BUSINESSEUROPE

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ISDS- Overview of BUSINESSEUROPE position

1. ISDS some facts

- There are more than 3.000 Bilateral Investment Treaties in place that include ISDS provisions;
- Around 90% of these BITs were never used by investors to initiate an ISDS case;
- 1.400 of these BITs have EU countries as parties;
- EU countries still have BITs between themselves that include ISDS provisions;
- European investors are the main users of ISDS. In the last 10 years they are responsible for more than 50% of the claims, while US investors account for 24%. This mirrors the global share of FDI, as EU countries account for 40% while the US accounts for 24%;
- Claims have risen in the last decade: 100 claims were filed between 1987-2002 and 568 claims between 2003-2013[1]. But this increase has been proportionate to the raise in Foreign Direct Investment- in 1960 the FDI global stock was US$ 60 billion and in 2013 it exceeds US$ 25 trillion[2];
- ISDS is not only an instrument used by large companies. For instance, in around 100 decided cases (2006-2011) that the OECD evaluated, 22% of complaints were filed by SMEs;
- Published claims by investors are concentrated against certain states such as Argentina (53 claims) and Venezuela (36 claims);
- 1/3 of the cases are settled before going to a final ruling. As for the remaining 2/3 that proceed to arbitration, States won in about 67% of the cases;
- Typically, an arbitrary award only provides for pecuniary compensation. Arbitrators do not have the power to change legislation or measures adopted by a State;
- Pecuniary compensation awarded to investors is only a fraction of initial claims, on average less than 10%;

[1] UNCTAD
[2] World Bank

2. ISDS some questions

a) Does ISDS give special rights to foreign investors?

The rights granted under BITs and the investment chapters in free trade agreements are normally "fair and equitable treatment", "no expropriation without compensation", "access to impartial arbitration" and 'free transfer of capital'. These rights are in line with Article I of the Protocol to the European Convention for the Protection of Human Rights and Fundamental Freedoms that says *"No one shall be deprived of his possessions except in the public interest and subject to the conditions provided by the law and by the general principles of international law".* In the same line the United Nations Universal Declaration of Human Rights says (art°17°) *"Everyone has the right to own property alone as well as in association with others"…. "No one shall be arbitrarily deprived of his property*". While Art° 10° establishes "*Everyone is entitled in full equality to a fair and public hearing by an independent and impartial tribunal*….". Art. 63-66 of the Treaty on the Functioning of the European Union (TFEU) establish the right of free movement of capital: "…all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited" and "…all restrictions on payments between Member States and between Member States and third countries shall be prohibited". So these can hardly be conceived as "special rights" but rather fundamental and basic rights. In addition, the rights a foreign investor has in the EU through a BIT also apply to EU companies abroad.

b) The EU and the US have sound legal systems. Why investors do not use the national courts?

Even if the EU and the US have developed economies with sound legal systems it is not guaranteed that investors will be able to receive adequate protection. For instance, the right of non-discrimination is not guaranteed in the US, unless there is an international agreement to which foreign investors can refer to. Companies' claims result from the breach of an International Treaty. In general, domestic courts do not consider themselves competent to interpret and apply International Law.

c) Does ISDS undermine the right of states to regulate?

As long as regulators respect international law, investors will not be able to raise any claims through ISDS procedures. Furthermore, even if a claim is decided in favour of the Investor **the State is not obliged to change or withdraw the legislation or measure that is at the base of the claim**. In the recent EU agreements that include ISDS provisions it is clearly stated that the EU preserves its right to regulate and to achieve legitimate policy objectives, such as public health, safety, environment etc. This is to reaffirm the already established practice in ISDS. For instance, the tribunal in the Saluka Investments BV vs The Czech Republic (2006) stated the following:
"It is now established in international law that States are not liable to pay compensation to a foreign investor when, in normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare."
It is also clear that States must not lower their environmental or labour standards in order to attract investments. Provisions forbidding such practices are already included

in BITs and FTAs. CETA contains many formulations to protect the right of States to regulate. It is expected that TTIP will include similar provisions.

d) Do companies use ISDS often, even when they are not sure the claim has real grounds?

