTAs). The increased discussion has seen the issues reach the point of controversy and even brought these investment treaties into a crisis of credibility. Intense discussions on the investment issues have been held at various venues including at the United Nations Conference on Trade and Development (UNCTAD), the UN Human Rights Council, the European Parliament, numerous civil society meetings and various national fora. There is now a search, internationally as well as regionally and nationally, for solutions to the manifold problems associated with these investment treaties.

A similar model exists in many of the BITs and many of the investment chapters of FTAs, especially those that involve the United States and the European Union. The controversial aspects include the provisions of these treaties and the investor-state dispute settlement (ISDS) system. Under ISDS, foreign investors can bring the host-country government to an international arbitration tribunal, and if an award is given against the government, it has to pay monetary compensation or face the prospect of its assets being seized abroad. There have been many cases of huge awards being granted by tribunals to foreign investors, and this may be the main reason why the investment treaties have become so controversial, as the affected host governments and the public in their countries have often been upset and even outraged by the tribunal decisions and awards. However, it is not only the arbitration system

but also the provisions of these investment treaties that are a major part of the problem. Indeed, these provisions may be the root of the problem.

This short paper gives a summary of the problems that countries have encountered with BITs and FTA investment chapters, and the actions that some of them have taken in response, as well as some of the responses of civil society, academics, the media and some international organisations. This paper is by no means comprehensive as it only intends to give a broad picture of the controversy.

2 Controversial Provisions of Investment Treaties

THERE are several provisions in BITs and the investment chapters of FTAs that give rise to problems, including those that relate to ISDS. The relevant provisions which an investor can cite as the basis of an ISDS claim are very broad and can be defined and interpreted in a manner favourable to and biased towards the investor's rights vis-à-vis the host state. As a result, the host government's possible (and natural) defence, that its behaviour or action was in accordance with national laws and objectives or social and public policies, is not likely to be sufficient. The following are among the problematic provisions:

- The **definition and scope of "investment"** is very broad; it covers all kinds of assets including direct investment, portfolio investment, credit, derivatives, contracts, intellectual property rights (IPRs), and expectations of future gains and profits. Thus ISDS cases can be brought if an investor feels aggrieved about how any of these "investments" are affected. Most notably, an investor who feels that his or her "expectations of future profits" are affected by a new policy or regulation or even by the non-renewal of a contract, could bring a case against the host state and expect to succeed.

- **National treatment.** Under this provision, the foreign investor has the right to be treated "no less favourably" than local investors, i.e., similar to or better than local investors. The foreign investor can claim to be discriminated against if the local investor is given a preference or other advantage. However, foreign investors themselves can be treated more

favourably. Notably, only foreign investors can bring ISDS cases against the state; this is a most favourable treatment giving great advantages to foreign investors vis-à-vis local investors.

- **Fair and equitable treatment.** This provision has been interpreted by some ISDS tribunals as requiring a stable legal and business framework or predictable investment environment for the investor. Investors have sued on the ground of non-renewal or change in the terms of licences or contracts, and changes in policies or regulations (including economic, health and environmental measures) that the investors claim will reduce their expectations of future profits. Claims of unfair treatment can be "practically limitless" in scope, according to a study by UNCTAD. This provision is invoked in many ISDS cases, sometimes in combination with other provisions. "Fair and equitable treatment" has been found to have been violated in 81% of cases won by investors which alleged a violation of FET among other provisions, according to a paper by the US non-governmental organisation Public Citizen on disputes under US trade or investment treaties.[1]

- **Expropriation.** Under this provision, "expropriation" is usually defined as direct expropriation (e.g., government takeover of a property) as well as indirect expropriation, in relation to which tribunals have ruled in favour of investors that claimed losses (including reduced expectations of future profits) due to changes to existing policies or the introduction of new government policies, measures and regulations.

