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

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As described in Part 1 of this post, the mounting debate about investor-state dispute resolution (ISDR) has crescendoed in the current Trans-Pacific Partnership (TPP) negotiations. There are at least two "schools" of concern with ISDR, both of them voiced inside and outside the TPP context.

Threats to Public Interest Policy

For a growing array of domestic policymakers, civil society organizations and people impacted by ISDR decisions, ISDR is viewed as a threat to vast swaths of public interest policy achieved through decades of struggle, and to the prospect of further advances. Either by winning an investor-state attack and collecting millions in compensation, or by preemptively chilling government actions to address critical public needs, international investor rights and private investor-state enforcement are seen as imposing significant limits on progressive reforms related to health, the environment, water or other natural resources. Further, the ISDR system is increasingly being understood as a threat to governments' ability to effectively respond to emergent demands, such as financial crises or climate change, the redress of which requires new policies and approaches.

The mere filing of an ISDR challenge can have a chilling effect on needed policy initiatives. Important mining policy reforms affecting access to clean water for millions of people in El Salvador have been bogged down in the face of ISDR challenges under CAFTA. The threat of a NAFTA claim by insurance firms against Ontario, Canada's proposed no-fault government auto insurance regime led to the abandonment of that proposal. Canada also reversed a nationwide ban on MMT, a gasoline additive banned in many U.S. states as a probable carcinogen, after the U.S. Ethyl Corporation filed a NAFTA investor-state case.

The filing of ISDR cases is also increasingly being used as a form of rough bargaining. Consider the *Renco* case against Peru under the U.S.-Peru FTA, which relates to the severe pollution created by a metal smelter owned by Renco subsidiary Doe Run in the town of La Oroya, which was listed as one of the top 10 most polluted sites in the world. The Peruvian government shut down the facility after Renco's years of delay in implementing environmental improvements. Renco has taken no action on the FTA case itself since its initial 2010 notice, despite being authorized to do so since April 2011.

But, Renco has used the investor-state case as a tactic to pressure the Peruvian government to allow it to reopen its smelter without installing pollution-capturing devices, and to evade a U.S. court case seeking compensation for children injured by the past pollution. Renco's investor-state case demands $800 million in compensation from Peru over the denial of a *third* extension on a 1997 environmental

remediation agreement after failing to fulfill contractual commitments to the Peruvian government to install pollution devices in the facility in La Oroya.

The Peruvian government has allowed the La Oroya smelter to restart zinc smelting operations and in November 2012 Doe Run took the first steps to restart lead smelting, which has already resulted in reports of fresh emissions. Meanwhile, Renco has also successfully used the mere filing of its investor-state case to delay and possibly derail a Missouri state court case demanding compensation for Oroyan children poisoned by the smelter.

After Renco's three unsuccessful attempts to remove the case from state courts where it would face more favorable prospects, the filing of the ISDR case led a federal judge to approve Renco's fourth attempt at removal. Why? "[U.S. law] allows removal of any action in state court in which 'the subject matter … relates to an arbitration agreement or award falling under the Convention' [Convention on the Recognition and Enforcement of Foreign Arbitral Awards]," she ruled.

Threats to Systems of Justice

For jurists, legal scholars and domestic practitioners, the ISDR critique is structural, focusing on the details of a parallel system of privatized justice.

Many of the lawyers who serve on ISDR tribunals also represent corporations in attacking governments, which creates inherent conflicts of interest by allowing lawyers to rotate between roles as arbitrators and advocates for investors in a manner that would be unethical for judges. Specific conflicts of interest have raised alarm, such as in the *Vivendi v. Argentina* case, in which the award was not annulled despite one of the tribunalists serving on the board of directors of a bank that held shares in Vivendi. The tribunalist did not disclose the conflict, much less recuse herself.