ISDS is a last resort tool. Companies use it in extreme cases when all other options have failed. Going against a State is not an easy decision and inevitably means that a company has had to stop business activity in the country. Data shows that around 90% of existing BITs have never been used by an investor to present a case. Additionally, recent EU FTAs include specific provisions to avoid frivolous claims and stricter definitions on important concepts such as "indirect expropriation". We must not forget as well that ISDS procedures can be expensive and a company will only use them if it has solid legal arguments supporting the claim. Furthermore, even if the global FDI stock exceeds $25 trillion there have been only around 500 cases since 1987.

e) Is there a lack of transparency in ISDS procedures?

It has been internationally recognised that more transparency is needed in ISDS procedures. As a consequence the United Nations has recently adopted far-reaching new rules on transparency on ISDS (UNCITRAL Rules). The EU is following a similar path in its recent FTAs with new provisions to ensure information on the case is available to the public and the hearings are also public. Of course, as it is the case for national courts, we need to ensure that sensitive information is fully protected and the impartiality and independence of the decision is ensured. Moreover, UNCTAD and ICSID offer information on ISDS cases in their online databases.

f) Is ISDS beneficial for SMEs or only for multinationals?

SMEs have usually more resource constraints and this limits their availability to go international and particularly to invest in foreign markets. For this reason SMEs are much more sensitive to legal uncertainty and to a sound legal framework that protects investments and ensures investors' rights will be fully respected. That is why a functioning and modern ISDS system is so important for SMEs. It will certainly encourage SMEs to invest and be more active in the international markets including the US. OECD data indicates that so far 22% of ISDS cases filed worldwide have been initiated by SMEs, which is in line with their overall level investments. Ensuring a better, more efficient and reliable protection framework will certainly enhance foreign direct investment particularly from SMEs.

3. ISDS improvements- business position

- We welcome measures aimed at making ISDS a more effective, modern, predictable and transparent tool.

- We view positively the new United Nations rules on transparency and welcome their inclusion in the EU agreements.

- We support clearer definitions of important concepts such as, “investor”/“investment”, “fair and equitable treatment” and “indirect expropriation”.

- We are also in favour of establishing a code of conduct for arbitrators that safeguards impartiality and prevents conflict of interests.

- We support provisions that filter clearly unfounded or frivolous claims.

- We believe a definition of investor is important to ensure that “shell” or “mail box” companies are not considered.

- We acknowledge critics about the arbitration court decision being final and binding. The creation of an Appeal mechanism is already foreseen in CETA. However the mechanism has never been implemented. Therefore we need to make sure that if implemented it is efficient, promotes worldwide consistency and does not deter SMEs from using ISDS.

- To ensure more access to ISDS for SMEs, there is room for improvement on the delays of procedure that should be shortened and on the enforcement of decisions. The cases of lack of enforcement should be taken at multilateral level, for instance in the framework of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”).

4. ISDS - assessment of recent developments

a) <u>CETA-changes introduced in ISDS in order to respond to critics.</u>

- Closed definition of Fair and Equitable Treatment

  CETA attempts to better define Fair and Equitable Treatment by proposing a list of possible breaches. This may be particularly problematic for investors:
  - Although there is case law where this list could be based on, it is likely that situations will arise in the future that would constitute breaches of Fair and Equitable Treatment and cannot be foreseen by the negotiators now. The list should not be closed and allow for the inclusion of new unforeseen cases. Furthermore, it should be ensured that the actions of the State are always proportionate to the State’s public interest objectives.
  - A limited interpretation of Fair and Equitable Treatment will further complicate the use of concepts such as: *manifest arbitrariness* or *targeted discrimination on manifestly wrong grounds*.

- Limitations in indirect expropriation

  CETA foresees the provision of guidance that would help tribunals determine cases of indirect expropriation. However, CETA also introduces general exceptions that would leave investors without compensation. BUSINESSEUROPE does not disagree with the right of States to regulate, but

calls also for the respect of investors' rights and property, including trade secrets and intellectual property rights. The definition of indirect expropriation should be as specific as possible in future BITs, for instance on what consists "manifestly excessive" expropriation.