- **Pre-establishment rights.** Many BITs and FTAs have this provision, which grants rights to the investors of the partner country to enter and establish themselves in the host country on terms no less favourable than those it accords to its local investors, as well as to acquire, expand, manage, operate and dispose of their property.

[1] http://www.citizen.org/documents/MST-Memo.pdf

- **Performance requirements.** Some investment treaties prohibit the host country from imposing on foreign investors performance requirements such as requirements to establish joint ventures with local investors, transfer technology and use local content, and limits on equity ownership. The host country would thus not be able to enjoy the benefits of such policies.

- **Freedom of capital flows.** The foreign investor is enabled to freely transfer capital into and out of the country as well as repatriate its profits. There are thus limits to the regulation and control over capital flows by the host state.

- **"Survival clause."** Many BITs have a clause that prolongs the practical effect of the treaties even after withdrawal by a party or expiry of the BIT. Under this clause, the provisions of the BIT will still be in force for many years (for example, 10 or 15 years) after the withdrawal or expiry. It is thus difficult to "escape" from a BIT. If a country finds it has made a mistake by signing a BIT and wishes to withdraw from it, or to not renew the BIT upon expiry, it will still have to abide by the rules of the BIT for many years. Also, if a party to a BIT does not give a notice of withdrawal upon expiry, the BIT is deemed to roll over and continue, usually for another similar period.

- **Dispute settlement system.** A major problem, as mentioned above, is that most BITs and some FTAs contain an investor-state dispute settlement system. Details are provided below.

3 Problems with the Investor-State Dispute Settlement System

ISDS is a mechanism in most BITs. It enables the foreign investors of BIT countries to directly bring a case against the host government before an international tribunal. In most BITs, a few tribunals are mentioned (the most used being the International Centre for Settlement of Investment Disputes (ICSID) based at the World Bank in Washington) and the investor is often given the right to choose the specific tribunal.

ISDS provides a powerful system for enforcing the rules of the BITs. Any foreign investor from countries in a BIT can take up a case claiming that the host government has not met its relevant BIT obligations. If the claim succeeds, the tribunal could award the investor financial compensation for the claimed losses. If the payment is not made, the award can potentially be enforced through the seizure of the government's assets.

The ISDS system of arbitration has come under heavy criticism, including for the following reasons:

- The decision of the tribunal is final, as there is no appeal mechanism. Thus a country involved in an arbitration case has to accept the decision, including the award, if any, even if it is dissatisfied with the decision and the reasoning behind it.

- The tribunal decisions are often seen to be arbitrary and have been known to contradict decisions of other tribunals in similar cases. There is no

system of precedent or accountability to a higher court, unlike in the national judicial systems of most countries.

- There is a perception, at least among many academics and civil society groups, that many of the tribunals have shown a pro-investor bias, taking the view that the investment treaties are mainly or solely to protect investor rights while the governments' rights are considered of lesser value.

- There exists a serious conflict-of-interest situation in the arbitration system and in some specific cases. A few lawyers monopolise the investment arbitration business, and they may act as lawyers in one case and as arbitrators in another. Many of their firms are also known to seek and encourage investors to take up cases.

A small group of lawyers, working either for investors or as arbitrators, and who are mainly based in Europe or North America, have been benefitting from the boom in litigation linked to investment agreements, according to a 2012 report by two European groups, Transnational Institute and Corporate Europe Observatory.

The report, *Profiting from Injustice*, revealed that:

- Only 15 arbitrators, nearly all from Europe, the US or Canada, have decided 55% of all known investment-treaty disputes. This small group sit on the same panels, act as both arbitrators and counsel and call on each other as witnesses.

- Many arbitrators show a clear bias towards investors. Several prominent arbitrators have been members of the board of major multinational companies, including those which filed cases against developing countries.

- In one case, the chair of a tribunal that ruled against Argentina was later found to be a board member of the largest shareholder of the firm that had sued and won. Yet a review panel ruled that the decision would remain and that there was no need for the case to be heard again by another panel.

