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Towards a more diligent and sustainable system of investment protection

Legal briefing

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Executive summary

This legal briefing sets out five key recommendations for policy-makers and legislators to help decide on whether a potential future MIC is a viable solution to make the ISDS system environmentally sound and democratically accountable. These recommendations are:

1. **Necessity of Investor-State Dispute Settlement**: give greater consideration to the question of whether there is a real need for supranational investor-state dispute settlement mechanisms;

2. **Role of domestic institutions**: make investment law more respectful to domestic courts and institutions through a requirement to exhaust local remedies and defer to domestic courts on matters of domestic law;

3. **Fairness of the MIC**: ensure that the MIC is inclusive, and can receive not only investors' claims against states, but also claims made by states and affected third parties against investors.

4. **Protection of responsible investment**: limit the jurisdiction of the MIC to claims by responsible investors who have not violated Union values, and exclude claims that target public interest legislation;

5. **Independence of adjudicators**: select and appoint members of the MIC in full accordance with the Magna Carta of Judges and through an accountable and transparent process with proper involvement of the European Parliament at EU level.

Introduction

On 21 December 2016 the European Commission announced that it would begin developing plans for a Multilateral Investment Court (MIC), and would hold online consultations to assist in this process. This MIC would have the power to hear claims on the basis of international investment agreements (IIAs) concluded by the EU, and would potentially replace the investor-state dispute settlement (ISDS) mechanisms currently included in Member State IIAs.
The reform of ISDS through the MIC is one option to address the deep flaws that exist in the current ISDS system; another is to opt for other readily available alternatives to ISDS and terminate existing IIAs. To help policy-makers and legislators decide on whether a potential future MIC is a viable solution to make the system environmentally sound and democratically accountable, ClientEarth has developed five key recommendations:

1. **Necessity of Investor-State Dispute Settlement**: give greater consideration to the question of whether there is a real need for supranational investor-state dispute settlement mechanisms;

2. **Role of domestic institutions**: make investment law more respectful to domestic courts and institutions through a requirement to exhaust local remedies and defer to domestic courts on matters of domestic law;

3. **Fairness of the MIC**: ensure that the MIC is inclusive, and can receive not only investors' claims against states, but also claims made by states and affected third parties against investors.

4. **Protection of responsible investment**: limit the jurisdiction of the MIC to claims by responsible investors who have not violated Union values, and exclude claims that target public interest legislation;

5. **Independence of adjudicators**: select and appoint members of the MIC in full accordance with the Magna Carta of Judges and through an accountable and transparent process with proper involvement of the European Parliament at EU level.

These recommendations aim to credibly improve the fairness and inclusiveness of investor-state dispute settlement by promoting greater reliance on domestic courts and alternative forms of investment protection, ensuring that investors are not given more rights than other citizens, and preventing irresponsible investors from benefiting from any potential future MIC.

1 Necessity of investor-state dispute settlement

Recommendation 1: give greater consideration to the question of whether there is a real need for supranational investor-state dispute settlement mechanisms

A key preliminary question that needs to be answered is whether specialized supranational investor protection mechanisms are desirable or necessary in the first place. European policy-makers must not rush too quickly into assuming that ISDS policies must be a part of EU and Member State investment agreements.

To begin with, policymakers and legislators should be mindful of the origins of the system of investment protection. As noted by Peter Muchlinski, a professor in International Commercial Law:

> "*the existing system of ISDS is largely an unforeseen historical accident, developed as an act of legal entrepreneurship by specialist lawyers. It was never seen as a general substitute for domestic legal dispute settlement, but as a stopgap in cases of extreme maladministration carried out by governments in weak governance zones. [T]he availability of ISDS in IIAs was also very much involved with the decolonisation process and was rooted in the mistrust placed in early postcolonial governments' ability to offer impartial justice to foreign investors, and their habitual disregard for the procedures of ad hoc international arbitration.*"[1]

The accidental origins of ISDS have led directly to many of the problems with the current system. The system was based on commercial arbitration, gave transnational corporations special rights - but no responsibilities - over their activities in another country, and allowed these companies to completely sideline the domestic judicial process.[2] Arbitrators were given a financial incentive to claim jurisdiction over cases and the more expansive their interpretation of IIAs became, the bigger the incentive for investors and their lawyers to bring cases before investment tribunals.[3]
The one-sided nature of the system has greatly contributed to its expansion in the past twenty years with less than four cases brought on the basis of less than 400 IIAs to more than 700 cases today on the basis of over 3000 IIAs since 1990.[4] What is more, the system has given rise to an increasing number of claims that target public interest measures, such as tobacco-control legislation,[5] a nuclear power phase-out,[6] refusal of permits relating to cyanide-based open pit gold-mining,[7] an oil pipeline,[8] and a coal-fired power plant,[9] and a moratorium on fracking.[10] Considering the significant amounts of money involved, ISDS has given transnational corporations an unprecedented powerful tool to put pressure on public-interest decision-making.[11]

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[1] Peter Muchlinski, ' Regulating Multinational Enterprises' in Marc Bungenberg and others (eds), European Yearbook of International Economic Law 2016 (Springer 2016), 391-422, at 416. See also Kenneth J. Vandevelde, 'A brief history of International Investment Agreements' 12 U.C.-Davis Journal of InternationalLaw & Policy 157 (2005), available at http://ssrn.com/abstract=1478757; Muthucumaraswamy Sornarajah, 'International Investment Law as Development Law: The Obsolescence of a Fraudulent System' Marc Bungenberg and others (eds), European Yearbook of International Economic Law 2016 (Springer 2016), 209-232.
[2] Gus van Harten, *Investment treaty arbitration and public law* (Oxford: Oxford University Press, 2007)
[3] Ibid.
[4] Kenneth J. Vandevelde, 'A brief history of International Investment Agreements' 12 U.C.-Davis Journal of InternationalLaw & Policy 157 (2005), available at http://ssrn.com/abstract=1478757; Pia Eberhardt, 'The Zombie ISDS: Rebranded as ICS, rights for corporations to sue states refuse to die' (Corporate Europe Observatory, February 2016) available at https://corporateeurope.org/sites/default/files/attachments/the_zombie_isds_0.pdf, page 11
[5] Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7; Philip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12
[6] Vattenfall AB and others v. Federal Republic of Germany, ICSID Case No. ARB/12/12
[7] Gabriel Resources Ltd. and Gabriel Resources (Jersey) v. Romania, ICSID Case No. ARB/15/31
[8] TransCanada Corporation and TransCanada PipeLines Limited v. The United States of America
[9] Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/6
[10] Lone Pine Resources Inc. v. The Government of Canada, ICSID Case No. UNCT/15/2
[11] Gus van Harten, *Investment treaty arbitration and public law* (Oxford: Oxford University Press, 2007)