In addition, the bill-by-the-hour fee structure for tribunalists, in contrast to domestic judges who are not paid for piecework, creates an incentive for lengthy proceedings, for which governments are usually billed even if a case is ultimately dismissed. This fee structure creates a dynamic in which the mere filing of a case creates an incentive for governments to concede to investor demands to avoid costs.

Another, more fundamental legal concern with the ISDR regime is that it empowers foreign corporations to not only circumvent sovereign immunity protections, but to directly challenge domestic laws and regulations outside of domestic courts. Exhaustion of domestic remedies is not required before proceeding to international tribunals even though the exhaustion requirement is a fundamental principle of international law.

Furthermore, as arbitral tribunals have extended beyond awards of cash damages and issued injunctive relief, severe conflicts of law problems are being created with investor-state actions being used to meddle in domestic court processes. For instance, in the *Chevron v. Ecuador* case under the U.S.-Ecuador BIT, a tribunal ordered Ecuador's executive branch to violate its constitutional separation of powers and somehow halt the enforcement of an Ecuadorian appellate court ruling that ordered Chevron to pay for its contamination of the Ecuadorian Amazon.

This case, alongside *Renco*, also highlights how the investor-state regime is increasingly being used to evade justice in domestic courts. Legal claims against Chevron were lodged in U.S. courts on behalf of indigenous and *campesino* farmer residents affected by the company's oil operations in the Ecuadorian Amazon. After a decade of litigation, the case was heading to a jury trial in U.S. federal court when Chevron moved in 2002 to transfer it to Ecuadorian courts, arguing that it could only obtain a fair trial in Ecuador. The plaintiffs consented to the transfer after Chevron signed an

agreement to abide with the final ruling of Ecuador's courts. In 2011, after an eight-year trial in Ecuador that generated over 220,000 pages of evidence, the Ecuadorian court ordered Chevron to pay $18 billion to clean up the environmental damage. An Ecuadorian appellate court affirmed the decision in January 2012. Chevron's executives vowed never to pay, despite Chevron's promise to U.S. courts that it would abide by the decision as a condition of moving the trial to Ecuador.

Having lost the case in Ecuador's domestic courts on the merits, Chevron – one of the wealthiest corporations on the planet, with revenues of $240 billion in 2011 – sought to escape its liability by commencing an investor-state case under the U.S.-Ecuador BIT that would shift the clean-up costs to the government of Ecuador, a country where the per capita income is $4,000 per annum. Ostensibly, the BIT was designed to allow U.S. investors to seek monetary damages from the government of Ecuador for expropriation or unfair treatment. But Chevron is using ISDR to try to immunize itself from liability in private litigation. It is asking a tribunal of three private lawyers to substitute its judgment for that of 18 years of robust U.S. and Ecuadorian court proceedings with respect to the merits of who is liable to clean up the toxic mess in the Ecuadorian Amazon. Although this BIT took effect in 1997, five years *after* the oil company abandoned its Ecuador operations, the tribunal issued an initial award ordering Ecuador's government to interfere in its independent judiciary and somehow suspend enforcement of the appellate court ruling until the ISDR investment tribunal can rule.

Increasingly Expansive Tribunal Interpretations of Obligations and Jurisdiction

Governments that previously agreed to ISDR provisions without trepidation have shown rising concern with a trend of tribunals creating new obligations for States with enormously elastic interpretations of the "minimum standard of treatment" and related "fair and equitable treatment" standards. By fabricating new obligations under these standards – obligations not contemplated when countries signed FTAs and BITs – tribunals are then issuing stunningly arbitrary awards. Tribunal-fabricated obligations related to fanciful notions of investors' expectations and what a tribunal deems a proportionate response by a government to an investor's malfeasance open the door to ISDR claims and awards over a wide range of government measures that are otherwise permissible under nations' constitutions and legal systems.