- A few law firms have been encouraging investors to sue governments as a weapon to weaken or prevent laws on public health or the environment. These investment lawyers are the new “ambulance chasers” and have fuelled an increase in cases from 38 in 1996 to 450 known cases in 2011.

- Countries have to pay exorbitant legal and arbitration costs averaging over $8 million per dispute and exceeding $30 million in some cases. The Philippines spent $58 million defending two cases against a German firm.

- Lobbying by arbitration law firms and arbitrators succeeded in stopping reform of investment agreements in the EU and US in recent years.

- “[F]airness and independence of investment arbitration is an illusion.”

4 High Claims and Awards, and Strong Enforcement

MANY of the ISDS claims have tended to be very high in recent years, running even to billions of dollars. The awards are usually lower, but some recent ones have also been very high, such as the $2.3 billion award granted to an American oil company against Ecuador. The ability to enforce these awards through seizure of assets owned abroad by the government makes ISDS a very powerful instrument. Some notable cases include:

- An award by ICSID to US oil company Occidental against Ecuador for $2.3 billion (main award $1.7 billion and interest $0.6 billion). The tribunal recognised that Ecuador cancelled its contract because the company had violated a key clause (it sold 40% of the concession to another company without permission), but gave the huge award nevertheless.

- A case was brought against South Africa by a European mining company making use of the provisions of fair and equitable treatment and expropriation, claiming that it was affected by the government's black empowerment programme. The case was settled. The lessons of this case prompted a Cabinet review and decision to withdraw from the country's existing investment treaties.

- A $2 billion claim was made against Indonesia by UK-based oil company Churchill after its contract with a provincial government was cancelled by the central government because it was not in line with the law.

- Australia has been sued for billions of dollars by the tobacco company Philip Morris because of its regulation on cigarette "plain packaging", under which cigarette boxes cannot promote the logo and brand names. This strengthened the Australian government's policy at that time not to have ISDS provisions in its future FTAs or other investment treaties. A case has also been brought against Uruguay by the same company for alleged breaches of the Uruguay-Switzerland BIT by requiring cigarette packs to display graphic health warnings. The company claims that the packaging requirements in both countries violate its investment, including its trademark which, as an intellectual property, is an investment asset.

- A Swedish company brought two cases against Germany for the latter's environmental policies requiring tighter regulations on coal-fired power plants to reduce carbon emissions, and phasing out nuclear power following the Fukushima nuclear disaster.

- US company Renco sued Peru for $800 million because its contract was not extended after the company's operations caused massive environmental and health damage.

5 Some Implications of BITs and ISDS

THE implications of the ISDS mechanism have been considered by analysts and policymakers as manifold and serious. These include:

- Acceptance of the BIT rules can carry very onerous implications because the government can be sued in an international court and thus will be constrained when formulating its future policies or implementing existing policies.

- It is difficult for the government to make or change policies as it cannot predict whether the move is allowable, since it is uncertain how a tribunal will view this; the view of one tribunal can differ from that of another.

- A wide range of policy areas that lie at the core of socio-economic development will be affected, including investment policy, equity shares, financial flows, capital controls and financial stability; health, safety and environmental policies; intellectual property and prices of or access to medicines and educational materials; and government procurement policies. There may be a "chilling effect" in being discouraged from adopting certain policies because of the possibility or fear of being sued.

- The country's judicial sovereignty will be affected. Investors will choose to take up cases in the international tribunal where their chances of success are stronger and the payout higher compared with local courts. Alternatively, if they lose a case in the local court, they can take it up

again in the international tribunal and possibly win. Local courts would consider the case on the basis of national laws, while the tribunal will instead refer to and interpret treaty provisions and international law.

- Likewise, policies made by the government and laws adopted by parliament can be challenged by foreign investors and the decisions will be made by a tribunal outside the country.

