Opinion of the European Economic and Social Committee on investor protection and investor to state dispute settlement in EU trade and investment agreements with third countries

(2015/C 332/06)

Rapporteur: Sandy BOYLE

At the plenary session on 10 July 2014, the European Economic and Social Committee decided, under Rule 29(2) of its Rules of Procedure, to draw up an own-initiative opinion on:

Investor protection and investor to state dispute settlement in EU trade and investment agreements with third countries.

The Section for External Relations, which was responsible for preparing the Committee’s work on the subject, adopted its opinion on 28 April 2015.

At its 508th plenary session, held on 27 and 28 May 2015 (meeting of 27 May), the European Economic and Social Committee adopted the following opinion by 199 votes to 55 with 30 abstentions.

Glossary of abbreviations used in this opinion

BIT — Bilateral Investment Treaty
CETA — Comprehensive Economic Trade Agreement (Canada)
CFR — Charter of Fundamental Rights
CS — Civil Society
CSO — Civil Society Organisation
EC — European Commission
ECHR — European Convention on Human Rights
ECT — Energy Charter Treaty
ECJ — European Court of Justice
EP — European Parliament
EU — European Union
FDI — Foreign Direct Investment
FTA — Free Trade Agreement
ICSID — International Centre for Settlement of Investment Disputes
IIA — International Investment Agreement
INTA — European Parliament International Trade Committee
IP — Investor Protection
ISDS — Investor State Dispute Settlement
LSE — London School of Economics
MS — EU Member States
NAFTA — North American Free Trade Agreement
OECD — Organisation of Economic Cooperation and Development
SME — Small and Medium-sized Enterprise
TBC — Transatlantic Business Council

TEU — Treaty of the European Union

TFEU — Treaty on the Functioning of the European Union

TTIP — Transatlantic Trade and Investment Partnership

UNCITRAL — United Nations Commission on International Trade Law

UNCTAD — United Nations Conference on Trade and Development

WTO-DSP — World Trade Organization — Dispute Settlement Procedure

1. Conclusions and recommendations

Conclusions

1.1 FDI is an important contributor to economic growth and foreign investors must have global protection against direct expropriation, be free from discrimination and enjoy equivalent rights as domestic investors.

1.2 A state’s right to regulate in the public interest is paramount and must not be undermined by the provisions of any IIA. An unambiguous clause which horizontally asserts this right is essential.

1.3 ISDS must not elevate the trans-national capital status to that of a sovereign state or enable foreign investors to challenge the right of governments to regulate and determine their own affairs.

1.4 Over time a number of abuses have arisen through the use of ISDS and these now need to be addressed. The systematic shortcomings arising from the working of ISDS include opacity, lack of clear rules of arbitration, the lack of right of appeal, discrimination against domestic investors who cannot use the system, the fear that purely speculative investments are protected, which, inter alia, do not have the effect of creating jobs, and the fear of exploitation by specialist legal firms. The objective now is to propose an alternative dispute settlement procedure in the interest of reconciling the legitimate demands of investors with the concerns of other civil society resulting from such negative perceptions with ISDS.

The EC consultation on ISDS in TTIP highlighted a marked division between the views of the broad business community and those in the vast majority of responses from the rest of CS.

1.5 Concerns exist over the powers invested in a panel of three private lawyers, to adjudicate and make binding decisions on areas of fundamental public interest. Despite the fact that UNCITRAL has recently adopted new rules on transparency concerns still exist that much of the current system lacks transparency and has no right of appeal.

1.6 The original concept behind ISDS has long since departed. It has now become a hugely profitable outlet for a small number of specialist investment law firms who dominate the business.

1.7 Certain specialist legal firms are now promoting ISDS as an important up front risk mitigation tool when entering into investments. In some prominent cases it has become a lobbying tool where the very threat of litigation creates a regulatory chill which inhibits legislators pursuing legitimate public interest policies. There is also concern that it has attracted speculative investment by hedge funds, etc.

1.8 A number of liberal interpretations made on what constitutes expropriation have led to growing concern that taxpayers are obliged to pay compensation for public interest policies that allegedly limit profits.
1.9 The EU Agreement with Canada (CETA), signed in late 2014, together with the separate investment chapter added to the EU-Singapore FTA, contain the first ever investment chapters negotiated by the EU in any agreement since the EU gained competence for investment under the Lisbon Treaty in 2009. Although these chapters look to provide improvements to the current ISDS system, as well as setting out what has claimed by the EC to be, a new ‘state of the art’ EU ISDS model, they fall well short of what is required to assuage public fears. The models in Singapore and CETA are not identical and, in the opinion of many, ISDS remains an imbalanced, highly expensive process which reins in democracy, has no right of appeal and puts at risk a government’s right to regulate by providing foreign investors with rights beyond those enshrined in national constitutions and above those enjoyed by domestic investors. The EESC is concerned to note that the CETA text on ISDS is currently the basis for negotiation in the EU Japan FTA.

1.10 Role swapping between arbitrators and counsel is a clear conflict of interest which CETA fails to tackle. This reaffirms the view that ISDS is not a fair, independent or balanced method for the resolution of investment disputes.

1.11 The EESC welcomes the public consultation exercise on ISDS in TTIP. In contrast to CETA, it has helped make TTIP negotiations more transparent and sets an important precedent which the Committee firmly believes must now be followed in all future trade negotiations. The EC response has been to identify four particular areas for further more detailed reflection and whilst the EESC does not see this as an all-inclusive list, it has provided detailed input on these specific issues in Chapters 7 to 10 of this opinion.

1.12 The Committee also welcomes the objective of eliminating ‘frivolous claims’ from any future Investor Protection mechanism. It is important that the parties to any IIA have the protection of a general political filter which allows them by agreement to block a claim on justifiable grounds from proceeding to arbitration.

1.13 Investors should be encouraged to see Treaty based dispute resolution as a last resort and to seek alternative methods such as conciliation and mediation. Private insurance and contract based protection are appropriate means whereby foreign investors can minimise their risk.