Such concerns were confirmed with the recent and historic $1.8 billion judgment (plus compound interest) against Ecuador in a case brought by Occidental under the U.S.-Ecuador BIT. While the press focused on the staggering penalty—the largest to ever come out of an International Centre for Settlement of Investment Disputes (ICSID) tribunal—that may not have been the real news. Perhaps even more shocking is the illogic that the tribunal used to rule that Ecuador violated the BIT's Fair and Equitable Treatment and Indirect Expropriation obligations.

The tribunal acknowledged that Occidental breached a government contract by selling a 40 percent share of its oil concession. The contract included a provision stating that the assignment of any share to another party without government consent would terminate the contract. And, the tribunal noted the Ecuadorian law that stated that such an action could result in forfeiture of the concession altogether. Thus, the tribunal concluded that Oxy should have expected its contract to be terminated and noted that it had a right to challenge this outcome in domestic court. But, the tribunal created a "proportionality" obligation, and opined that Ecuador's action in enforcing the exact language of the contract was unduly harsh. Having found a FET violation, the tribunal declared that this also equated to an indirect taking without further analysis or explanation. It then ordered Ecuador to pay 100 percent of the lost future earnings under the contract, even though the whole conflict related to Oxy's sale of a 40 percent share.

Recognizing and seeking to limit tribunals' expansive interpretations of governments' obligations to investors, some States have attempted clarifications and interpretive annexes to rein in ISDR

tribunals. But this summer's CAFTA *Railroad Development Corporation v. Guatemala* award showed that the touted U.S. Customary International Law (CIL) Annex has proved quite useless in foreclosing tribunals from generating ever-expanding interpretations of States' obligations to investors, such as those based on fanciful notions of investors' expectations. Rejecting the arguments raised by Guatemala, the United States, El Salvador and Honduras that the minimum standard of treatment obligation must be interpreted under a CIL state practice and *opinio juris* analysis, the tribunal instead imported an inventive MST interpretation from the NAFTA *Waste Management II* award and ordered Guatemala to pay $11.3 million, plus backdated compound interest and fees, for actions that did not violate the CIL denial of justice standard.

While ISDR tribunals have expanded States' obligations to investors, they have also been widening the jurisdiction through which the investors can seek to enforce those "obligations." Despite the standard "Denial of Benefits" language, investors from countries that are not signatories to an agreement increasingly are launching investor-state cases via subsidiaries. For example, in the Pacific Rim v. El Salvador case brought under CAFTA, a Canadian firm reincorporated a Cayman Islands subsidiary as a U.S. corporation three months before launching a CAFTA investor-state case against El Salvador. The case made it through CAFTA's preliminary objections process. Only after three years and millions in costs did the tribunal dismiss the CAFTA aspect of the case. The tribunal agreed with El Salvador's denial of benefits arguments, but noted that had the firm done a more careful job of setting up its U.S. subsidiary, the Canadian firm could have used CAFTA's ISDR provisions.

Perhaps the most glaring example of the increasingly common and unfair practice of nationality-shopping can be found in the multi-front war being waged against cigarette plain packaging health policies. Philip Morris International moved the head office of its Australian subsidiary to Hong Kong shortly before it attacked Australia under the Hong Kong-Australia BIT in 2011. However, the corporation claimed to be a Swiss-based company when it launched its 2010 ISDR attack against Uruguay under a Uruguay-Swiss BIT. Meanwhile, the firm described itself as a U.S.-based company when it made a submission in 2010 to the Office of the U.S. Trade Representative in support of including ISDR in the TPP.

The Perfect Storm over ISDR Makes Landfall in the TPP

With public and policymaker alarm about ISDR growing in parallel to the upward trajectory of arbitrary ISDR awards against common public interest policies, the TPP negotiations could have been a venue to address well-founded concerns. Instead, U.S. official have dismissively waived off congressional and civil society reform proposals, doubling down to try to expand both the substantive investor rules and the scope of ISDR. This does not bode well, neither for the TPP, nor the future of the investor-state dispute resolution system.