Brewing Storm over ISDR Clouds: Trans-Pacific Partnership Talks – Part I

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Lori Wallach (Public Citizen)

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Trans-Pacific Partnership (TPP) negotiations have become the territory where a brewing perfect storm over investor-state dispute resolution (ISDR) is making landfall. The June 2012 leak of the draft TPP Investment Chapter text added energy, but much more is fueling this tempest.

In general the ISDR system is coming under increased scrutiny. Public and policymaker concerns in numerous countries have been building alongside awareness of the regime and its implications as large ISDR awards in challenges against common public interest policies increase.

U.S. government insistence that the TPP include an expansive ISDR system is having a boomerang effect. And I am not mainly referring to Australia's announcement that it will not submit to ISDR in the TPP given the Australian Productivity Commission's 2010 conclusion that ISDR is not in the national interest.

Rather, policymakers, jurists, and legal scholars are increasingly questioning the very notion of elevating an individual foreign firm or investor to equal status with sovereign nation signatories to have the power to privately enforce a public treaty. In countries with well-functioning domestic court systems, the obvious question is why should there ever be a parallel system of privatized justice, much less one with the structural problems inherent in ISDR?

Studies showing no correlation between having investment agreements with ISDR and attraction of foreign direct investment have diminished the ostensible upside of ISDR-enforced investment treaties for developing countries. South Africa and India are among those now conducting critical reviews of the regime. Brazil, the number one FDI recipient in Latin America and fifth highest recipient in the world, has refused to be bound to ISDR.

The Perfect Storm Emerging over IDSR

When ISDR was limited to the ostensible intent of the international investment regime – establishing a venue for compensation when governments expropriated factories, land or other "hard" investments in countries without well-functioning court systems – it was of little impact or interest to most. But now the ISDR regime being spread through Free Trade Agreements (FTAs) and Bilateral Investment Treaties (BITs) is increasingly resulting in diverse, damaging and direct impacts on peoples' day-to-day lives around the world. ISDR has enabled a stunning array of investor-state attacks on health, tobacco, natural resources, financial, environmental, oil and gas extraction, land-use, transportation, toxics and other policies.

But government actions deemed subject to ISDR now include environmental and health protections (from toxics bans to cigarette packaging requirements), natural resource management (from water rights to mining policy), the functioning of domestic court systems, the denial of regulatory permits, emergency regulatory measures taken during financial crises, and more. In fact, all of the 16 pending ISDR claims under only U.S. FTAs—seeking over $13.1 billion in damages—relate to environmental, energy (including oil and gas extraction), land use, public health and transportation policies – not traditional trade issues.

Second, the use of ISDR is skyrocketing. BITs with investor-state enforcement have existed since the 1950s, but between 1972 and 2000 only about 50 disputes were resolved. Since 2000, the number of new treaty-based investor-state cases launched per year has soared by 254%. The sudden flood of cases has persisted throughout the last decade, pushing the cumulative number of filed cases through 2011 (450 cases) to nine times the cumulative number seen in 2000 (50 cases). Just this year, 43 cases have been filed at the International Centre for the Settlement of Investment Disputes alone.

Correspondingly, the number of countries facing ISDR challenges has increased. And, there is nothing like being the subject of an ISDR case to alter government and public perceptions of the regime. Meanwhile, the awards being generated are adding up. Over $3 billion has been awarded to corporations and investors under U.S. FTAs and BITs alone, over 85 percent of which pertains to challenges against natural resource, energy, and environmental policies, not to traditional expropriations involving government seizure of land or a factory. The recent "win" by Exxon-Mobil in an investor-state North American Free Trade Agreement (NAFTA) case attacking a Canadian province's offshore oil and gas exploration regulations will add significantly to the $365 million that governments have had to pay to investors attacking environmental, zoning, timber and other policies just under NAFTA and the Central America Free Trade Agreement (CAFTA).

Third, the definition of "investment" in FTAs and BITs is much broader than the real property and specific interests in property that are typically protected under domestic property rights law. In recent U.S. FTAs and the U.S. demands for the TPP, the definition includes regulatory permits and licenses; financial instrument such as futures, options, and derivatives; intellectual property rights; procurement contracts between a state and a foreign investor; and natural resource concession contracts granted by a national government to a foreign investor. In addition, the standard investor-state definition of an "investor"—a person or legal entity that makes an investment—has not required that person or entity's actual business activities or commitment of capital in the host country to be substantial.

Further, "indirect" expropriation provisions in BITs and FTAs provide property rights not available in many nations' domestic legal systems. Under ISDR, governments can be required – and have been, a la the NAFTA Metalclad case – to pay compensation based on a government action or policy diminishing the value of an investment, regardless of whether there has actually been appropriation of an asset by the government or a full and permanent destruction of all value of the property.

Fourth, in an era of growing public awareness of corporate influence on every aspect of our lives, the ISDR regime is an example of a system of global governance that formally prioritizes corporate rights over nations' rights to regulate and govern their own affairs. When the cases pertained to actual expropriations, this perspective would not have had traction.

But boil down the current ISDR regime to its core elements: foreign private commercial interests are elevated to equal standing with nations to directly enforce public treaties that provide them with greater rights than those afforded to domestic commercial interests or citizens. Using foreign tribunals, they can skirt domestic courts to extract large sums of taxpayer monies on claims that any

one of a vast array of government actions undermines what a three-person tribunal of private lawyers, who rotate between serving as “judges” and suing governments, decide to be the reasonable expectations of an investor. There are extremely limited opportunities for “appeal,” regardless of the arbitrariness of a given award. And now specialized private equity firms have sprung up to finance this system of foreign corporations raiding public treasury funds.

From a conservative perspective, this system poses an unparalleled threat to national sovereignty and solvency, and from a progressive perspective to democratic governance and the public interest polices won through years of struggle. In the past, little attention was paid to the ISDR regime by the vast majority of voters, policymakers, journalists, academics or civil society advocates. Now the results of the regime are awakening diverse interests to a quiet but very troubling transformation of the legal system that has taken place over the last few decades without their awareness, much less consent.

This awakening is creating a growing drag on TPP negotiations, where U.S. negotiators have made the expansion of both the substantive investor privileges and the scope of coverage for investor-state enforcement regime a priority.

Part II of this blog will explore in more depth the converging streams of concern about the ISDR regime and what it means for TPP.