In light of what ISDS has become, an increasing number of countries are reconsidering their approach to investment protection and are in the process of terminating or revising their IIAs. Countries reconsidering their approaches and terminating their agreements include key global economies like Indonesia, India, and South Africa.[12] Other countries such as Brazil have refused to include ISDS in their international investment agreements.[13] Within the EU, several Member States are terminating their intra-EU IIAs. It is therefore doubtful whether an expansion of this post-colonial system to global dimensions is warranted and whether the system should not simply be phased out.

Second, the Commission's main argument for the development of the MIC is that "international investment rules and international investment dispute settlement have a role to play in encouraging and retaining investment".[14] However, studies remain inconclusive as to whether ISDS in fact helps to attract investment, and instead shows that investment decisions are largely based on factors such as the level of education of the population, tax rates, and other regulatory policies.[15] Ireland, a Member State that attracts considerable amounts of foreign direct investment,[16] is only party to one international investment agreement with ISDS: the Energy Charter Treaty. Moreover, evidence suggests that foreign firms are treated as good, if not better, than domestic firms in host countries.[17]

Third, most domestic legal systems already offer adequate protection for investors, making it difficult to justify such a potentially expensive and far-reaching system.[18] Recognizing this, the recent Australia–United States Free Trade Agreement excluded ISDS from its investment chapter, because the parties concluded that this was unnecessary in light of the adequacy of both countries' judiciary systems.[19] Indeed the United States Trade Representative noted on this point:

> *"[a]mong other things, Australia has an open economic environment and a legal system similar to that of the United States, U.S. investors have confidence in the fairness and integrity of Australia's legal system, and the United States has a long history of close commercial relations with Australia that has flourished largely without disputes of the type addressed by international investment provisions."*[20]

[12] Ecuador decided to renounce the ICSID Convention, India has recently sought to terminate 57 of its BITs (see Kavaljit Singh and Burghard Ilge 'India overhauls its investment treaty regime', Financial Times Blog 15 July 2016), Indonesia has announced that it will terminate or renegotiate its IIAs, terminating at least ten of them, with likely another eleven to follow (see Michael Ewing-Chow, 'Indonesia to terminate' Financial Times 26 March 2014 and Juniate Losari, 'Indonesia is letting its bilateral treaties lapse so as to renegotiate bettter ones' Financial Times 15 April 2014), and for South Africa see Adam Green, 'South Africa: The BITS in Pieces' Financial Times 19 October 2012

[13] Fabio Morosini and Michelle Ratton Sanchez Badin, 'The Brazilian Agreement on Cooperation and Facilitation of Investments (ACFI): A New Formula for International Investment Agreements?' Investment Treaty News (4 August 2015) available at https://www.iisd.org/itn/2015/08/04/the-brazilian-agreement-on-cooperation-and-facilitation-of-investments-acfi-a-new-formula-for-international-investment-agreements/

[14] European Commission, 'The Multilateral Investment Court project' available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=1608 (accessed on 13 March 2017)

[15] Lauge Skovgaard Poulsen, 'The Importance of BITs for Foreign Direct Investment and Political Risk Insurance: Revisiting the Evidence,' in: K. Sauvant, ed., Yearbook on International Investment Law & Policy 2009/2010 (New York: Oxford University Press, 2010)

[16] Ireland is listed as 9th biggest recipient worldwide of FDI by the United States Central Intelligence Agency, see CIA world factbook at https://www.cia.gov/library/publications/the-world-factbook/geos/ei.html (accessed on 13 March 2017)

[17] Emma Aisbett and Louge Poulsen, 'Relative Treatment of Aliens:Firm-level Evidence from Developing Countries' GEC Working Paper 122 (December 2016)

[18] Gus Van Harten, 'Key Flaws in the European Commission's Proposals for Foreign Investor Protection in TTIP', Osgoode Legal Studies Research Paper No. 16/2016, 2-7

[19] Jan Kleinheisterkamp and Lauge N. Skovgaard Poulsen, 'Investment Protection in TTIP: Three Feasible Proposals' in Marc Bungenberg and others (eds), European Yearbook of International Economic Law 2016 (Springer 2016), 527-542, at 533-535

[20] The statement can be found at page 5-6 of the report of the statements made by the US Trade Representative: https://ustr.gov/archive/assets/Document_Library/Reports_Publications/2005/2005_TPA_Report/asset_upload_file120_7517.pdf (accessed on 14 March 2017)

Lastly, ISDS may have perverse effects on the development of independent and strong judicial systems in countries that currently face rule of law challenges. If access to justice is a driver for attracting foreign investment, then countries have an incentive to improve local court systems. Removing investment disputes to supranational ISDS fora removes the economic incentive for developing a strong and independent domestic judiciary In other words, investor-state dispute settlement should not take away a potential economic incentive to developing a strong and independent domestic judiciary.