- The country will become vulnerable to million-dollar and billion-dollar legal suits brought by foreign private investors. This may potentially cost the government much in the way of financial resources.

An interesting letter (in April 2015) signed by eminent US legal and economic experts, including Laurence Tribe of Harvard Law School (President Barack Obama's law professor when he studied at Harvard), argued that ISDS undermines the US justice system. "ISDS weakens the rule of law by removing the procedural protections of the legal system and using a system of adjudication with limited accountability and review. It is antithetical to the fair, public, and effective legal system that all Americans expect and deserve," stated the letter.

6 Tide Turning Against Investment Treaties

THE problems associated with investment treaties and ISDS have led to serious rethinking about their benefits and desirability, or lack thereof. Strong criticism has come from civil society, academics and public intellectuals as well as policymakers in both developing and developed countries.

Some developing countries have taken measures to terminate their BITs, usually by not renewing them when they expire, or are considering withdrawal. Some countries are formulating their own model BITs which would not contain some of the controversial provisions of traditional BITs. Some countries have also withdrawn from membership of ICSID.

South Africa undertook a Cabinet review of its BITs after a case brought against it in relation to its black empowerment programme. It decided to withdraw from its BITs when each of them expires. It also introduced a national law on investment in which the rights of investors are balanced with the right of the state to make and implement policies in the national interest. Namibia is also considering a similar move.

Indonesia has announced a policy to withdraw from its BITs upon their expiry. It is also in the process of developing its own model BIT.

Bolivia, Venezuela and Ecuador have withdrawn their membership of the ICSID Convention. Bolivia has also withdrawn from its BITs. Ecuador established a commission to analyse its existing BITs, and its findings are expected to lead to a withdrawal from many of them.

India has formulated a model BIT which is more balanced than the traditional BITs. It has not been renewing many of its BITs upon their expiry and is using the model BIT to discuss possible future investment treaties.

Interestingly, the disillusionment with investment treaties has also become increasingly evident in recent years in developed countries, their institutions and their media. The term "toxic" has been used by leading Western politicians and financial media to describe ISDS.

The German government announced a few years ago that it did not want the ISDS system to be inside the Transatlantic Trade and Investment Partnership (TTIP) that the European Commission was negotiating with the US. This was a remarkable turnaround since Germany had been one of the main advocates of BITs. One reason for this could be the aforementioned two cases brought against the country by a Swedish company claiming billions of euros because of the German policies to phase out nuclear power and tighten emissions regulations in power plants.

Germany was not the first developed country to rethink its stance on ISDS. Earlier, the Australian government had decided not to enter into any new BITs or FTAs that contain ISDS; this could have been influenced by the Philip Morris case against its cigarette plain packaging measures. (Under a subsequent administration, Australia watered down this ban by considering membership of FTAs with ISDS on a case-by-case basis.)

Two top officials of the European Commission, the President Jean-Claude Juncker and the Trade Commissioner Cecilia Malmstrom, when they were newly appointed, made known their scepticism if not opposition to ISDS. The Trade Commissioner even called ISDS "a very toxic issue". Both officials hinted that they would make it difficult for future EU trade deals to contain ISDS in its normal form. They were partly responding to the European Parliament, many of whose members were strongly opposed to having ISDS in the TTIP. The Socialists and Democrats in the European Parliament issued a statement (21 January 2014) that accepting ISDS would open the door for

big corporations to enforce their interests against EU legislation, and they requested the European Commission to drop ISDS within the TTIP altogether.

European non-governmental organisations (NGOs) are also up in arms against ISDS, accusing the international tribunals that hear the cases of being heavily biased in favour of investors and against the states, and also of being riddled with conflict-of-interest situations. Over a million people in Europe signed petitions against the TTIP, with the main focus of popular concern being the inclusion of ISDS in the proposed agreement.

