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Future of Investment Law without Investor-State Dispute Settlements

Introduction

With the TTIP and CETA trade agreements, investor-state dispute settlements (ISDSs) have come to the attention of the general public due to the fact that they are now becoming a more serious danger even in OECD countries. We oppose the inclusion of investor-state dispute settlements in TTIP and CETA. But it must not be overlooked that the so-called developing countries in particular have been suffering under these extrajudicial grievance mechanisms, which are part of numerous bilateral investment protection agreements, for a long time. For example, the Canadian company Pacific Rim is suing the government of El Salvador for failure to meet anticipated profits of US$ 301 million because the Salvadoran parliament imposed a mining moratorium due to the massive social and ecological damage that was being inflicted on its country and it has not issued any mining permits since then. Germany alone is party to 129 bilateral investment agreements, 85 of which include ISDSs. The EU, which has been responsible for investment policy since the Treaty of Lisbon, is currently preparing other agreements that are to include ISDS. How are we to deal with investor-state dispute settlements beyond TTIP and CETA? This paper will analyze the problems associated with ISDSs and illustrate various alternatives. We support replacing private ISDSs with a public, international investment court.

Violation of Democratic Principles Based on the Rule of Law is Unacceptable

ISDSs allow foreign companies to bring their "host states" before international arbitral tribunals if they believe that the extensive property rights granted to them in investment agreements have been violated. ISDSs therefore violate fundamental principles of our conception of democracy, above all the rule of law. The fact that ISDSs are not new but rather constitute a system that is already built into many trade agreements does not make the issue any better – it only illustrates the need for action all the more clearly.

The central pillar of the rule of law is the neutrality and independence of courts and judges. Unlike existing national courts, tribunals are composed ad hoc of three private arbitrators who are chosen by the parties to the agreements themselves from a small elite circle and who simultaneously work as attorneys at firms that represent the plaintiffs in ISDS proceedings. In these proceedings, this circle of arbitrators is subject to tremendous institutional incentives to increase the number of arbitration proceedings through corresponding legal interpretations because it increases their profits. Moreover, ISDS proceedings are financed by investors who take home a significant share of the compensation amounts if they win, which also creates negative incentives. Consulting and representing companies involved in ISDS proceedings has become a market unto itself – one that turns enormous profits from governmental payments in compensation for damages. As a result, neither judges nor attorneys are independent or neutral in the ISDS system.

Our system of rule of law guarantees public and transparent proceedings that constitutionally and legislatively ensure the independence of the court (Art. 20(3) of the Basic Law for the Federal Republic of Germany (GG), Art. 97(1) of the GG, Section 42 of the German Code of Civil Procedure (ZPO), to name just a few examples) and offer the possibility that rulings might be reviewed through appellate proceedings. ISDS proceedings do not meet these minimum requirements of the rule of law.

As the name implies, ISDS proceedings are only available to investors. They alone are able to bring charges. Moreover, only foreign investors can bring charges against a state. Domestic companies, by contrast, only have recourse to state courts. This creates distorted incentives to fictitiously relocate corporate headquarters abroad as a way of avoiding normal state actions. Vague terms like "indirect expropriation" or "fair and equitable treatment" de facto allow any regulatory intervention, e.g., for purposes of environmental protection or social concerns, to be misused as a basis for bringing charges.

This system may have once been justified by actual arbitrary expropriations. The soaring increase in suits in recent years (of 568 known cases since 1987, 166 occurred in the last three years alone), the unknown number of unpublished proceedings, the development of an expensive elite of attorneys who specialize in investor-state suits, as well as influential and globally active businesses that utilize the services of these attorneys show that the ISDS system has lost all legitimacy. Consequently, we no longer have companies that need protection from arbitrary state actions but states that need protection against interventions into their rights of sovereignty and their scope of democratic action.

ISDSs additionally breed enormous legal costs: Proceedings cost an average of US$ 8 million in addition to very high claims to compensation for damages – amounts in the tens of millions are not unusual. It must also be kept in mind that investment arbitration has always had a tendency to divide the procedural legal expenses among both parties instead of having the losing party pay. For that reason, taxpayers may pay even when the state wins.

Even the threat that companies and economic lobbyists might bring an action against a planned law can have a chilling effect on the legislative process. New Zealand, for example, decided not to implement new, stricter packaging requirements for cigarettes until an action brought by Philip Morris against Australia about the same issue was resolved. The German coal-fired power plant Kohlekraftwerk Moorburg likewise lowered its environmental standards due to an action by Swedish power company Vattenfall. By contrast, that kind of leverage is not available to other, particularly local interests such as unions, NGOs, and citizens' initiatives. Even governments themselves have no way of holding a suing company accountable for any of its own violations, for instance through countersuits.

Moreover, the inequality between the Global North and the Global South is tremendous. While even industrialized countries like Germany are brought before tribunals for genuinely political decisions like opting to phase out nuclear power (Vattenfall vs. Germany), 62% of these kinds of actions are brought by companies from industrialized countries against countries of the Global South. So, for example, the French company Veolia brought an action against Egypt because it had raised the minimum wage in the water sector; the Mexican government had to pay damages to a US-based food company because it had imposed a tax on beverages that contained corn syrup, which is

harmful to human health; and the natural resources company Doe Run Peru demanded US$ 800 million from Peru for revoking its operating license in Oroya after the company failed to implement environmental protection measures it had agreed to. Since the start of the financial crisis in 2008, more and more crisis-stricken European countries like Greece and Spain have been on the receiving end of legal action. The existing ISDS system increasingly serves to socialize highly speculative business risks.