- The filter mechanisms introduced in CETA to avoid frivolous claims

  CETA allows for tribunals to review and dismiss claims that are unfounded as a matter of law or without legal merit. Claims brought before a tribunal should generally be subject to a preliminary review, according to Rules 41(2) and 41(5) of the ICSID Convention, Regulations and Rules. This preliminary assessment might be very difficult in a number of cases. BUSINESSEUROPE considers that the review procedure should not affect the right to justice, for instance if used as a means to block justified cases.

  The recent financial crisis underlined the States' interest for prudential measures to ensure the integrity and stability of financial markets. CETA provides for the establishment of a Financial Services Committee in the event of ISDS cases related to prudential measures adopted ensure financial stability. The Committee will be led by financial authorities from Canada and the EU and its role will be to review an ISDS case before it proceeds to tribunal.

  However, it should be ensured that such filter mechanisms are not used to circumvent the obligations of States under CETA. A filter mechanism should only be applied in well-founded, emergency situations. Financial services should not unjustly receive less substantive protection and are not unjustly denied access to ISDS. Furthermore, the review of the cases should not be left only to the discretion of the Financial Services Committee.

- Streamlining damage compensation- lost profits

  CETA foresees that compensation is limited to actual damage, not including future profits. Companies plan investments on a long term basis taking into account in their calculations expected profitability margins. Compensation should take into account legitimate expectations from the investor.

- Investor pays in case the claim is unfounded

  The 'loser pays' principle is settled in the EU, but – so far – it is not an established practice in investment disputes. Instead, the principle of 'paying one's own expenses' applies. The 'loser pays' principle is only used as an exception, in cases where the tribunals rule that a claim is manifestly lacking legal merit, or is frivolous, or that one of the parties has acted in bad faith.

  In theory, the 'loser pays' principle is used as a means to prevent frivolous cases. Nevertheless, BUSINESSEUROPE is reluctant about the benefits of the blanket application of the principle, as it poses certain risks and challenges:

- It can prevent the launch of legitimate and well-founded cases – an investor may ultimately lose a case, but still have good reasons on legal grounds to have the matter adjudicated;
- It could deter SMEs from using the system;
- On some cases it is difficult to establish the losing party, as both parties may partially win claims. The tribunal should be flexible to decide on who bears the arbitration costs.

- Transparency in the procedures- hearings open to the public and interested parties (NGOs, Trade Unions) will be able to make submissions

  CETA bases transparency procedures for ISDS cases on the recently (April 2014) adopted UNCTAD enhanced rules. These include: public accessibility to documents, public hearings and the ability of non-parties to file submissions to ISDS procedures (amicus curiae submissions). There are also provisions that allow the protection of sensitive information. BUSINESSEUROPE welcomes this approach but supports that a balance needs to be found between transparency and the protection of information that is sensitive for companies for commercial or security reasons. In these cases confidentiality needs to be ensured. Furthermore, transparency should neither hinder the conduct of the work of the tribunal (including the public hearings), nor pose a disproportionate burden to parties (ex. documentation, public hearings – including security and financial burden).

b) **Other technical elements of ISDS**[3]:

- Appeal mechanism- how should it work
  - Does not exist yet – there is on-going discussion on whether one should be created and at which level: bilateral or multilateral? There are legal questions that need to be answered.
  - There are provisions for an appeal mechanism in the U.S. model BIT, but it has never been used so far. Similar provisions exist in CETA as well.
  - Such a mechanism should have a multilateral character. It could be similar to the Appellate Body of the Dispute Settlement Body of the WTO. Such an institution could eventually lead to a more consistent interpretation of investment law, and thus to greater legal certainty for investors and States.
  - It should be however ensured that the overall costs and length of the procedure do not rise at a level that the use of the Appeal Mechanism becomes prohibitive especially for SMEs.
  - Moreover the review should be limited to the legal interpretation and implementation.

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[3] Another technical issue is the use of the 'umbrella clause', which some EU Member States traditionally included in their BITs. As they consider this important to guarantee efficient protection of investors, they would also like to see an umbrella clause in TTIP.