The Secretary-General of the Organisation for Economic Cooperation and Development (OECD), a grouping of rich countries, wrote an opinion piece on the "increasing problems" of investment treaties. The *Financial Times* and *The Economist*, two of the most prominent pro-free enterprise newspapers in the Western world, also joined in the onslaught against BITs. The *Financial Times* even published a full-page article on what it headlined as "toxic deals".

The winds of change were also evident when representatives of many governments and organisations spoke in favour of urgent reform of the whole ISDS system at the World Investment Forum organised by UNCTAD. Although there were also defenders of the system, there were many criticisms against ISDS, including that the provisions of the treaties are problematic, the arbitration system is biased and flawed, and that national laws, parliaments and government policies are being seriously undermined by allowing foreign investors to bypass them by taking up cases in international tribunals that do not take account of the national laws when making their decisions.

In the US, whose government is the staunchest supporter of the traditional investment treaties whether BITs or FTAs, there has been a strong NGO, trade union and academic movement against these treaties, especially ISDS. Some members of the US Congress have also spoken up critically against the investment chapters of US FTAs, particularly the Trans-Pacific Partnership (TPP) agreement. Some 120 legal scholars from the US and Europe signed a statement opposing ISDS in the TPP.

7 Conclusion

GIVEN the problematic provisions, the flaws in the arbitration system, the survival clause and the many risks, countries should be very cautious about signing on to a BIT of the normal type. The risks and potential costs can be seen to outweigh the benefits.

There are interesting options for developing countries that would like to rethink their participation in BITs or even to withdraw from the BIT system. Following recent experience, these options include conducting a review of the country's BITs to assess their costs and benefits; withdrawing from the ICSID Convention; and attempting to renegotiate the BITs with its partners.

If the country has concluded that the BITs are inappropriate and pose serious risks, it can withdraw from the treaties, including by non-renewal when they expire. Dealing with the survival clause is a challenge, but renewing the BITs for yet another term would prolong the period during which the country has to bear the risks. Some countries have also drawn up their own model BIT, which can then be used to renegotiate the existing treaties or to negotiate new ones. There are also countries which have formulated a national law on investor protection that balances investor rights with the rights of the state to regulate investments and to make policies in the national interest. Countries that have lost faith in the traditional BITs should also be very cautious about negotiating FTAs that contain an investment chapter with the traditional provisions and ISDS.

At the international level, the debate on what to do about the investment agreements will rage on. Most supporters of the system continue to insist there is nothing wrong with it. Some may acknowledge flaws in the system, particularly in the ISDS mechanism, but propose only small changes (such as establishing an appellate body to deal with appeal cases) while largely maintaining the provisions.

In contrast, others believe that the system is fundamentally flawed and that a thorough revamp is required. For them, the alternative would be an agreement which balances the legitimate rights of foreign investors with the rights of the state to regulate investors and to have laws and policies in the national and public interest. It will take some time to move from the present system to the alternative one, or alternative ones, but this shift is required to correct the situation wrought by some of the most unfair economic treaties in the world.

A SUMMARY OF PUBLIC CONCERNS ON INVESTMENT TREATIES AND INVESTOR-STATE DISPUTE SETTLEMENT

International investment agreements, specifically bilateral investment treaties and the investment chapters in free trade agreements, have come under the spotlight for what are seen as skewed provisions that grant excessive rights to foreign investors and foreign companies at the expense of national policymaking flexibility. Of particular concern is the investor-state dispute settlement framework embedded in many of these treaties, which enables foreign investors to sue host-country governments in opaque international tribunals.

The serious risks involved have prompted a rethink of investment pacts in developing and developed countries alike. In place of the current lopsided system, calls are growing for agreements which would balance legitimate investor rights with the rights of the state to regulate investment and formulate policies in the public interest.

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is a series of papers published by **Third World Network** on trade and development issues that are of public concern, particularly in the South. The series is aimed at generating discussion and contributing to the advancement of appropriate development policies oriented towards fulfilling human needs, social equity and environmental sustainability.

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