1.14 The need for FDI protection varies from country to country. In countries with a democratically functioning mature legal system free from corruption, investment disputes should be dealt with by mediation, domestic courts and State to state resolution. These components are present in EU, US and Canada and the current high levels of transatlantic investment flows show conclusively that the lack of ISDS provision does not impede investment. The EESC therefore concludes that an ISDS provision is not necessary in TTIP or CETA and is opposed to its inclusion.

1.15 ISDS has the potential to derail both TTIP and CETA. The EC needs to consider if continuing to pursue this politically sensitive and publicly unpopular objective is a sensible and correct way forward.

1.16 There is a clear message emerging from developing countries that ISDS is an unacceptable mechanism which will be strongly resisted by an increasing number of important global players. If an alternative system is not found, it will become more difficult to incorporate IP into future agreements with countries where it is most needed.

1.17 There are considerable EU treaty-related and constitutional law concerns regarding the relations of ISDS ruling with the EU legal order. Private arbitration courts have the capacity to make rulings which do not comply with EU law or infringe the CFR. For this reason, the EESC feels that it is absolutely vital for compliance of ISDS with EU law to be checked by the ECJ in a formal procedure for requesting an opinion, before the competent institutions reach a decision and before the provisional entry into force of any IIAs, negotiated by the EC.

Recommendations

1.18 If a catch all solution for resolving investment disputes is to be found, it cannot be based on a modest revamping of the current, ISDS system which has a very low level of public support.
1.19 At a time when all G7 States are engaged in advanced negotiations on comprehensive trade and investment deals there is a unique opportunity to find a credible system which marries the legitimate interests of investors with the rights of a state.

1.20 If a unitary authority is to be the way forward, it should not be composed of private attorneys and must be more accessible to SMEs and have a built in right of appeal.

1.21 The EESC strongly urges the EC to consider the UNCTAD proposals for Reform of ISDS and concludes that the establishment of an International Investment Court provides the best solution to ensure a democratic, fair, transparent and equitable system.

2. Introduction

2.1 By adopting its REX/390 (1) opinion by an overwhelming majority, the EESC decided to draw up an own-initiative opinion on ISDS. Although this recommendation was specific to the TTIP, it was subsequently agreed to broaden the remit to cover IP and ISDS in trade and investment agreements with third countries.

2.2 Although this opinion examines the broad implications of ISDS, it is inevitable that much of the material used and references made relate to the TTIP. For the duration of the TTIP negotiations, ISDS has been a dominant issue for EU and US stakeholders.

2.3 The EC held an online public consultation over 15 weeks (March to July 2014) on ISDS in TTIP. The EESC thought it wise to await the publication of the results of this consultation and to hold a subsequent public hearing before finalising its opinion. The results were published in mid-January 2015 followed by the hearing on 3 February 2015. Both were of great assistance in drafting this opinion.

3. Background

3.1 The system

3.1.1 ISDS is an instrument of public international law that grants a foreign investor the right to initiate dispute settlement proceedings against a foreign government under the terms of an IIA. The Treaties are designed to create some basic obligations of the parties regarding foreign investment, by providing guarantees that governments will respect key principles such as:

— an obligation not to discriminate on grounds of nationality and to ensure fair and equitable treatment;

— a prohibition of direct or indirect expropriation without prompt, adequate and protective compensation;

— protection on the possibility to transfer capital.

3.1.2 In the event of an alleged breach of these obligations by a state, foreign investors covered by the terms of the IIA, can bring a claim to international arbitration through the mechanism of ISDS. Claimants are required to prove that the measures in question caused them significant damage. If the case is upheld, the host country is required to provide compensation for the damage caused. Unlike the WTO DSP, if a state loses a case, it is not bound to change its legislation.

3.1.3 ISDS is based to a large extent on the argument that it provides a depoliticised neutral space to resolve disputes between foreign investors and host states. It enables companies to sue states at international tribunals. This remedy is only available to foreign corporations or to transnational corporations using a cross-border subsidiary. Affected communities, citizens, domestic entrepreneurs and governments cannot make use of the same mechanism.

3.1.4 Arbiters are not tenured judges with public authority as in domestic judicial systems. The tribunals are comprised mainly of three private lawyers who sit in closed session and are appointed on an ad hoc basis. Their decision is final and not subject to any formal appeal process.

(1) EESC Opinion on Transatlantic trade relations and the EESC’s views on an enhanced cooperation and eventual EU-US FTA (OJ C 424, 26.11.2014, p. 9).
3.1.5 If both disputing parties so wish, ISDS proceedings can be kept fully confidential, even if the dispute involves matters of public interest. Although the standard US BIT does facilitate greater transparency, in many current agreements secrecy still exists. The UNCITRAL rules on transparency will substantially improve the position if universally implemented.

3.2 Facts and statistics

3.2.1 93% of BITs contain an ISDS provision (2). ISDS is also present in certain international trade agreements such as the NAFTA and in international investment agreements such as the ECT. In 2014, ECT surpassed NAFTA as the most frequently invoked treaty (3).

3.2.2 Member States have concluded over 1 400 BITs since the 1950s, representing about half the global total (4). All contain largely similar provisions on IP and ISDS. EU investors are reported to be the largest users of ISDS globally (50% of all cases).

3.2.3 The EU is currently negotiating the TTIP with the US, a comprehensive FTA with Japan and it has recently concluded negotiations with Canada. These more than any other issue have prompted a huge public debate on the need for an ISDS mechanism in any investment chapter.

3.2.4 Only nine EU Member States have BITs with the US (Bulgaria, Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania and Slovakia), seven Member States have a BIT with Canada and none with Japan. All of these predate accession to the EU.

3.2.5 FDI stock held by US investors in these nine Member States equals 1% of the total US FDI in the EU. In terms of outward FDI from these Member States to the US, the figure stands at only 0.1% of the total FDI stock in the US (5).

3.3 Caseload

3.3.1 ISDS cases proliferated dramatically between 2002 and 2014 (58 in 2013 and 42 cases in 2014) (6) with the number of treaty based arbitrations reaching 610 by the end of 2014. However, since most arbitration fora do not maintain a public registry of claims, the total number of cases is estimated to be higher.

3.3.2 Of the 356 known cases that have been concluded, 25% were resolved in favour of the investor and 37% in favour of the state. The specific terms of 28% of the cases remained confidential.

