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Investment protection in TTIP: the European Commission refuses to change the system

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Berlin, 2 October 2015. The **European Commission's** new proposal for an 'investment court' has been unable to diminish the wide-ranging public criticism of the investment protection mechanism envisaged in TTIP (the Transatlantic Trade and Investment Partnership)[1]. The reason is simple: the Commission's proposal remains **firmly committed to providing foreign investors with the highly controversial right** to investor-state dispute settlement (ISDS). This mechanism allows investors to sue a state for implementing measures (aimed at e.g. health, environmental and consumer protection and policies to end financial and economic crises) if these measures are perceived as threatening corporate interests. ISDS decisions are made by international tribunals, and they can result in countries having to pay horrendous levels of compensation to corporations. Providing investors with the right to sue for compensation through TTIP will significantly expand the global reach of ISDS and mean that states are likely to face many more of these cases. Clearly then, these corporate rights come at the expense of the public interest on both sides of the North Atlantic[2].

In contrast, a lengthy European debate on reform in this context[3] led the European Parliament (EP) to call for a 'new system' of dispute settlement that conforms to democratic and constitutional standards. Also, the EP is against providing foreign investors with 'greater rights than domestic investors'[4]. Nevertheless, the draft chapter on investment protection in TTIP, which was proposed by Trade Commissioner Malmström, demonstrates that the European Commission is still unwilling to implement such a fundamental reform of investment protection.

Although the Commission's proposal does include some positive approaches it is mainly limited to making cosmetic changes to the current ISDS mechanism. The Commission has also failed to effectively limit substantive investor rights. Instead, they would provide foreign investors with a privileged position in relation to other companies and the public

1 See the Commission's formal proposal on TTIP's investment chapter from 12th November 2015, available at: http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf, and the Commission's guidelines in German on a previous and largely matching version from 16 September, available at: http://europa.eu/rapid/press-release_MEMO-15-5652_de.htm/.

2 On the concerns expressed about ISDS, see Pia Eberhardt, Investitionsschutz am Scheideweg – TTIP und die Zukunft des globalen Investitionsrechts, Internationale Politikanalyse, May 2014. For examples of problematic cases that have arisen during practical implicationin practice, see p. 7 and p. 12, available at: http://library.fes.de/pdf-files/iez/global/10773-20140603.pdf.

3 See the analysis of the proposals made until now by PowerShift, Sie bewegen sich – doch nicht, published on 20 May 2015, available at: http://power-shift.de/wordpress/wp-content/uploads/2015/05/PowerShift-Analyse-ISDS-Reformdebatte-Sie-bewegen-sich-doch-nicht-Mai2015.pdf.

4 See the European Parliament resolution from 8 July 2015 and its recommendations on the TTIP negotiations, 2014/2228 (INI). p. 2. d) xv, and especially its call 'to replace the ISDS system with a new system for resolving disputes between investors and states', available at: http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+TA+P8-TA-2015-0252+0+DOC+PDF+V0//EN.

interest. Consequently, the Commission's proposal barely even touches on many of the central points of criticism of the ISDS mechanism (see below for a detailed overview of these points and the proposal's effect).

First of all, no convincing reasons have been provided in favour of including investment protection in TTIP at all. Foreign investors already enjoy strong levels of protection both in the US and in the EU, which are enforced effectively by national and European courts. As such, specialised investment protection through international law is unnecessary,[5] a point that has even been stressed by the German government.[6]

The **Commission's proposal provides foreign investors with privileged levels of protection both in terms of their property and their expected profits; as such, the Commission's proposal affords foreign investors 'greater rights' than are provided to domestic investors.** Moreover, those rights go far beyond the prohibition of discrimination and actually can secure foreign investments against legitimate, democratic political change.[7] But in fact, restricting investor rights to the prevention of discrimination instead would be very easy.[8] Doing so would be the only way to guarantee states the flexibility they need to implement legislation that reflects the public interest.[9] The Commission's approach is to protect the states' 'right to regulate' through a specific clause in the treaty.[10] Nevertheless, this approach has been unsuccessful in the past as the existing clauses on the right to regulate have rarely played a role in ISDS decisions. Moreover, the Commission's proposals reduces the right to regulate to a vague interpretative guideline that provides wide-ranging scope for investor-friendly decisions.[11]

The special rights provided to investors are not linked to any reciprocal responsibilities, such as job creation, adhering to human rights, labour and consumer rights legislation or to health and environmental protection standards.