Policy-makers should exercise great care and proper diligence when negotiating IIAs, reassessing the value of ISDS in our contemporary world. Investor protections should be designed to serve the world that exists today, not the world of the 1970s, and should seek to achieve sustainable development goals.[21]

ISDS is not the only option available for protecting investment. A number of alternatives could provide protection and ensure security for investments without the harms caused by outdated ISDS mechanisms. These alternatives include:

- strengthening the domestic judiciary;
- insurance for investors, such as through the Multilateral Investment Guarantee Agency of the World Bank;[22]
- dispute prevention;[23]
- more conciliatory forms of dispute settlement only, such as mediation;[24]
- investment promotion;[25]
- state-to-state dispute settlement.

European policy-makers should look to these new alternatives, rather than unnecessary and harmful ISDS, in drafting EU and Member State investment policies.

2 Role of domestic institutions

Recommendation 2: make investment law more respectful to domestic courts and institutions through a requirement to exhaust local remedies and defer to domestic courts on matters of domestic law

If policy-makers and legislators decide that ISDS is necessary and goes ahead with the negotiation of the MIC, a key issue will be making investment law more respectful of domestic courts and institutions. In order to do this, two important provisions must be included. First, the agreement should explicitly oblige parties to the proceedings to exhaust local remedies before

[21] See for instance the Declaration of Namur at http://declarationdenamur.eu/en/ (accessed on 14 March 2017)
[22] The website of the Multilateral Investment Guarantee Agency can be found at https://www.miga.org/
[23] An example is the approach taken by Brazil in its recently signed investment agreements. See for instance the Investment Cooperation and Facilitation Agreement between the Federal Republic of Brazil and the Republic of Malawi. This agreement does not contain investor-state dispute settlement through a compulsory judicial process, but favours a collaborative approach aimed at a positive agenda to attract investment and dispute prevention instead of settlement. The agreement can be found at http://investmentpolicyhub.unctad.org/Download/TreatyFile/4715 (accessed on 14 March 2017)
[24] Ibid.
[25] Ibid.

bringing a claim at the international level. This would bring investment law back in line with customary international law and international human rights law. Secondly, the agreement should require the MIC to involve domestic courts or authorities of the host state for matters of domestic law. This would not only ensure proper guidance on how domestic law should be understood, but also help to avert the risk of the agreement being found incompatible with the EU Treaties. Both requirements would do justice to the principle of subsidiarity and Article 1 of the Treaty on European Union (TEU), which provides that "decisions are taken as openly as possible and as closely as possible to the citizen."

2.1 Exhaustion of local remedies

Under both customary international law and international human rights law, individuals are required to seek redress before domestic courts before bringing international proceedings against the state for wrongful acts.[26] This requirement is known as the 'exhaustion of local remedies' (ELR) rule. The ELR rule is there to make sure that states have an opportunity to remedy wrongful acts through their own court systems before disputes are taken to the international level. ELR therefore safeguards the powers of domestic courts, and by extension the sovereignty of the state. The ELR rule is similar, in that sense, to both the principle of subsidiarity and the aforementioned Article 1 of the TEU, which provides that "decisions are taken as openly as possible and as closely as possible to the citizen."

In two cases involving treatment of foreign companies by their host states, the International Court of Justice (ICJ) laid down key aspects of the ELR rule. In *Interhandel*¸ the ICJ found that the ELR requirement "is a well-established rule of customary international law" that gives "the State where the violation occurred [...] an opportunity to redress it by its own means, within the framework of its domestic legal system".[27] The ELR rule applies whenever international and domestic proceedings "are designed to obtain the same result."[28] In a second case, *ELSI*, the ICJ further clarified that for the ELR rule to apply "it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as far as permitted by local law and procedures, and without success."[29] The ICJ also found in ELSI that the ELR rule is so important that it cannot be construed as having been implicitly set aside through an international agreement.[30]

The ELR requirement can also be found in all the major international and regional human rights systems. The European Court of Human Rights, for example, "may only deal with the matter after all domestic remedies have been exhausted, according to the generally recognised rules of international law, and within a period of six months from the date on which the final decision was taken."[31] Similarly, the International Covenant on Civil and Political Rights, the American Convention on Human Rights, and the African Charter on Human and Peoples' Rights

[26] Martin Dietrich Brauch, 'IISD Best Practices Series: Exhaustion of Local Remedies in International Investment Law'(IISD, January 2017) available at https://www.iisd.org/library/iisd-best-practices-series-exhaustion-local-remedies-international-investment-law (accessed on March 14 2017)
[27] Ibid, at 2; Interhandel (Switz. v. U.S.), Preliminary Objections, 1959 I.C.J. Rep. 6, at 27 (Mar. 21). Available at http://www.icj-cij.org/docket/files/34/2299.pdf (accessed on 14 March 2017), at 27
[28] ibid
[29] See Brauch *supra* n 26; Elettronica Sicula S.p.A. (ELSI) (Italy v. U.S.), Judgment, 1989 I.C.J. Rep. 15, 28 I.L.M. 1109 (July 20), para. 59
[30] Ibid., para. 50
[31] Article 35 (1) ECHR, available at http://www.echr.coe.int/Documents/Convention_ENG.pdf (accessed on 14 March 2017)

all contain ELR rules.[32] The only requirement for the ELR rule is the availability of effective and adequate or sufficient remedies in domestic law.[33]

International investment law, by contrast, usually does not follow the ELR rule. This practice is in fact so well established that the International Law Commission (ILC) has noted that IIAs "abandon or relax the conditions relating to the exercise of diplomatic protection, particularly the rules relating to [ELR]".[34]

There are a few IIAs that do explicitly require ELR, including those of several Member States.[35] Moreover, recently countries and regional economic communities such as Argentina, India, Turkey, the United Arab Emirates, Uruguay, the Southern African Development Community (SADC), and the East African Community (EAC) have begun to insist that investors either pursue or exhaust local remedies before having recourse to international forms of dispute settlement.[36]

Most IIAs, however, do not require ELR. IIAs eliminate the ELR requirement in several ways.