3.4 Time and cost

3.4.1 The average cost of an arbitration case is USD 4m per party, approximately 82% of which is legal fees (7). Some can take several years to conclude.

3.4.2 High costs have led to the growth of third party funding of claims. By reducing the financial risk for companies this contributes to an increase in frivolous cases for which States still bear full legal costs. The EESC is strongly opposed to the reported speculative investment by hedge funds in specific ISDS cases for a share in any compensation awarded (8).

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(2) OECD (2012) ISDS a scoping paper for the investment policy community.
(3) UNCTAD Recent Trends in IIAs and ISDS — No 1, February 2015.
(4) Notice accompanying Public Consultation on ISDS in the TTIP.
(5) UNCTAD — ISDS Information Note on the US and EU.
(6) See footnote 3.
4. The case in favour of ISDS

4.1 With the exception of Ireland, all Member States have ISDS in BITs. There are also 190 Intra-EU BITs which account for 16% of all ISDS cases known globally.

4.2 The EC negotiating mandate endorsed in 2012 by the then 27 Member States includes the objective of achieving ISDS. What is envisaged is ‘an effective and state of the art dispute settlement mechanism’.

4.3 The EC position (9) is that ISDS is an:

— important tool for protecting investments and therefore for promoting and securing economic growth in the EU;

— effective way of enforcing the obligations our trading partners agree on with our investors when they sign investment treaties.

4.4 A Business Round Table organised by the EESC Employers’ Group on TTIP concluded in a common declaration (10) that: ‘An international agreement such as TTIP should create the right conditions to attract a high level of future investment in the transatlantic market. This includes granting ample access and non-discriminatory treatment for investors on both sides and improving the current framework for IP, including ISDS by making it more accessible to SMEs and striking a proper balance between investor rights, the right of states and local authorities to regulate in the public interest’. The need to ensure that the ISDS provisions proposed in TTIP in no way hinder the ability of the EU Member States to regulate in the public interest was also pointed out in the conclusions to a joint meeting on the transatlantic negotiations held by the Farmers and Consumers and Environment categories in June 2014.

4.5 The need for an ISDS mechanism is strongly endorsed by the business communities on both sides of the Atlantic who see it as a fundamental safeguard for inward investors and advocate that:

— it is a vital part of investment protection, providing for a neutral and fact-based dispute resolution mechanism, with rules to promote compliance and prevent abusive actions;

— it helps to establish the right of states to regulate and the right of investors to be protected under international law.

4.6 It also argued that ISDS is a last resort tool and it is used only in extreme cases when all options have failed and that around of 90% of the BIT have never been used for investors to present a case. Although global FDI stock exceeds USD 25 trillion, there have been only around 500 cases since 1987. Arbitrary award only provides for pecuniary compensation. Arbitrators do not have the possibility to change legislation or measures adopted by states (11).

4.7 The business community also argues that a functioning and modern ISDS system is also important for SMEs who filed 22% of worldwide cases (12).

4.8 Despite the calls from the business community for the negotiations of a liberal investment agreement (13), there is recognition that measures should be taken to make ISDS a more effective, modern predictable and transparent tool. It supports clearer definitions of important concepts such as ‘investor/investment’, ‘fair and equitable treatment’ and ‘indirect expropriation’ (14).

(9) EC — Factsheet on ISDS — Paragraph 2 — 3 October 2013.
(10) EESC Business Round Table — Common Declaration on TTIP, 16.12.2014.
(13) Transatlantic Business Council — Comments of the TBC regarding the proposed TTIP, 10.5.2013.
(14) Business Europe: TTIP — An Indispensable Tool to Protect Investors, 2.5.2014. ISDS — Overview of Business Europe position — February 2015.
4.9 Given the very high profile of TTIP, CETA and EU-Japan FTA negotiations, it is argued that failure to deliver a negotiated agreement in such cases would be seriously detrimental to the prospects of negotiating an ISDS provision in any other BIT because each agreement will have an impact on others in the pipeline.

5. Concerns and opposition

5.1 Support for ISDS is not replicated in other key areas of CS. However, there is a broad consensus that inward investors need protection from direct expropriation, are not discriminated against and have access to the same avenues open to domestic investors.

5.2 Strong Trans-Atlantic opposition has been voiced by trade unions, NGOs, consumer, environmental and public health organisations.

5.3 The primary concern is that the ISDS system is not fit for purpose and that it elevates transnational capital to a legal status equivalent to that of the sovereign state. The Committee however notes that if two countries desire to promote economic relations with each other through an IIA, each will promise the other that they will guarantee certain levels of treatment to investors and investments from the other country.

5.4 From modest beginnings, when ISDS was designed to assist FDI to obtain compensation for direct expropriation of private property by national governments in developing nations with poorly functioning court systems, it has grown into a mechanism which:

— fundamentally shifts the balance of power between investors, states and other affected parties;

— prioritises corporate rights over the right of governments to regulate and the sovereign right of nations to determine their own affairs.

5.5 Expropriation has expanded to include measures tantamount to expropriation, indirect and regulatory expropriation. The effect has been to admit claims against any state measure which may potentially have an impact on profits, future profits or reasonable expectation of profits, even if the policy or measure is of a general nature and does not apply to the specific investment.

5.6 Adverse domestic court rulings have been challenged as ‘expropriations’ including the USD 500m suit by US pharmaceutical giant Eli Lilly against Canada alleging that the Federal Court rulings regarding two patented drugs violate the firm’s investor rights. This is the first attempt by a patent-holding pharmaceutical corporation to use extraordinary privileges provided by US trade agreements as a tool to push greater monopoly patent protections (15).

5.7 Specialist corporate law firms are now advising and capitalising on cases which have little to do with expropriation of private property. A handful of investment law firms have ridden the litigation boom and dominate the business.

5.8 Is ISDS necessary in the TTIP?

5.8.1 In TTIP, it is difficult to argue that investors have cause to worry about domestic legal systems. Both the EU and the US have mature and robust legal systems. There is no obvious reason why the rights of FDI cannot be protected adequately by the incorporation of a simple rule of non-discriminatory legal protection and equal access to domestic courts. Similar arguments can be advanced in the cases of Canada and Japan. If it proves difficult to enforce international rights through negotiation, mediation or in domestic courts in these highly developed democracies, then the issue should be primarily settled by State to State resolution.