The Commission's proposals also foresee the constitution of an **'Investment Court System' (ICS); however, this would only be a 'court' in name.** Essentially, ICS would be implemented with the sole intention of enforcing investors' rights in disputes with states. This means that

5 For a detailed discussion of the counter-arguments to those set out by the Commission, see Powershift's analysis (Fn. 3), p. 3 ff.

6 See the Bundestag speech by Federal Minister for Economic Affairs and Energy Sigmar Gabriel from 25 September 2014, available at: http://www.spd.de/aktuelles/123966/201040925_gabriel_rede_ceta_bundestag.html.

7 This is particularly due to the broadly defined right to fair and equitable treatment (FET) set out in Section 2, article 3 paragraphs 1–4, and the protection against indirect expropriation in Section 2, article 5, paragraph 1, and alt. 2 and Annex I.

8 See in particular the case with the national treatment rule in articles 2-3 of the Commission's proposal on the general rules for TTIP's chapter on trade in services, investment and e-commerce from 31 July 2015, available at.: http://trade.ec.europa.eu/doclib/docs/2015/july/tradoc_153669.pdf. See also the preferred restricted form ofnational treatment clause in article 3 of the Model treatydrafted on behalf of the BMWi by international law professor Markus Krajewski 'Modell-Investitionsschutzvertrag mit Investor-Staat-Schiedsverfahren für Industriestaaten unter Berücksichtigung der USA' (model investment protection agreement with investor-state arbitration for industrialized countries taking into account the United States), page 9 f, available at: http://www.bmwi.de/BMWi/Redaktion/PDF/MO/modell-investitionsschutzvertrag-mit-investor-staat-schiedsverfahren-gutachten,property=pdf,bereich=bmwi2012,sprache=de,rwb=true.pdf.

9 The BMWi's assessors also argued in favour of doing so, see the point by Krajewski (Fn. 8), p. 10 f: 'Therefore, in the context of an agreement with the United States or other countries that have a functioning legal system that is comparable to the German judicial system, we recommend dispensing with the standards of fair and equitable treatment and indirect expropriation in investment protection, and instead only applying non-discrimination standards.'

10 Section 2, article 2, especially paragraph 1 and 2 (investment and regulatory measures/objectives).

11 See the points below on the inadequately secured 'right to regulate'.

people who are affected by the business practices of global corporations through wage dumping, a lack of labour protection, land acquisition and environmental degradation will still lack an international law remedy against foreign investors who profit from their situation. This **one-sidedness** entails the risk that members of the 'court' will, just like current ISDS arbitrators, see themselves as institutional guardians of investor rights and accordingly provide investors with generously interpreted privileges; this is already the case with ISDS tribunals. Like any powerful international institution, international courts tend to expand their competencies. Seen in this light, the fact that **safeguards for judicial independence are to be much weaker than under common constitutional rule of law standards seems even more worrying. ICS 'judges' are to work part-time** and would mainly be paid per case. This provides judges with a **financial incentive to accept large numbers of court cases and consider them favourably to invite future claims.** This same **structural incentive for investor-friendly judgements** also constitutes a key problem with the previous current system of ISDS arbitration. The obvious solution would be to employ full-time judges on fixed salaries, and to ban them from engaging in other forms of occupation. This would also help to prevent conflicts of interest. The importance of this point has even been recognized by the Commission;[12] nevertheless, in its proposal it has only included an option to change the remuneration of judges at some point in the future in its proposal.[13] However, to accomplish these changes to the way in which judges are paid will hardly be politically possible after the treaty has come into force.

Clearly, the Commission's proposal does not represent a convincing response to the dangers inherent to the ISDS system; however, it does at least contain some improvements compared to the draft agreements with Canada (the Comprehensive Economic and Trade Agreement – **CETA**) and Singapore. The Commission's latest proposal would no longer permit investors to be involved in the selection of the arbitrators who would preside over their case. Instead, judges would be permanently employed by the countries that are party to the agreement; their appointment would last for a fixed term, and they are to be randomly selected on a case-per-case basis to hear cases.[14] In addition, the consistency of outcomes would likely be improved through a new Appeal Tribunal and more extensive possibilities to appeal and review decisions, which should also help regulate the proper conduct of judges.[15]

Although the Commission has made these proposals for TTIP, it is determined to ratify CETA without first implementing these same minimal reforms; however, investment protection in CETA and TTIP cannot be treated as separate issues. Without making the necessary corresponding changes to CETA, the close economic ties in North America will enable US investors to avoid the new regulations in TTIP and opt for the more favourable CETA agreement by structuring their investments through subsidiaries in Canada. Therefore, the EU needs to develop a unified approach that applies to both treaties from the outset. However, in light of these critical aspects stated above, neither CETA nor TTIP are acceptable in their current forms.