Some IIAs explicitly depart from the ELR rule by providing that consent to arbitration implies that the Parties to the agreement have renounced or waived ELR for the purpose of the agreement.[37]

Some agreements, such as the EU-Canada Comprehensive Trade and Investment Agreement (CETA), contain a tacit waiver by requiring investors to drop the pursuit of local remedies when they bring a claim before a CETA tribunal.[38]

However, most IIAs remain silent on the issue.[39] Where an IIA is silent, investment arbitrators have often interpreted this silence in a way that eliminates ELR requirements, and expands their own jurisdiction to hear claims to cases where investors have not exhausted all local remedies. This is in direct contradiction of the principle under the ICJ's ELSI decision that ELR is so important that it cannot be construed as being implicitly set aside by international agreements.[40]

In particular, arbitrators have done this by interpreting article 26 of the ICSID Convention as not requiring ELR. Article 26 ICSID provides that:

> *"Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention*."

This provision has been interpreted as meaning "that there is no need to exhaust domestic procedures before initiating ICSID arbitration, unless otherwise stipulated."[41] But this is not clear

[32] Article 41 (1) (c) of the International Covenant on Civil and Political Rights, available at http://www.ohchr.org/Documents/ProfessionalInterest/ccpr.pdf (accessed on 14 March 2017); Article 46 (1) (a) of the American Convention on Human Rights available at http://www.cidh.org/Basicos/English/Basic3.American%20Convention.htm (accessed on 14 March 2017); fef Article 56 (5) of the African (Banjul) Charter on Human and People's Rights available at http://www.achpr.org/files/instruments/achpr/banjul_charter.pdf (accessed on 14 March 2017)

[33] See Brauch *supra* n 26 at 5-6

[34] In fact, the ILC proposed that the draft articles on diplomatic protection "do not apply to the extent they are inconsistent with special rules of international law, such as treaty provisions for the protection of investments." See article 17 of the 2006 Draft articles on Diplomatic Protection available at legal.un.org/ilc/texts/instruments/word_files/english/draft_articles/9_8_2006.doc (accessed on 14 March 2016)

[35] See for instance the recent Albania- Lithuania Bilateral Investment Treaty and the Romania - Sri Lanka Bilateral Investment Treaty. See Brauch *supra* n 26 at 7-8

[36] For the difference in pursuit or exhaust local remedies see Brauch *supra* n 26 at 9-10

[37] See for instance article 11 (4) of the BIT between the Czech Republic and Saudi Arabia, available at http://investmentpolicyhub.unctad.org/Download/TreatyFile/978

[38] Article 8.22 (f) and (g) of the Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part (2017) OJ L 11/23

[39] See Brauch *supra* n 26 at 9-10

[40] Elettronica Sicula S.p.A. (ELSI) (Italy v. U.S.), Judgment, 1989 I.C.J. Rep. 15, 28 I.L.M. 1109 (July 20), para. 50

[41] Lanco International Inc. v. Argentine Republic, ICSID Case No. ARB/97/6, Preliminary Decision on Jurisdiction, para. 37

from the provision: article 26 could also be interpreted (in accordance with *ELSI*) to mean that ELR applies unless states explicitly agree that it does not. Given these two choices, arbitration tribunals have gone with the former interpretation over the latter one, construing article 26 of the ICSID Convention to be an explicit waiver.[42]

Arbitrators have also done away with the ELR rule in cases that do not fall under the ICSID Convention.[43] For example, in *Nykomb v. Latvia*, a case under the Energy Charter Treaty, the arbitration tribunal stated, shockingly, that "no such general obligation to exhaust local remedies can be derived from [...] international law in general."[44]

Given this trend of failure to apply the ELR rule in IIAs, it is paramount to ensure that the MIC contains an explicit ELR requirement. The MIC could model its ELR requirement after one of the IIAs and model IIAs that do have such a provision.[45] For instance, an ELR rule could be formulated in the following way:

Example of an exhaustion of local remedies rule

"A state party, an investor, or an affected third party must exhaust local administrative and judicial remedies before it may submit a claim before the Multilateral Investment Court seeking damages for an alleged breach of an International Investment Agreement."

The ELR rule may be qualified with exceptions recognised under international law. For example, it can exempt parties from ELR requirements where no domestic remedies are available. This would be in keeping with new generation agreements like the SADC Model BIT, under which there is no need to exhaust domestic remedies if the investor establishes that "there are no reasonably available domestic legal remedies capable of providing effective relief for the dispute concerning the underlying measure, or that the legal remedies provide no reasonable possibility of such relief in a reasonable period of time."[46]

Including an ELR rule will ensure that investment law will be again back on par with international human rights law and customary international law. If ordinary citizens, often with far more limited resources than transnational corporations using IIAs, are required to exhaust domestic remedies foreign investors should at least be required to do the same. Not including an ELR rule would therefore send a wrong signal that investor rights are procedurally more important than human rights.

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[42] See Brauch *supra* n 26 at 15
[43] ibid
[44] Nykomb Synergetics Technology Holding AB v. The Republic of Latvia, SCC, award of 16 December 2003
[45] See for instance article 14.3 of the India Model Bilateral Investment Treaty available at https://www.mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf (accessed on 14 March 2017) and article 29 (4) (a) of the Model BIT of the Southern African Development Community available at http://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf (accessed on 14 March 2017)
[46] Article 15 of the Model BIT of the Southern African Development Community available at http://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf (accessed on 14 March 2017)

2.2 Involvement of domestic institutions for questions of domestic law

A second important issue relating to the relationship between the proposed MIC and domestic courts is how the MIC should deal with matters of domestic law. Investment arbitrators are generally specialists in international investment law, and are not necessarily familiar with the intricacies of a domestic legal system. For example, CETA sets the following requirements for members of its investment Tribunal:

> *"The Members of the Tribunal… shall have demonstrated expertise in public international law. It is desirable that they have expertise in particular, in international investment law, in international trade law and the resolution of disputes arising under international investment or international trade agreements."*[47]

CETA therefore does not require tribunal members to have any expertise in matters of domestic law, environmental law, social law, human rights law or any other field of law that covers legitimate public interests of importance to local communities. In fact, one of the major objections against the investment protection regime is that it removes decision-making from local communities.[48] As professor Martti Koskenniemi has argued:

> "*The main issue is really not about whether to decide in favour of investor interests or countervailing values. It is instead, whether to protect the autonomous power of domestic political communities or to let the conditions of local lives be decided in the ('dis-embedded') processes of economic globalization*."[49]

In order to be respectful of domestic political communities, the MIC must be required to defer to domestic authorities on matters of domestic law. Investment arbitrators are inexperienced with local legal systems and are not experts in the policy areas they may be called on to interpret. Only by requiring them to defer to local authorities can it be assured that they do not incorrectly read or apply domestic rules, or subordinate unfamiliar social and environmental interests to familiar investment ones.