5.8.2 A LSE report, analysing the US 2012 BIT model, found that 'particular areas in which the US BIT goes beyond UK law is significant. On these grounds and in the light of the scale of US investment in the UK, we think that there is significant risk of political costs to the UK arising from future preferred policies being abandoned or modified on account of objections from US investors in the UK.'

5.8.3 It is not credible to claim that the lack of an ISDS mechanism is an impediment to inward investment. The volume of inward investment varies widely across the EU. Some of the EU Member States which have ISDS procedures in BIT's with the US are the lowest recipients of US inward investment:

— FDI stocks between US and EU currently stand at over USD 2.5 trillion (EUR 1.5 trillion) either way. Belgium alone enjoys a level of US FDI four times that of China.

— Brazil, Latin America’s largest recipient of FDI, has no investment agreements which contain ISDS.

— Australia has shown that a country can credibly exclude investment protection from a trade agreement with one country (the US) and still include it with another (Korea). There is no reason why the EU could not follow a similar path.

5.8.4 It is extremely questionable that the non-presence of an ISDS mechanism in the TTIP would weaken the ability of the EU to include ISDS in future bilateral investment and investment agreements with non OECD countries such as China. China has already built a dense network of more than 130 BITs (including 26 Member States). The desire in China for an agreement is as strong as in the EU. What is more questionable is if it would be in the interests of the EU to allow Chinese state owned enterprises, which are essentially an arm of the Chinese government, to use ISDS to challenge government policy. This would allow a foreign country to use what is supposed to be a commercial process to engage in what should be resolved through negotiation and diplomacy.

5.8.5 A detailed paper published in March 2015 by the Centre for European Policy Studies, the Centre for Transatlantic Relations and the John Hopkins University concluded: ‘[…] including an investment protection chapter in TTIP that is accompanied by ISDS is unlikely to generate significant economic or political benefits for the EU. Our analysis also suggests that the inclusion of such provisions would lead to significant economic and political costs for the EU. While it is important not to exaggerate the scale of potential costs, our overall assessment is that the costs are highly likely to exceed any potential benefit to the EU. Accordingly, we would suggest that unless ISDS is accompanied by considerable concessions by the United States so as to offset ISDS-related costs, it would be prudent for the EU to consider alternatives’ (16).

5.9 The current political scene

5.9.1 South Africa, Bolivia, Ecuador, Venezuela and Indonesia have started to cancel or phase out existing BITs. India, reportedly is also reviewing its treaties and in the wake of the Philip Morris case, Australia has announced that it will not agree to the inclusion of an ISDS clause in any future agreements.

5.9.2 The National Conference of Legislators, which represents all 50 US state parliamentary bodies, has announced (17) that it ‘will not support any trade agreement that provides for investor state resolution’ because it interferes with their ‘capacity as state legislators to enact and enforce fair, non-discriminatory rules that protect public health, safety and welfare, assure worker health and safety and protect the environment’.

5.9.3 Resistance to ISDS is also growing in Europe with Germany, Austria, Greece and France questioning the investor rights in the TTIP.

5.9.4 Warning shots have been fired in the EP by members of the influential INTA who have called for ISDS to be dropped from TTIP.

5.9.5 The Committee of the Regions warns that ISDS between the EU and US which circumvents the ordinary courts entails a significant risk and can therefore be dispensed with (18).

5.9.6 These sentiments echo those of the multitude of European CSOs opposing ISDS in the TTIP. One of the key points is that if an investor turns to the domestic legal system first and obtains a final judgement, that investor can still bring a claim to an investment tribunal. The tribunal therefore becomes the ultimate adjudicator which is seen as anathema to democracy.

6. The EC Public Consultation on Investor Protection and ISDS in TTIP

6.1 The EESC welcomes the EC’s decision to launch a public consultation exercise on ISDS in TTIP. Excluding duplicate resubmissions, 143 053 responses were received which demonstrates the extent of public interest. The Commission Staff Working Document published in January 2015 provides a thorough analysis of the content and substance of the public response (19).

6.2 The consultation was based on a reference text based on CETA. Unfortunately, this draft agreement and that with Singapore were not subject to public consultation. However, the fact that CETA on which negotiations had been concluded, was used as a basis for public consultation after the ink was dry, has led to some concerns that the public consultation was little more than a fait accompli, designed to rubber stamp the new generation of Investment Agreements proposed by the EU. This fear was exacerbated by the fact that the consultation document concentrated on modalities and contained no specific question as to the principle of ISDS being included in the TTIP. However, the purpose of the consultation was to consult stakeholders on ways to improve ISDS in TTIP.

6.3 The consultation added little new to the plethora of information already available from the active online public debate on ISDS. However, it was an extremely useful exercise in tying together the various strands of the argument and in giving civil society an opportunity to have a direct input.

6.4 It is unfortunate that some advocates of ISDS have dismissed the 97% responses submitted collectively through various online platforms. Collective submissions are a legitimate part of public consultation. The EESC welcomes the EC assurance that ‘All replies have been taken into account on an equal basis’.

6.5 The EESC notes that less than 1% of respondents stated they are investors in the US, but does not consider this to be a matter of concern. On issues such as democracy and the sovereign rights of states to determine their own affairs, broad based CS input and opinion are essential and vital ingredients.

6.6 Four areas have been identified by the EC where further improvements should be explored:

— protection of the right to regulate

— establishment and functioning of arbitral tribunals

— relationship between domestic judicial systems and ISDS

— review of ISDS decisions through an appellate mechanism.

(18) CoR — TTIP — ECOS-V-063 02/15
They are amplified upon in the concept paper ‘Investment in TTIP and beyond the path for reform’, presented by Commissioner Malmström to the European Parliament and to the Council in May 2015.

6.7 The EESC is surprised to learn that, at the at the Civil Society Dialogue meeting on 18 May, it was confirmed that the IP model currently being used in the FTA negotiations with Japan is the one agreed in CETA. Given that the Commissioner, in her concept paper ‘Investment in TTIP and beyond — the Path for Reform’ presented to the EP on 6 May, has identified numerous areas for further improvement in the CETA text, the Committee is concerned that this continues to form the basis for negotiation with such an important global partner as Japan.