12 See the speech by Trade Commissioner Cecilia Malmström to the Committee on International Trade of the European Parliament on 18 March 2015, p. 3, available at: http://europa.eu/rapid/press-release_SPEECH-15-4624_en.pdf: 'Of course, this [proposal] does not go the whole way to creating a permanent investment Court, with permanent judges who would have no temptation to think about future business opportunities.'

13 Section 3, article 9, paragraph 15, article 10, paragraph 14.a

14 Section 3, article 9, paragraphs 2, 5 and 7, article 10, paragraphs 3, 5 and 9.

15 Section 3, articles 10 and 29.

Criticism of ISDS	Does the Commission's ICS proposal solve the problem?
I. Fundamental criticism	
There is **no need for ISDS**. Property and investments already enjoy strong levels of protection and the relevant legal systems function properly. This is particularly the case with industrialized countries such as the US, the EU and Canada.	**No.** ISDS is still included in TTIP, as the proposed ICS mechanism is merely a modified version of investor-state dispute settlement. Accordingly, TTIP would dramatically increase the risk of ISDS claims against the EU and the US being brought by investors, and this would occur at a time during which the numbers of such cases are already significantly rising.
II. Tangible Substantive investor privileges for investors	
Foreign investors are provided with **exclusive rights that are vaguely defined and provide for wide-ranging interpretations.** This includes the right to **'fair and equitable treatment'** (FET) and the prohibition of 'indirect expropriation'. In numerous arbitral awards these rights served as a basis for investor compensation for non-discriminatory state measures that reflected the public interest.	**No.** The definition of FET contains a list (which is similar to the one set out in the draft CETA agreement) that explicitly states what was merely implicit in previous agreements. FET is defined broadly and it will enable legal action to be taken against a wide spectrum of non-discriminatory policies that have been implemented in the public interest. For example, the Commission's proposal for TTIP explicitly states that tribunals can take into consideration whether the investor's legitimate expectations have been frustrated, when making a judgement on whether a measure violates the FET standard. Although the draft proposal stipulates that this provision should not be interpreted as requiring states not to change their policies, however, this does not necessarily mean that states won't still be liable to pay compensation to investors if they do. Moreover, previous ISDS case law provides no reason to hope that arbitrators would abandon their generous interpretational approach regarding the FET-clause under these circumstances. The wide-ranging definitions of 'expropriation' and 'investment' result in a level of property and investment protection that goes far beyond national and European law. According to the annex on 'expropriation', which is also included in the US standard model bilateral investment treaty, policies that are implemented in the public interest can be viewed as indirect expropriation 'in rare circumstances', such as when arbitrators view them as disproportionate.

There is **no effective protection** from ISDS cases for **non-discriminatory policies implemented in the public interest.**	**Not really.** It would only be possible to protect polices implemented in the public interest if investment protection was reduced to a ban on discrimination and if vague standards such as FET and indirect expropriation were excluded from the treaty. However, the Commission's proposal rejects this approach. Instead, it touts a new provision aimed at protecting a state's 'right to regulate'. Unfortunately, its proposal does not explicitly exempt state regulatory measures from the investment protection standards, and instead only provides vague interpretative guidance. This will not prevent tribunals from claiming that policies implemented in the public interest breach the TTIP investment chapter. The broad rights provided to foreign investors supposedly 'shall not affect' the state's right to regulate; however, as the US trade representative has already stressed, an award made by an ISDS tribunal against a particular measure would not meaningfully affect its legal position anyway. Instead, its decision would 'merely' require a state to provide compensation to investors, and not to change state policy. Of course, the obligation to pay compensation (even when this obligation is posed only as a threat) could always be used to intimidate governments and other public bodies to reject policies that are actually in the public interest. However, arbitrators are expected to ignore such intimidation and rely on the fact that – technically at least – their awards will not force states to change policy. Moreover, the right to regulate is to be restricted and watered down in a number of other ways: governments seeking to defend themselves from compensatory claims will have to convince a tribunal that the measures they put in place were 'necessary' in order to meet a specific public interest and that this interest was actually 'legitimate'.