Inspiration for this requirement can be taken from the draft agreement providing for the accession of the European Union to the Convention for the Protection of Human Rights and Fundamental Freedoms. Following this text, the agreement establishing the MIC could include a provision requiring the prior involvement of the Court of Justice of the European Union for questions of both primary and secondary EU law, and similar rules regarding local questions.

An added advantage of this approach is that it would help to prevent the MIC from being found incompatible with the EU Treaties. As ClientEarth argued extensively in a legal study, EU ISDS mechanisms are at risk of being found incompatible with the EU legal order, precisely because tribunals set up under these agreements would be dealing with questions of EU law without proper involvement of the Court of Justice of the European Union.[50]

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[47] CETA 8.27 (4)

[48] Martti Koskenniemi, "It's not the Cases, It's the System: M. Sornarajah, Resistance and Change in the International Law on Foreign Investment. Cambridge: Cambridge University Press, 2015. Pp. xx + 437. £80. ISBN 9781107096622' (2017) Journal of World Investment & Trade, 343 – 353, at 343

[49] Ibid.

[50] Laurens Ankersmit and Karla Hill, 'Legality of Investor-state dispute setllement under EU law' (ClientEarth Legal Study 2015) available at http://documents.clientearth.org/wp-content/uploads/library/2015-10-15-legality-of-isds-under-eu-law-ce-en.pdf (accessed on 14 March 2017)

3 Fairness of the MIC

Recommendation 3: ensure that the MIC is inclusive, and can receive not only investors' claims against states, but also claims made by states and affected third parties against investors.

Another issue of concern, if the Commission decides to move forward with the MIC, relates to the fairness and inclusiveness of investment arbitration. ISDS provides a forum for investors to pursue their complaints regarding the behaviour of host states. However, most IIAs (including CETA[51]) do not permit states or affected third parties to bring claims against investors. ISDS is therefore a lopsided procedure that unfairly privileges investors' rights over the rights of people and their governments. Moreover, the limited possibility of participation by affected third parties does not allow those individuals and organisations to have a say in cases that may have significant consequences for their interests.

Some IIAs attempt to make ISDS slightly fairer by allowing states to bring counterclaims against investors for any breach of their obligations. The possibility for counterclaims by states may be either expressly provided for in the IIA (an example is the 2015 India Bilateral Investment Treaty (BIT)), or may be inferred from the language of the IIA.[52] For instance, arbitrators in the recent *Urbaser v Argentina* case interpreted the Spain-Argentina BIT's rules on who can bring a claim as implicitly permitting counterclaims by the state on the basis of human rights violations.

***Urbaser v Argentina*: a counterclaim based on the right to water[53]**

Urbaser was a shareholder in a utility company that supplied water and sewage services in Buenos Aires. The utility company went bankrupt in the wake of Argentina's financial crisis in the early 2000s, and blamed its losses on Argentina's actions during the crisis period. Urbaser sued Argentina for various breaches of the Spain-Argentina BIT as a result.

Argentina filed a counterclaim, arguing that the utility company's failure to provide services violated the human right to water.

Urbaser objected to this, arguing that Argentina couldn't make such a counterclaim because the BIT did not permit it. The tribunal disagreed, finding that it did have jurisdiction over the counterclaim, and potentially on claims by states against investors, as well. The fact that the BIT did not expressly permit counterclaims was not enough to sway the Tribunal, which held instead that the disputing parties had consented to counterclaims. In fact, the Tribunal found that the BIT in question permitted either party to bring a claim, including the possibility of a

[51] Articles 8.18 and 8.23 CETA
[52] Edward Guntrip, ' Urbaser v Argentina: The Origins of a Host State Human Rights Counterclaim in ICSID Arbitration?' EJIL: Talk! Blog available at http://www.ejiltalk.org/urbaser-v-argentina-the-origins-of-a-host-state-human-rights-counterclaim-in-icsid-arbitration/ (accessed on 14 March 2016)
[53] Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic, Award of 8 December 2016

counterclaim and applied conditions to the counterclaim that were relatively flexible.[54]

Despite the fact that Argentina eventually lost the case on the merits, Urbaser shows that it is entirely possible for investment tribunals to adjudicate claims by states against investors--even in the absence of explicit language to that effect in an IIA. This was an innovative position, given the more restrictive stance taken by other tribunals.[55]

Some recent IIAs allow third parties, under certain conditions, to submit amicus curiae ('friend of the court') briefs, explaining their position on a case that has been brought by an investor. Generally, those submissions are only allowed where the parties to the proceedings (that is, the investor and the state) do not object, where the amicus submission would assist the investment Tribunal by bringing a different perspective or insight, and where the third party has a significant interest in the case.[56]

The Commission has recently proposed that in addition to submitting amicus curiae letters, third parties with a 'direct and present interest' in a case should be allowed to intervene in support of one of the parties to the proceedings.[57] ClientEarth welcomes this proposal as a step in the right direction of making ISDS fairer and more inclusive. A fair process ensures that everyone who might be negatively affected by proceedings shall have standing before a court or tribunal. If this is not possible, an adjudicator cannot make a balanced judgment on the basis of all the relevant facts. A potential agreement establishing a MIC must therefore provide public notice of claims and allow sufficient time for all affected parties to apply for standing.