7. The right to regulate

7.1 The EESC is concerned that the submission to the public consultation by the European Service Forum calls for exceptions and limitations to be brought down to a minimum and for the EC to ‘use its negotiating mandate under the Lisbon Treaty to improve and strengthen, and not dilute’ ISDS. These demands include ‘unqualified Most Favoured Nation and National Treatment clauses, unqualified Fair and Equitable Treatment clause; a broad umbrella clause, no exceptions for particular sectors, no filter mechanisms, full compensation for direct and indirect appropriation’ (20).

7.2 ISDS is increasingly being used to bypass national legal systems and instead to sue governments in private international tribunals, demanding taxpayer compensation for public interest policies that allegedly limit profits. This is particularly prevalent in areas of health and environmental protection.

7.3 Recent high profile cases have strengthened opposition to ISDS:

— Philip Morris v Australia over cigarette packaging arguing that they deprive it of the value of its investment in trademarks and other intellectual property.

— using the provisions of the ECT, Vattenfall is seeking over USD 3.7 billion from Germany following the decision to phase out nuclear energy.

— Lone Pine v Canada for CAD 250m after the province of Quebec imposed a moratorium on fracking over environmental concerns.

— Veolia v Egypt over its decision to increase the minimum wage on the basis that it will damage the Company’s profits.

— Libya was ordered to pay USD 935m to a Kuwaiti company for lost profits from real and certain opportunities arising from the cancellation of a tourism project (21). The investor had only invested USD 5m in the project and construction never started.

— Romania was sued by Micula over an investment it made before the country acceded to the EU in which it took up a government business incentive. As it acceded, in order to comply with state aid rules, Romania discontinued its incentives programme. The Tribunal awarded compensation of USD 116 000 plus interest (estimated total USD 250 000) for not respecting its obligations under the BIT. In 2014, DG Competition served an injunction on Romania provisionally ordering it not to pay as it would be considered illegal state aid. In spite of this, the arbitrators have authorised Micula to pursue compensation before US courts, using a clause referring to the New York Convention.

(20) ESF Response to ISDS Public Consultation, 20.6.2014.
(21) http://www.iisd.org/itn/2014/01/19/awards-and-decisions-14/
7.4 Investment treaties prohibit any restrictions on the repatriation of funds or profits. Governments may not impose capital controls to halt attacks on their currencies or restrict hot money flows in a crisis even though the IMF believes that such controls are an essential policy measure. No state has been hit harder by ISDS cases than Argentina which has had to pay out over USD 500m following its decision to decouple the peso from the US dollar in 2002.

7.5 Exclusions for public services exist under Chapter 11 of CETA (Cross Border Trade in Services) but there are no exemptions or exclusions for them under Chapter 10 (Investment Protection). In principle whilst it must be right that investors are protected from arbitrary acts by State authorities, the definition of expropriation and especially indirect expropriation raises concern as to the ability of States to bring certain activities currently provided by commercial entities back within State provision for legitimate public policy reasons. Expropriation under Chapter 10 includes any legislation that has the effect of reducing the value of private business. Compensation must reflect ‘true loss’. This could make it economically prohibitive for states to bring services back under state provision.

7.6 There is a recognition in CETA that the definition of indirect expropriation is too broad and Annex X.11 paragraph 3 seeks to clarify the matter by setting out those public policy objectives that would not constitute indirect expropriation such as health, safety or the environment. There is a danger, however, that this could be interpreted as being prescriptive, leaving other wider public policy objectives, such as economic or fiscal policy or renationalisation of key services, open to claims of indirect expropriation within the context of ISDS. It is essential that this matter is clarified.

7.7 In announcing its plans to prevent investors from abusing ISDS, the EC states that in the TTIP it ‘would like to include provisions that prevent frivolous claims’ (22). CETA draft also provides for a fast track procedure for rejecting unfounded and frivolous claims. However, defining the term ‘frivolous’ in strict legal terminology will be extremely difficult and has the potential to provide further fertile ground for specialist investment lawyers.

7.8 CETA draft also provides for a closed definition of ‘fair and equitable treatment’. This is seen as too broad by those opposed to ISDS and not flexible enough from business community. It still gives latitude to the tribunal to interpret and lacks a flexible review mechanism.

7.9 The mere threat of a case under ISDS can create a regulatory chill which dissuades governments from regulating in the public interest for fear of litigation and resulting penalty charges. For example, the New Zealand government has put on hold its own tobacco plain packaging law pending the decision on the Philip Morris case against Australia.

7.10 In a briefing from law firm Freshfields Bruckhaus Deringer for its multinational clients — ‘Businesses are now more attuned to the potential relevance of investment treaties, not only as a last ditch protection when things go wrong but also as an important up-front risk mitigation tool when entering into investments’.

7.11 Although the EC has committed to ensure that under future EU Trade/Investment agreements a state cannot be forced to repeal a measure, this ignores the potential impact of the threat of a huge fine once a multi-billion dollar lawsuit has been filed.

7.12 The CETA draft also provides that the costs of arbitration should be borne by the unsuccessful disputing party. This means that those submitting trivial claims will be required to pay all costs. However, the huge size of many of the most recent claims is unlikely to make this an impediment for cash rich multinational companies and specialist legal firms when measured against potential gains. On the other hand, average costs of USD 4m per party must act as a major deterrent to SMEs making claims under ISDS provisions.

(22) EC Factsheet on ISDS, paragraph 8, issued on 3 October 2013.
8. Establishment and functioning of arbitral tribunals

8.1 The existing system is explained in chapter 3. It is an issue of widespread concern in the consultation.

There is general agreement that ISDS cannot continue in its present format.

8.2 Investment arbiters

8.2.1 Arbiters are selected for each case by both parties naming their arbiter and the two must agree on a third. If they cannot there is usually an appointing authority to decide on the third. This is in contrast to national judges who are assigned without party input. They are typically drawn most frequently from ICSID and UNCITRAL and are highly select members of the legal profession including senior lawyers, professors and former judges. In contrast to WTO practice, it does not appear that government ISDS defence counsel or government investment treaty negotiators have been selected as arbiters for cases involving other states.