Umbrella clauses are being used to extend investment protection to simple agreements between foreign investors and states. This enables investors to take their claims for breaches of the treaty before an ISDS tribunal and circumvent a state's national court. This is particularly problematic regarding **concessions made in the wake of the privatization of public services,** as this clause **'bolsters' privatizations by international law.**	**No.** The Commission's proposal also contains an umbrella clause for written agreements between states and investors. As such, the new proposal goes even further than the much-criticized draft of the CETA agreement.
The transfers provisions **conflict with capital controls and financial transaction taxes.** Regulations governing the free movement of capital **are incompatible with measures to control capital movements, and taxes on financial transactions.**	**Not from what we can see.** The text replicates the free transfers obligations from other FTAs that restrict commonsense capital controls and conflict with financial transaction taxes. A note states that language is still to be added in a horizontal portion of the agreement regarding cases of "balance of payments and external financial difficulties…" The balance-of-payments provisions of existing agreements (e.g. GATS) have been insufficient to fully protect legitimate capital control measures from this obligation.
The level of compensation paid to investors does not actually reflect a real loss and extends well beyond actual damages suffered by the investor. In fact, the compensation that they receive goes far beyond real losses, and this results in **states having to pay horrendous levels of compensation to investors.**	**No.** The Commission's proposal still provides for the compensation of expected losses by foreign investors. This goes beyond the protection of property as laid out in national constitutions and discriminates against domestic firms. It also leads to much higher levels of compensation than would otherwise be the case, as the following example shows: The owners of Yukos were awarded EUR 1.9 billion in compensation by the European Court of Human Rights. In contrast, the ISDS tribunal, which based its judgement on the Energy Charter Treaty, awarded Yukos US$ 50 billion (equivalent to EUR 45.8 billion).

The widely interpretable rights provided to investors **are not linked to any reciprocal duties.**	**No.** Although TTIP is to include a chapter on sustainability, it foresees no enforceable duties for investors. Also, TTIP lacks an effective mechanism with which stakeholders and civil society actors could force companies to comply with human rights, environmental protection standards etc.
ISDS decisions can conflict with other obligations such as EU law and thus place states in a difficult position. The case of Micula vs. Romania, for example, resulted in an ISDS court ordering compensation for the withdrawal of a subsidy that was incompatible with European law; however, that compensation itself breached EU law, because it would have propped up the unlawful subsidy the compensation was aimed at redressing.	**Partly.** The Commission's proposal contains a passage that is clearly based on the Micula vs. Romania case (Section 2 article 2, paragraph 4). This clause stipulates that the investment protection provisions 'shall [not] be construed as keeping a state from discontinuing the granting of a subsidy and/or requesting its reimbursement.' However, the Commission apparently overlooks the fact that the conflicts between EU or domestic law and investment protection standards extend well beyond state subsidy law. Tribunals may still hold states liable to compensation for many measures required by national or European law (e.g. environmental or consumer protection regulation). Further significant and striking conflicts (such as those in subsidy law) also exist in tax law, environmental liabilities, penalties and fines. Investors can undermine all of these financial obligations simply by suing for the same amount of compensation before an arbitrational tribunal.
III. Structure of the ISDS system (incl. procedural law)	
ISDS **empowers foreign investors alone to bypass domestic courts** and go before extrajudicial tribunals, or to re-litigate issues decided in domestic courts before those tribunals. This undermines the rule of law and creates a discriminatory structure in which foreign investors enjoy greater procedural rights than domestic businesses and NGOs.	**Hardly.** There would still be no duty to exhaust local remedies before seeking redress at an ISDS tribunal. In all other disputes, however, this prerequisite must have been met before individuals can bring cases before an international court or tribunal. This includes cases brought by victims of human rights violations. The prior involvement of national courts is (among other purposes) aimed at providing the state in question with the opportunity to remedy its violation on the national level. The Commission's proposal, however, stipulates that ISDS and domestic legal avenues are partly exclusive. This would make it even less likely that investors would use national courts, because doing so would block them from accessing the far more lucrative ISDS mechanism. In addition, it appears that this restriction would only apply to actions aimed at gaining compensation. This means that before, after and during an ISDS case, it would still be possible for corporations to attempt to have a policy repealed by a national court.