However, inclusion of such procedural rights does not go nearly far enough -- and worse, has not been included in the text of CETA. One related issue is, for instance, the possibility of out-of-court settlements without proper democratic scrutiny of such settlements. Almost a quarter of disputes is settled.[58] Those settlements might affect the rights and interests of third parties, for instance, if a mining permit is handed out as part of a settlement that will affect the environment and interests of local inhabitants. In fact, a recent study has found that settlements are more likely when the investor and the state want to hide substantive or procedural outcomes from other affected persons.[59] Therefore, EU needs, firstly, to ensure that it establishes internal rules that apply to EU institutions when they engage in a settlement agreement, including the right to challenge any such decision to engage in a settlement agreement before domestic courts, or alternatively, prior approval of the European Court of Justice for such settlement. At international level, a potential future agreement establishing the MIC should ensure that such settlements are

[54] Ibid, paras. 1110-1134

[55] Edward Guntrip, ' Urbaser v Argentina: The Origins of a Host State Human Rights Counterclaim in ICSID Arbitration?' EJIL: Talk! Blog available at http://www.ejiltalk.org/urbaser-v-argentina-the-origins-of-a-host-state-human-rights-counterclaim-in-icsid-arbitration/ (accessed on 14 March 2016) citing Saluka Investments B.V. v. The Czech Republic, UNCITRAL

[56] See, Art. 37 (2) ICSID Aribtration Rules. Similar rules apply under article 4 of the UNCITRAL Transparency Rules, with the notable improvement of giving the Tribunal more independence from the Parties to allow for amicus submissions.

[57] Section 3 subsection 5 article 23 of the Commission's proposal for an Investment Court System in TTIP

[58] Lise Johnson and Brooke Skartvedt Guven, 'The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest' Investment Treaty News, 13 March 2017 available at https://www.iisd.org/itn/2017/03/13/the-settlement-of-investment-disputes-a-discussion-of-democratic-accountability-and-the-public-interest-lise-johnson-and-brooke-skartvedt-guven/ (accessed on 14 March 2017)

[59] E. M. Hafner-Burton, S. Puig, and D.G. Victor, 'Against international settlement? The social cost of secrecy in international adjudication' (2017) Yale Journal of International Law, 45

fully accessible to the public and are subject to compliance with procedural and substantive requirements of domestic and international law.[60]

The Rosia Montana case - *Gabriel Resources v Romania*[61]

In 2015 Canadian mining company Gabriel Resources brought an ISDS claim against the Romanian government over government actions relating to the largest cyanide based open-pit gold mine project in Europe in Rosia Montana, Romania.[62] Despite a resolution of the European Parliament to ban cyanide based gold mining in Europe[63], if approved, the mine project would increase the total use of cyanide in Europe over thirteen times. It would also result in the relocation of around 6000 local inhabitants, destruction of four mountains and its ecological infrastructure, and the destruction of UNESCO candidate world heritage site.[64] After nationwide protests and several court victories for local residents against both the government and Gabriel Resources, the Romanian government has not given permission for the project.[65] The CEO of Gabriel Resources has stated that he believes that the claim might be worth over 4 billion Canadian dollars.[66] The local NGOs and residents only have a limited possibility in this case to request leave for a submission of an *amicus* brief under the conditions set out in the Canada-Romania BIT. They have no full participatory rights in the case, and their rights may therefore not be adequately taken into account by the tribunal involved.

IIAs are extremely imbalanced, because they only allow claims by investors not by states or affected third parties. Some IIAs give states the possibility to introduce counterclaims, and some permit amicus curiae submissions by third parties, but these mechanisms are in no way equivalent to the right to raise autonomous claims against investors. This creates an asymmetry in proceedings, addressing state wrongdoing against transnational corporations, but not any wrongdoing by corporations against the state, the people, or the environment.[67] It presupposes that only states can do harm, and that investors only have rights, not obligations.
This is a woefully inadequate system in a world in which transnational investors have enormous power to impact the environment, human rights, and labour rights.[68]
ClientEarth understands that the Commission will not address the substantive obligations of either states or investors in its MIC proposal.[69] The MIC is intended to replace the current

[60] Lise Johnson and Brooke Skartvedt Guven, 'The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest' Investment Treaty News, 13 March 2017 available at https://www.iisd.org/itn/2017/03/13/the-settlement-of-investment-disputes-a-discussion-of-democratic-accountability-and-the-public-interest-lise-johnson-and-brooke-skartvedt-guven/ (accessed on 14 March 2017)
[61] Gabriel Resources Ltd. and Gabriel Resources (Jersey) v. Romania, ICSID Case No. ARB/15/31
[62] Stephanie Danielle Roth and Jürgen Maier, 'Silence is Golden' (28 November 2016) available at http://www.forumue.de/silence-is-golden/ (accessed on 15 March 2017)
[63] European Parliament resolution of 5 May 2010 on a general ban on the use of cyanide mining technologies in the European Union
[64] More information can be found at https://www.rosiamontana.org/?language=en (accessed on 15 March 2017)
[65] Ibid.
[66] Thomas Biesheuvel and Irina Savu, 'Paulson-Backed Gabriel Threatens $4 Billion of Claims in Romania' 11 September 2013 available at https://www.bloomberg.com/news/articles/2013-09-11/paulson-backed-gabriel-threatens-4-billion-of-claims-in-romania (accessed on 14 March 2017)
[67] Gus Van Harten, 'Key Flaws in the European Commission's Proposals for Foreign Investor Protection in TTIP', Osgoode Legal Studies Research Paper No. 16/2016, 2-7
[68] Ibrahim Kanalan, 'Horizontal Effect of Human Rights in the Era of Transnational Constellations: On the Accountability of Private Actors for Human Rights Violations' Enterprises' in Marc Bungenberg and others (eds), European Yearbook of International Economic Law 2016 (Springer 2016),423-460

procedural and institutional provisions for ISDS that are set out in, for example, CETA Chapter 8, Section F.