8.2.2 As stated by Corporate Europe Observatory (CEO) (23) many have also acted as counsel in other cases: 50 % for investors and 10 % for states. This role swapping among a relatively small number (15 lawyers acted as arbiters in 55 % of all cases) (24) is sometimes seen as leading to mutual corporate solidarity that can lead to 'unhealthy compromises' (25). An increase in challenges by opposing party to proposed arbiters indicates concerns over the impartiality of the candidate pool (26).

8.3 It is clear that the CETA provisions on choice and conduct of arbiters and conduct of proceedings, although recognised by many as representing an improvement in some areas, do not have broad based CS support. There are serious concerns on the establishment and functioning of arbitral tribunals:

— States proposals to regulate in the public interest could still be subject to a claim for compensation which will be heard by a panel of three private lawyers.

— conflicts of interest guarantees are weak and do little to assuage fears that this can be eliminated within an ISDS system. Article X.25 of CETA stipulates that arbiters must comply with the International Bar Association Guidelines on Conflicts of Interest in International Arbitration. However, this does not solve the fundamental problem of specific individuals serving as counsel and arbiters for the same party in different cases, which is the key conflict of interest issue.

— CETA draft stipulates that UNCITRAL transparency rules shall apply to the disclosure of information to the public and that hearings shall be open to the public. This initially attractive aid to transparency is severely tempered by the fact that the Tribunal has wide discretion to hold sessions in camera and to withhold documents.

(23) Corporate Europe Observatory (CEO) is a non-profit research and campaign group carrying out research and publishing reports on corporate lobbying activities at the EU level (http://corporateeurope.org/).


(26) UNCTAD — Reform of ISDS — In Search of a Roadmap — Issues Note No 2, June 2013, p. 4.
9. Relationship between domestic judicial systems and ISDS

9.1 FDIs currently enjoy an almost unique right whereby an individual can bring a state to arbitration under International Law. Human Rights Law gives specific rights but, largely to avoid bypassing national court systems, individuals are required to exhaust local remedies before a claim can be brought to an international court. CETA does not require exhaustion of local remedies. Investors are only required to seek consultation.

9.2 Member States have raised key treaty-related and constitutional law concerns about the ISDS, as it is set out in CETA and envisaged for TTIP \((27)\). Proposed improvements to ISDS in BITs to date have not alleviated these concerns \((28)\). In its trade policy (TFEU Article 205 and 207), the EU is bound by the principles set out in TEU Article 3, the CFR and other EU legal standards.

However, under a trade agreement, where investment disputes are determined by international arbitration procedures which are not bound in such a way, it is possible to reach decisions that are not in keeping with EU law (see Paragraph 7.3 — Micula v Romania).

9.3 This delegation of jurisdiction to private arbitration courts not bound by EU principles may not be covered by the Lisbon Treaty and could be significantly ultra vires. The ECJ has made the establishment of such international jurisdiction to be conditional on there being no impairment of the principle of respecting the autonomy of the EU legal system and the allocation of powers fixed by the Treaties \((29)\).

9.4 Since ISDS in TTIP has to be established in a mixed agreement the consent of all 28 Member States parliaments is necessary before the (provisional) entry into force. The subsidiarity principle must be recognised in relation to the exclusion of national courts.

9.5 It should be recognised that there is tension between EU law and International Law, in particular where the ECJ's monopoly on jurisdiction is concerned (TEU Article 19 and TFEU Article 263 and subsequent). The opinion of the ECJ on the EU's accession to the ECHR \((10)\) and the EC approach calling for supremacy of the EU Law in the case Micula v Romania are evidence in this respect. Article 14.16 of the CETA draft denies direct effect of CETA and requires the provisions of the agreement to be incorporated in EU or Member State law in order to be invoked by investors. This further complicates relations between EU legal order and ISDS cases decided by arbitral tribunals.

9.6 With regard to the creation of the first-ever ISDS in EU free trade treaties with a world-wide impact on Member States and many EU citizens, the EESC is of the view that it is absolutely vital that the ECJ review compliance with EU law in advance. This is of particular importance in relation to the EU’s fundamental values and the CFR, but also as regards the ECJ’s monopoly on legal interpretation and subsidiarity. Therefore, an appropriate legal opinion must be obtained and taken into account before the agreement enters into force, and also prior to its provisional entry into force (TFEU Article 218). In this respect, it should be noted that if CETA enters into force, it contains a survival clause which in the case of any termination would extend provisions for 20 years for investments made before the termination.

\((27)\) Legal opinion: ‘Europa- und verfassungsrechtliche Vorgaben für das Comprehensive Economic and Trade Agreement der EU und Kanada (CETA)’ (European and constitutional law provisions for the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada) by Dr Andreas Fischer-Lescano, Bremen, October 2014; ‘Modalities for investment protection and Investor-State Dispute Settlement (ISDS) in TTIP from a trade union perspective’ by Dr Markus Krajewski, Friedrich-Alexander-University, Erlangen-Nürnberg, FES October 2014; ‘Freihandelsabkommen, einige Anmerkungen zur Problematik der privaten Schiedsgerichtsbarkeit (Free trade agreements: some comments on the issue of private arbitration)’ by Prof. Siegfried Broß, Report on Mitbestimmungsförderung (co-determination promotion) No 4, H.Böckler Stiftung, 2015.

\((28)\) CETA: “Verkaufte Demokratie”, Corporate Europe Observatory.


9.7 There is an urgent need that the EC reflects on how to deal with existing intra-EU BITs and BITs of EU Member States with third countries, especially developed countries such as the US, Canada, which contain non-reformed ISDS mechanisms and which can currently be used to challenge the right of the state to regulate and to achieve legitimate state policies. Most of these agreements also contain survival clauses, which further complicate their termination process.

10. **Appeals Mechanism**

10.1 Broad CS for an Appeals Mechanism was evident in the Public Consultation and was reaffirmed at the EESC Public Hearing.