ISDS tribunals enjoy wide discretion – they are not bound by a system of legal precedent or any substantial review.	**Partially.** An appeal tribunal would be created (with wider grounds for appeal than are allowed for annulment under existing ISDS rules). But there is no requirement for the 'judges' to adhere to a system of legal precedent, either in the initial claims process or in the appeals process. Only the proposed "Services and Investment Committee" can issue a binding interpretation at its own discretion.
ISDS incentivizes a pro-investor bias among arbitrators. Only foreign investors can bring a case before a tribunal, and they have a 50% weighting in the selection of arbitrators who decide their case. Moreover, arbitrators are not paid a fixed salary, but are to be paid on a case-per-case basis by the parties involved. This situation provides monetary incentives to arbitrators to accept large numbers of court ISDS cases and to award compensation to investors.	**Partly.** Foreign investors will no longer be able to choose their arbitrator because these are now to be selected randomly from a pool of 'judges'. Nevertheless, investors are still the only parties who can bring actions before tribunals, and arbitrators still have a significant financial interest in deciding as many cases as possible. After all, arbitrators are still going to be paid mostly per case (except for a relatively low salary retainer fee paid to the arbitrators for their general availability of € 2,000 per month). This could technically be changed later by the Services and Investment Committee. However, it is (politically) questionable whether such a decision in favour of accepting fixed salaries for judges would be made by the Committee in the future if salaries were not fixed from the outset. Consequently, the proposal still provides financial incentives for arbitrators to accept investor claims and consider them favourably, in order to invite them to bring more claims in the future.
ISDS arbitrators are paid according to the time they work, incentivizing drawn-out proceedings that mean higher costs to taxpayers.	**No.** Arbitrators would still be paid a daily rate, in accordance with ICSID rules. While the proposal says that provisional awards should be concluded within 18 months, it allows the tribunal to easily exceed that "deadline" by simply stating their reasons for doing so.

ISDS arbitrators can act as lawyers for investors in other ISDS cases or have economic ties with the investors involved in the cases they are presiding over. This clearly results in **conflicts of interest.**	**Partially.** The Commission's proposal states that arbitrators cannot be involved in a case if this results in a conflict of interest. In addition, arbitrators are no longer permitted to act as consultants, experts or witnesses in other ISDS cases. However, they are still permitted to act as arbitrators in other systems of arbitration, including other ISDS mechanisms. This means that all of the structural incentives for investor-friendly decisions are still present, albeit indirectly. Furthermore, the definition of a conflict of interest is still defined quite vaguely and it leaves much to discretion. However, the proposed method of notifying conflicts of interest does at least have a slight advantage over the currently often used ICSID rules: it will no longer be necessary to convince the other two arbitrators overseeing a case of partiality of an arbitrator before he or she can be excluded from a tribunal. Instead, this decision will be left to the president of the ICS 'court', who is also a judge. The president's decision, however, can only be challenged by an appeal in cases of serious infringements of the regulations.
'Investment' is broadly defined. This enables companies to contest government policies serving the public interest in many areas without even having a genuine foreign investment in that state.	**No.** The definition of 'investment' uses the same very broad definition that has been employed in previous investment treaties. Consequently, 'investments' include different types of assets such as shares, dividend rights, and even concessions and intellectual property rights.
Companies from countries that are not party to the agreement and even **domestic companies** can use foreign branches to take their own government before ISDS tribunals.	**Hardly.** The proposal requires an investor to be involved in 'substantial economic activity' in the respective home state (either the US or an EU member state). However, this minimum condition can easily be circumvented, especially by multinational corporations, through clever corporate structuring.

Investors can use **'treaty shopping'** to select the treaty with which they want to raise an ISDS case. At worst, this would only mean restructuring their company or establishing a branch in another country.	**Partially.** Apart from the required 'substantial economic activity' in the host state (see above) the proposal states that 'the Tribunal shall decline jurisdiction' when it is clear that the investment was acquired only in order to launch a case. But to prove treaty shopping in cases where the dispute became manifest shortly after the investor acquired their investment, the defending government would have to show that the dispute 'was foreseeable on the basis of a high degree of probability' at the time the investment was acquired. The provision grants tribunals broad discretion in interpreting this ill-defined hurdle.
Third parties affected by ISDS cases **do not have sufficient rights to participate.**	**Partially.** The proposal provides for a new intervention right for anyone with a 'direct interest' in the outcome of a case. The scope of this right, however, remains unclear. For example, it is not clear whether it also applies to NGOs that often are solely capable to effectively pursue many matters of environmental or consumer protection, and the decision on their admission would be left to the arbitrators. The additional rules on written submissions as amicus curiae would not solve the problem, because they only provide for an extremely weak position in the proceedings. For example, as under existing ISDS rules, it would be left entirely to the arbitrators' discretion whether the arguments of an amicus should be considered in their decision at all.

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