However, even without extending the substantive obligations of corporations, or reducing those of states, the MIC could contribute to making investment arbitration fairer and more inclusive. It could do this by expanding the scope of personal jurisdiction in the MIC to allow it to hear claims by investors, states, and affected third parties.

Opening up the jurisdiction of the MIC in this way would ensure that the MIC could hear claims over breaches of investor obligations that may be contained in future IIAs. It would allow claims based on other international legal instruments containing obligations for transnational corporations. And it would permit third parties to intervene where their rights are affected by proceedings before the MIC.[70] This is a necessary part of making the MIC fairer and making it a forum that protects the rights of all people--not just those of corporations. It would therefore be a necessary step that would need to be accompanied with meaningful reform of the current international regime on investor rights and obligations.

4 Protection of responsible investment

> ***Recommendation 4: limit the jurisdiction of the MIC to claims by responsible investors who have not violated EU values, and exclude claims that target public interest legislation.***

The MIC that the Commission is currently considering will be established by an international agreement to which the EU will be a party, and will be funded by public money. It will therefore be a public service provided to investors. As such, it is legitimate to ask, as a matter of public policy, what kind of investments the EU wants to protect through the MIC.

The Commission intends to pursue a trade policy 'based on values'.[71] Moreover, the EU Treaties make clear that this is not only a policy preference but also a legal obligation. The Treaties make clear that in its relations with the wider world, the EU 'shall uphold and promote its values', 'contribute to the sustainable development of the earth' and the 'eradication of poverty and the protection of human rights, in particular the rights of the child'.[72] Moreover, the 'Union's action on the international scene shall be guided by [...] democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms'.[73]

In light of these policy objectives and legal guidance, the EU should not set up an international court that would allow investors to bring claims that violate these values. In order to ensure that the MIC can be used only by responsible investors, the Commission should include in its proposal three relatively simple features:

[69] ClientEarth supports the inclusion of substantive obligations for investors in IIAs, as well. This is not a novel idea: India's Model BIT, for example, includes a number of obligations that investors must respect when they make an investment in a host country. See articles9-12 of the India Model Bilateral Investment Treaty available at https://www.mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf (accessed on 14 March 2017). However, that is not the subject of this legal policy brief.

[70] The UN Human Rights Council, for example, is currently negotiating a treaty that would impose binding human rights obligations on transnational corporations. See UN Human Rights Council Resolution 26/9, Elaboration of an international legally binding instrument on transnational corporations of and other business enterprises with respect to human rights 26 June 2104 A/HRC/26/L.22/Rev.1.

[71] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Trade for All Towards a more responsible trade and investment policy, COM/2015/0497 final

[72] Article 3 (5) TEU

[73] Art. 21 (1) TEU

1. **a clean hands clause**, allowing only responsible investors to bring claims;

2. **a public interest carve out**, protecting legitimate public interest measures from challenge; and

3. **a supremacy clause**, clarifying that investment protection should not come at the expense of the EU's human rights and environmental obligations as contained in international agreements.

Together, these three measures would provide an incentive for investors to act responsibly and ensure that they cannot use the MIC to pursue claims that violate EU values.

4.1 Clean hands clause

In order to ensure that investors do not use the MIC to pursue claims that violate EU values, the Commission should include a 'clean hands clause' in its proposal. This clause would aim to dismiss any claim regarding an investment that violates core EU values, or that has violated host state law. As a result, it ensures that only investors with 'clean hands' can bring a claim before the MIC. Those that have violated EU or host state rules would not be able to take advantage of the special protections offered by this public service.
Including a clean hands clause in the MIC would be relatively easy. CETA Article 8.1 already makes clear that covered investment that is inter alia "made in accordance with the applicable law at the time the investment is made". Moreover, CETA Article 8.18(3) already includes a list of reasons for excluding investors from ISDS. This list could simply be expanded to cover situations in which investors have committed fraud, human rights abuses, or otherwise violated national or international environmental, social, consumer, or labor laws.

Example of *a clean hands clause* based on Articles 8.1 and 8.18 (3) CETA:

"An investor may not submit a claim if the investment has been made through fraudulent misrepresentation, concealment, corruption, conduct amounting to an abuse of process, ***fraud, human rights abuses, or not in accordance with the applicable environmental, social, and consumer law, including international law."***

Including a clean hands clause in the MIC would follow the EU's current approach towards public procurement. Under the EU's public procurement Directive, public authorities can, and are in some instances required to, exclude tenders that violate certain EU values.[74] For example,

[74] Article 57 of the Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC (2014) OJ L 94/65

public authorities must exclude tenderers who have been convicted of child labour or other forms of trafficking in human beings.[75]

4.2 Public interest carve-out

In addition to the clean hands clause, the Commission's MIC proposal should also include a public interest carve-out that would exclude challenges to public interest legislation. This public interest carve-out would ensure that claims involving tobacco legislation, environmental permits, health care legislation, minimum wage legislation, or other public interest rules cannot be brought before the MIC.

A public interest carve-out is extremely important, because one of the most serious downsides to ISDS as it currently exists is that investors have used it to challenge national environmental, health, and human rights rules, or to pressure states not to adopt such rules under threat of litigation. For example, after Philip Morris used the Australia-Hong Kong BIT to attack Australia's plain packaging laws, Australia insisted that a 'tobacco carve-out' be included in the Transpacific Partnership (TPP) agreement.[76]

The MIC's public interest carve-out could be inspired by the TPP's 'tobacco carve-out', expanded to include a broader set of public interest laws and policies.

Example of a public interest carve-out

"No claims can be brought before the Multilateral Investment Court challenging public interest measures contributing to or aiming at inter alia environmental, social, human rights, or consumer protection."