10.2 CETA draft contains no appeals system. However, it opens the possibility for such a system to be created. CETA does foresee future consultations on appeals systems and modes. This prospect of 'jam tomorrow' minimises the importance of the issue. An urgent solution must be found.

10.3 In principle a Tribunal award is final and only in very extreme circumstances is revision or annulment possible. This falls well short of any national court system and fails to address fundamental concerns expressed in the Consultation.

11. **How to reform the ISDS system**

11.1 UNCTAD has defined five options for reforming ISDS:

— Tailoring existing systems through IIAs

— Limiting investor access to ISDS

— Promoting Alternative State Resolution (ASR)

— Introducing an appeals facility

— Creating a standing International Investment Court.

11.2 The EESC considers that these options merit further detailed consideration. The EC has worked on the first four options while defining a new approach to investment protection and ISDS in the CETA and the EU-Singapore draft agreements. The consultation exercise has demonstrated that deep rooted concerns still exist. The Committee considers that the concept of creating an International Investment Court is the best way forward because it would go a long way in ensuring legitimacy and transparency of the system and lead to more consistent interpretation and greater accuracy of decisions. In this connection the EESC welcomes the statement made by the Trade Commissioner to INTA on 18 March that 'A multilateral court would be a more efficient use of resources and have more legitimacy'.

11.3 However, the EESC does not consider that running in parallel negotiations on ISDS in TTIP with a medium-term option of an International Investment Court is a viable way forward. If agreement within TTIP is found, it will almost certainly become the gold standard and undermine any prospect gaining support for an International Court. The position is further complicated by the fact that TTIP does not have an automatic read-across to CETA. It is important to emphasise that negotiations on CETA have concluded and there is no guarantee that the Canadian government will agree to incorporate any changes agreed in TTIP.

(31) ICSID Convention Article 52.
11.4 By adopting the current strategy, the EC faces the prospect that its first venture into negotiating Investor Protection could result in three different systems covering the US, Canada and Singapore. On the other hand, if the Commission does deliver a uniform system, this will only be achieved after very tough negotiations. The EESC believes it would then be virtually impossible to gain the support necessary to refocus efforts towards the creation of an International Court.

11.5 The EESC therefore concludes that with major global players such as the US, Canada and Japan, all involved in concurrent new trade and investment talks a unique opportunity exists to pursue an international investment court. The Committee also believes that this also represents the best prospect of persuading developing countries where the need for IP is arguably far greater, to buy into a new global system.


The President
of the European Economic and Social Committee
Henri MALOSSE
to the opinion of the European Economic and Social Committee

The following counter opinion, which received at least a quarter of the votes cast, was rejected during the discussion:

Delete the whole text of the opinion and replace as follows:

1. Conclusions and recommendations

1.1 Foreign Direct Investment (FDI) is an important contributor to economic growth and jobs. Companies that invest in another country are ipso facto taking a specific risk, but foreign contractors need to be protected against disproportionate and abusive treatment by the host State where they have invested, such as through direct expropriation, discrimination on grounds of nationality and unfair and unequal treatment when compared with domestic investors. A neutral dispute mechanism is important. Investments are often very long term and political circumstances in host States can change.

1.1.1 An International Investment Agreement (IIA) between two States (or regions) involves international law. To be effective that needs an effective, balancing, international dispute settlement mechanism.

1.1.2 In most IIAs however the dispute settlement mechanism puts together individual companies and the host State through the Investor to State Dispute Settlement (ISDS) Procedure (1). ISDS is retrospective in character. Unlike the WTO Dispute Settlement Procedure, if a State loses a case only payment of compensation is involved. It does not need to repeal the relevant legislation. Investment is not a WTO competency, being dropped from the Doha Round Agenda in 2003.

1.2 The EU is both the largest provider and recipient of international investment. Investment is a core interest for EU business, including SMEs. The Committee therefore welcomes the Commission position (2) that ISDS is:

— an important tool for protecting investments and therefore for promoting and securing economic growth in the EU;

— an effective way of enforcing the obligations our trading partners agree on with our investors when they sign investment treaties.

1.2.1 A Business Round Table organised by the EESC Employers’ Group on the Transatlantic Trade and Investment Partnership (TTIP), concluded (3) that: ‘An international agreement such as TTIP should create the right conditions to attract a high level of future investment in the transatlantic market. This includes granting ample access and non-discriminatory treatment for investors on both sides and improving the current framework for IP, including ISDS by making it more accessible to SMEs and striking a proper balance between investor rights, the right of States and local authorities to regulate in the public interest’.

(1) Provision for ISDS is found in some 93 % of the more than 3 250 IIAs signed to date, although the procedure has only been used in under 100, less than 3 %.
(2) EC — Factsheet on ISDS — Paragraph 2, 3.10.2013.
(3) EESC Business Round Table — Common Declaration on TTIP, 16.12.2014.
1.3 The EU-Canada trade agreement (CETA), yet to be ratified, includes an extensive investment protection chapter including provision for ISDS. This, together with the investment chapter in the EU-Singapore Free Trade Agreement (1), is the first ever investment agreement negotiated by the EU since it gained competency for investment under the Lisbon Treaty in 2009. This has gone a long way to address outstanding concerns, but ISDS needs to evolve further.

1.4 Apart from the principle of 'Most Favoured Nation' (MFN), and the cover normally included by the Commission to deal with compensation in cases of war, revolution and so on, the Committee urges that investor protection under an IIA and therefore open to the use of ISDS, must be restricted to cover the four substantive protections, namely

— not to discriminate on grounds of the nationality of an investor;

— a minimum standard of treatment, usually described as 'fair and equitable';

— prompt, adequate and effective compensation when expropriation occurs (not discriminatory and with due process);

— allowing transfer of funds related to the investment.

1.5 Over time a number of real and perceived abuses have arisen through the use of ISDS and these need to be addressed. ISDS needs to be updated. The Committee welcomes the four areas for further study on investment protection and ISDS identified by the Commission in January 2015 as a result of its public consultation on investment protection and ISDS in TTIP, following its inclusion in the mandate for the negotiations given unanimously by the Member States.

1.5.1 These covered:

— the protection of the State’s right to regulate;

— the establishment and functioning of arbitral tribunals;

— the review of ISDS decisions through an appellate mechanism;

— the relationship between ISDS and domestic judicial systems.