The changes to the CETA ISDS proposed by Germany's Social Democrats will only serve to legitimize their approval of CETA. The reforms to the ISDS system pursued by the European Commission will not go far enough to solve the problems described here. Its proposals, such as establishing greater transparency, a code of conduct for arbitrators, or vague letters of intent to create possible appeals processes in the future, will not challenge the system: Actions before private tribunals against political decisions in the public interest will still be possible. And so investors' rights will continue to enjoy exclusive protections and to be asserted in expensive extrajudicial proceedings.

There may be loopholes in those safeguards, but there is no justification for such excessive protection for foreign investors at the expense of democratic, rule-of-law principles – expenses that must be borne by societies.

Abolishing private tribunals

Given that the disadvantages far outweigh the advantages, we reject the integration of private tribunals into investor-state conflict resolution in future investment agreements. This applies to agreements between states that satisfy the requirements of the rule of law as well as with states whose legal systems need improvements. As the 2011 Green caucus in the European Parliament has already called for in the negotiations on the reorganization of European investment policy, we support the termination of existing bilateral investment treaties (BITs). The EU-level investment treaties that are to be renegotiated should strike a fair balance between private interests and the regulatory necessities of the public purse. These new BITs must be based on a clear and extremely narrow definition of expropriation. The state must have the freedom to issue new rules without being penalized so that they can better protect the environment and address health and social concerns. Private tribunals will no longer have a place in such modern BITs. Many countries, such as South Africa, have already introduced reforms into their investment policies and are renouncing ISDSs.

The idea that investment protection agreements attract direct investments is empirically unproven; often entirely unrelated factors play a decisive role. Brazil, for example, does not have a single investment protection agreement and is not suffering from a lack of foreign investment. Moreover, direct foreign investments are not necessarily good for so-called developing countries. That applies to the commodities sector, for one example, where little to no value is created for those societies and only a small elite profits while the development of the state – a development that reaches the poorest strata of society – is left entirely unaffected.

Better utilization of ISDS alternatives and ecologically sound development

- In many cases, actions before existing, independent courts facilitate effective legal enforcement. This includes not only national courts but also existing international courts like the European Court of Human Rights, which has already decided investor-state cases.
- By strengthening conflict-prevention and mediation measures, potential conflicts can be curbed or resolved before they escalate. Both sides save a lot of time and money. Examples include institutionalized dialogs between investors and state authorities or an ombudsperson to whom companies, states, or social groups can turn when their rights are threatened or have already been violated.
- Numerous agreements include the possibility of state-to-state actions when investor rights are truly seriously violated.
- There are already options for private protections for business. However, they are inadequate for many businesses in many countries. There should be a more vigorous discussion of ways to increasingly secure private risks privately. Private coverage systems should also include accountability and review mechanisms for responsible social, ecological, and humane entrepreneurship.
- State investment guarantees or export credit insurance (Hermes cover) may be one option for ensuring businesses' investments in "high-risk" countries. However, these guarantees or pledges should only be awarded on the basis of clear ecological, social, and development-policy criteria. Additional steps toward development and reform are necessary.
- Another option is reforming and strengthening the Multilateral Investment Guarantee Agency (MIGA). As a multilateral agency with a clear development mandate and strict ecological criteria for ensuring political risks, it can make an important contribution to investment protection. Alternative investment protection agreements that focus on ecological and social investment frameworks should be developed further. One example would be the UNCTAD proposal titled Investment Policy Framework for Sustainable Development.

Creating an international investment court

Apart from these options (many of which already exist) for businesses to secure themselves against risk or to protect their investments, there is another alternative, albeit one that will not be implemented overnight: Direct foreign investments that comply with social, ecological, and human rights standards can help improve living conditions in the target countries. To that end, we support the creation of a public and independent international investment court that would replace the existing arbitration mechanisms. This new court could ensure that investors' valid interests in proceedings based on the rule of law are protected while safeguarding states' regulatory interests at the same time. But the new court would also hold businesses liable for violations of social, environmental, and human rights standards. In practice, this would mean:

- Proceedings would have to be more transparent and public. There is a valid public interest in gaining access to all relevant information about each case. This includes the amount of the claims to compensation for damages, the status of negotiations, the participating judges, and the complaint.
- All parties to a dispute must be granted the opportunity to appeal decisions.
- Along with investors' rights, investors' obligations must also fall under such a court's jurisdiction. States, individuals, or groups must be able to enforce their rights against businesses. Universally valid human rights as well as other binding or even nonbinding social and ecological requirements and standards (like the ILO's Core Labor Standards, the OECD Guidelines for Multinational Enterprises, or the Global Compact) must form the basis for such actions.
- Human rights as well as environmental and social standards must be rooted in such a way that they allow democratic states to have broad regulatory latitude in these areas.
- It must be possible to immediately reject obviously unfounded actions.
- The losing party should bear the litigation costs.
- Invocation of lower standards derived from other agreements ("importation of standards") must be ruled out.
- The appointment and independence of judges should be controlled according to the standards of other public international courts.
- At least half of the employees in this investment course should be women. Moreover, the staff should be geographically representative. While the amount of compensation should be limited by the harm caused, there must also be some assurance that so-called developing countries in particular are not driven into debt traps to pay compensation for damages. To that end, the economy of the sued state must also be taken into consideration when compensation is determined.
- Small businesses must not be disadvantaged with respect to access to the court.
- The court should be equipped with a staff that can process lawsuits quickly. Long lead times before trial must be avoided in order to establish legal certainty.