CETA does currently contain a 'right to regulate' clause that states that 'the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity'.[77] However, the right to regulate clause merely restates Parties' ability to regulate in the public interest. It does not exclude claims by investors based on such public interest legislation. In other words, under CETA a government may adopt public interest regulations, but will still be required to pay compensation to investors if those regulations infringe on their rights. A public interest carve-out

[75] Article 57 (1) (f) of the Directive
[76] Article 29.5 TPP states 'A Party may elect to deny the benefits of Section B of Chapter 9 (Investment) with respect to claims challenging a tobacco control measure of the Party. Such a claim shall not be submitted to arbitration under Section B of Chapter 9 (Investment) if a Party has made such an election. If a Party has not elected to deny benefits with respect to such claims by the time of the submission of such a claim to arbitration under Section B of Chapter 9 (Investment), a Party may elect to deny benefits during the proceedings. For greater certainty, if a Party elects to deny benefits with respect to such claims, any such claim shall be dismissed.'
[77] Article 8.9 (1) CETA

would solve this problem by ensuring that investors could not challenge legitimate public interest regulations in the first place.

4.3 Supremacy clause

In addition to a clean hands clause and a public interest carve-out, the Commission should also include in its MIC proposal a supremacy clause clarifying that investment protections do not outweigh the EU's social and environmental commitments. Sometimes, investors' rights come into conflict with EU obligations under international human rights, labour, or environmental agreements. In such cases, it is necessary to clarify which rules investment arbitrators should prefer. Unfortunately, in a number of ISDS cases, investment arbitrators have found that obligations under international environmental or human rights agreements cannot justify infringing on investors' rights.[78] This is an unacceptable outcome. Countries must have the policy space they require to fulfil their international social and environmental commitments.

Including a supremacy clause in the MIC would make clear to investment arbitrators that obligations arising out of international environmental, social and human rights agreements trump obligations arising out of IIAs.[79] In the event of a conflict between these rules, investor protections would give way to public social and environmental obligations.

Inspiration for the MIC's supremacy clause can be taken from NAFTA article 104, which provides that in the event of any inconsistency between NAFTA and a list of environmental agreements, the obligations under the environmental agreements shall prevail.[80]

Example of a supremacy clause

"In the event of any inconsistency between an international investment agreement and any international environmental, social, or human rights agreement binding on one Parties to a dispute, the obligations under the international environmental, social, or human rights agreement shall prevail."

In combination with the clean hands clause and the public interest carve-out, the MIC's supremacy clause would help to insure that this special dispute settlement process, provided as a public service to investors, could be used only by responsible investors who respect EU and host state law.

[78] See Markus Krajewski,'Ensuring the Primacy of Human Rights in Trade and Investment Policies: Model clauses for a UN Treaty on transnational corporations, other businesses and human rights' (Study commissioned by CIDSE) available at http://www.cidse.org/publications/business-and-human-rights/business-and-human-rights-frameworks/ensuring-the-primacy-of-human-rights-in-trade-and-investment-policies.html (accessed on 14 March 2017), at 13 referring to SAUR International SA v. Republic of Argentina, ICSID Case No. ARB/04/4, para. 331. See also B. Farrugia, 'The human right to water: defences to investment treaty violations', (2015) Arbitration International 31 (2), 261 at 265; Andreas Kulick, Global Public Interest in International Investment Law (Cambridge: Cambridge University Press, 2012) at 233-245
[79] See Krajewski *supra* n 78
[80] Andreas Kulick, Global Public Interest in International Investment Law (Cambridge: Cambridge University Press, 2012) at 232-233

5 Independence of adjudicators

Recommendation 5: select and appoint members of the MIC in full accordance with the Magna Carta of Judges and through an accountable and transparent process with proper involvement of the European Parliament at EU level.

Despite some improvements over the selection of tribunal members under CETA, concerns remain over the independence of adjudicators under the EU's current approach towards appointment of tribunal members.[81] Both the German and European Association of Judges have objected to the ICS proposed under the TTIP negotiations, because the selection of tribunal members is not in line with the Magna Carta of Judges by the Consultative Council of European Judges.[82]

The members of tribunals under the MIC should meet the requirements of judicial independence set out by the Magna Carta. Judicial independence should therefore be statutory, functional and financial. Moreover, the selection, nomination, and career of these tribunal members must be based on objective criteria and taken by a body in charge of guaranteeing independence. This means that as far as the EU is concerned that the European Parliament should be able to elect candidates out of a list of candidates established by the national councils for the judiciary.

This means that notably in contrast to the selection under ICS in CETA:

- There can be no financial incentive to hear claims;
- There should be no undue influence on these members, for instance by allowing tribunal members to work as arbitrators in investment cases on the side;
- The objective criteria for selection should include experience and knowledge of areas of law outside international investment law and international trade law;
- There should be clear and transparent rules regarding the selection process of the members and the appointment cannot be left to a committee such as the CETA Joint Committee. Instead EU candidates should be appointed by the European Parliament on the basis of a list established by the national councils for the judiciary.

Conclusion

ISDS is a hugely flawed system in drastic need of re-evaluation. In that sense, the Commission policy towards reform is to be welcomed. However, such a reform cannot be mere window dressing with a few cosmetic changes. Such a reform would risk vastly expanding and legitimising a system which is currently unfair, one-sided, and completely oblivious to the importance of domestic courts.

Therefore, it is key that a potential future MIC credibly improves the fairness and inclusiveness of investor-state dispute settlement by promoting greater reliance on domestic courts and alternative forms of investment protection, ensuring that investors are not given more rights than

[81] Gus Van Harten, 'Key Flaws in the European Commission's Proposals for Foreign Investor Protection in TTIP', Osgoode Legal Studies Research Paper No. 16/2016, 3
[82] The text can be found here: https://wcd.coe.int/ViewDoc.jsp?p=&id=1707925&direct=true (accessed on 14 March 2017)

other citizens, and preventing irresponsible investors from benefiting from the system. If no such credible reforms take place, a more viable policy option would be to terminate IIAs altogether.

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ClientEarth is a non-profit environmental law organisation based in London, Brussels and Warsaw. We are activist lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

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