1.5.2 The Committee considers due protection of the State’s right to regulate to be essential, and any remaining ambiguities removed. As stated in the Committee’s opinion on TTIP (2), it is ‘essential that any ISDS provision proposed in the TTIP does not hinder the ability of the EU Member States to regulate in the public interest’. Previous IIAs have been primarily drafted with the need to protect investments. Both CETA and the Singapore Agreement have tightened key definitions to avoid unwarranted interpretations and specifically refer to the right to regulate in the preamble to each agreement. The EESC considers that this should now be included in the body of the relevant text, as a specific Article of any such agreement.

1.5.3 It is essential that arbitrators on ISDS tribunals must be fully impartial and not open to conflicts of interest. The Committee urges that all arbitrators must be chosen from a roster pre-established by the Parties to the relevant agreement, and that clear qualifications are established for such arbitrators, notably that they are qualified to hold judicial office and have proven expert knowledge in the relevant fields of international law.

(1) Also still to be ratified, and subject to legal challenge in the ECJ as to whether it is a ‘mixed’ agreement and therefore needing approval by all Member States Parliaments.

(2) EESC Opinion on Transatlantic trade relations and the EESC’s views on an enhanced cooperation and eventual EU-US FTA — 4 June 2014 [OJ C 424, 26.11.2014, p. 9].
1.5.4 An appellate mechanism is also essential — a legal process without a right of appeal is rightly very rare, although this exists in current IIAs. The EESC notes reference was made to an appellate mechanism in the original TTIP negotiating directives. Design of such a mechanism will be critically important, including the methods how members are designated, their qualifications and remuneration, together with any time limits to be applied. It should cover errors of law and errors of fact. Early consideration should be given as to whether a bilateral mechanism could be made multilateral, perhaps modelled on the WTO Appellate Body. Any such mechanism will involve extra costs, but that should be taken into account.

1.5.5 The relationship between ISDS and domestic judicial systems will be harder to resolve. IIAs are international agreements and domestic courts do not necessarily have the competence to interpret matters of international law. Even the best system can falter, but double claims should be prohibited. Either potential litigants should make a final choice at the start of proceedings, or lose the right to go to domestic courts as soon as they turn to ISDS.

1.6 A multilateral, international court is the longer term answer. This needs to be developed in parallel with the development of ISDS in TTIP and elsewhere. It is imperative that some form of international investor protection remains whilst such an international body is negotiated and established.

1.6.1 It is important to ensure critical mass for the establishment of an international court as the longer term objective for investment dispute settlement. The widespread acceptability of such an international appellate mechanism is likely to stem from it being set up through consensus, which should deal with potential related problems that all new international institutions, including the International Criminal Court, face.

1.6.2 The EESC cautions against the suggestion that, as all ‘G7’ members are currently involved in IIA negotiations, these ones start to develop an international court separately by themselves. Critical mass can only be achieved if a much wider spread of countries involved from the onset, and the door is left open for others to join as and when they are interested.

1.6.3 In the meantime, the EESC recommends the EU and the US to engage on a bilateral investment dispute settlement mechanism in the TTIP.

2. Background

2.1 The Committee notes that if two countries desire to promote economic relations with each other through an International Investment Agreement, each will promise the other that they will guarantee certain levels of treatment to investors and investments from the other country. These promises, willingly entered into, then need to complete full domestic ratification processes. They do not in any way prioritise corporate interest over the right of governments to so regulate. In the interests of the rule of law governments do however need to be held to the guarantees they give.

2.2 The Committee recognises that, although negotiating States look to include provisions to protect their own companies against discriminatory actions of trade partners, it is unrealistic for an aggrieved company to expect that any dispute should automatically be taken up at State-to-State level, thus raising the issue to a political or diplomatic level.

2.2.1 If companies were to rely on the EU to take disputes up on a State to State basis, only a very few could be so pursued, and smaller companies would be less likely to have their voices heard. It is unlikely that there would be many cases between two mature democratic legal systems, but if State-to-State Dispute Settlement Procedure were to become the norm, the number of potential cases would be bound to rise, with major resource implications for States.

2.2.2 As Commissioner Malmström herself has pointed out (\(^1\)), in connection with the TTIP negotiations, international law cannot be invoked in US courts, and no US law prohibits discrimination against foreign investors. In other countries, domestic courts may be less trustworthy.

\(^1\) European Parliament, 6 May.
2.2.3 Investment is not identical to trade. In a trade dispute the onus is clearly on a State to take the lead. Such disputes are likely to involve a class of production, such as bananas, solar panels or textiles: dumping is a key WTO DSP issue.

3. The evolution of ISDS

3.1 Although the overall number of ISDS cases (1) remains small, its use has grown substantially since 2002. This is proportionate to the increase in overall FDI, which globally by 2013 had exceeded USD 25tr. European investors have launched some 50% of all claims since 2002. A sizeable number of these have been launched by smaller or specialist companies (2). It is important that any reformed ISDS procedure must be made more accessible to SMEs.

3.1.1 Of the 356 known cases that have been concluded, 25% were resolved in favour of the investor, and 37% in favour of the State. The rest were settled (3).

3.2 Due to issues — both perceived and in reality — arising from the outcome of a number of ISDS cases worldwide, including a number that are still on-going, an increasingly notable part of public opinion in the EU, led by unions, NGOs and other organisations, has become concerned about its use, with opposition growing to an investment chapter and ISDS in TTIP.

3.3 Without reform of ISDS, and the inclusion of an Investment Chapter in TTIP, the Committee notes that previous arrangements as found in the 1 400 Bilateral Investment Treaties (BITs) negotiated by individual Member States (with the exception of Ireland), and those in particular previously reached by nine Member States with the US, would of course still stand and remain valid.

Results of the vote

For: 94
Against: 191
Abstentions: 25

(1) 610 cases by the end of 2014.
(2) The Stockholm Chamber of Commerce reports that out of some 100 cases completed between 2006 and 2011, some 22% were undertaken by SMEs; the BDI also report that some 30% cases undertaken by German companies were from SMEs.
(3) EC Factsheet on ISDS, 3 October 2013.