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Introduction

In the past few years the European Union has negotiated a large number of trade agreements, many of which include an arbitration paragraph. Since the entry into force of the Lisbon Treaty, the closing of such agreements is largely a responsibility of the European Union. It is only in the case of investment treaties that the member states — and hence the national parliaments — still have an explicit say in the matter. For the fraction of GUE/NGL — the union of the United European Left and Nordic Green Left in the European Parliament — ISDS has been a major obstacle in the debate. This paper presents the position of the members who have been most active in committee on International Trade.

1. ISDS, ICS and MIC are seriously flawed

Investor to State Dispute Settlement is an umbrella term for any type of arbitration in which investors can claim money from states when these formulate policies that threaten the investors' profits.

While the public support for ISDS had been waning for quite some time, within the European Union the abbreviation ISDS got a nasty taste during the negotiations of a free trade agreement between the EU and the USA. In order to address that unrest, former Commissioner Karel De Gucht opened a public consultation about it in 2014. 150.000 people responded to that consultation, 97% of the responses was negative[1].

In 2015, in order to address the massive opposition to ISDS, De Gucht's successor Cecilia Malmström formulated the so-called Investment Court System[2] which was supposed to address the most important flaws of ISDS, and to make the agreement with Canada, CETA, more palatable. ISDS was abandoned in favour of ICS, or so it was presented. In 2016 the proposal was followed by a Multilateral

[1] http://trade.ec.europa.eu/doclib/cfm/doclib_results.cfm?docid=153044

[2] http://trade.ec.europa.eu/doclib/press/index.cfm?id=1396

Investment Court, which was supposed to offer a multilateral arbitration court that would execute the arbitration chapters in various trade agreements world wide.

Some of the changes are, to be fair, real improvements, addressing some of the many objections against the system. The Commission proposes to increase the transparency of the court proceedings, an appeals court will be installed, a permanent court allows for the development of case law, and certain requirements will be imposed on the arbitrators.

But a significant number of objections are still firmly in place. A major problem with ISDS in all its varieties is that it is a parallel court system that largely ignores national law, European law and any international treaties, except for the trade agreement that the arbitration paragraphs are part of. Even when an appeal is made, it can only address what is formulated in the trade agreement. ISDS can simply sidestep democratically established laws. As US trade representative Robert Lighthizer has said in last year's Congressional hearings: "I am troubled by the fact that anyone, anyone can overrule the United States Congress and the President of the United States when it has passed a law"[3]. That statement is also at odds with the claim made by the European Commission that ICS and MIC guarantee the right to regulate.

Moreover, the system does not require that national remedies are exhausted before arbitration can be invoked. It can therefore not be maintained that arbitration is meant for countries whose national remedies are insufficient.

To top that, the arbitration system is exclusively reserved for foreign investors. National investors, let alone citizens or NGOs, have no access to the system. Also there are no qualifications that the foreign investors need to adhere to, such as having their non-financial reporting in order, for instance, respecting human rights, or obeying due diligence standards.

Finally, while a code of conduct is being drafted for arbitrators, its enforcement is doubtful, and the arbitrators are still being paid by the hour. The Magna Carta of Judges[4] that was drawn up by the Council of Europe would demand that judicial independence be statutory, functional and financial. Such is not the case for arbitrators of the MIC.

It is our firm conviction that the ICS and the MIC are still essentially instances of ISDS: dispute settlement that is exclusively reserved for foreign investors who wish to litigate against their host state. As such we oppose them equally.

In the next paragraphs we will address the question of whether, despite all these objections, some form of investment protection is still necessary. The controversial cases are well known, but what about legitimate cases? Also, isn't a country simply more attractive to investors when it offers guarantees that there is a safety net for investments? And finally, can't we find a way to mitigate investment protection in such a way that it can make even countries with the most fragile rule of law attractive to foreign investors?

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[3] https://docs.house.gov/meetings/WM/WM00/20170622/106158/HHRG-115-WM00-Transcript-20170622.pdf

[4] https://rm.coe.int/16807482c6

2. The need for ISDS is doubtful

The list of controversial ISDS cases is long, and the reasons to frown upon them are manifold. Foreign investors have used ISDS to fight democratic decisions to establish minimum wages, to ban nuclear energy, to ban the exploitation of a gold mining using cyanide and to establish rules to prevent children from smoking, to name but a few. Surprisingly and disappointingly enough, according to a study done by the Transnational Institute, Corporate Europe Observatory and others[5], the Investment Court System would not yield a better result. ICS would not be less susceptible to such controversial cases — in fact, it may even be more open to them.

However, governments sometimes do take measurements that completely ignore the interests of a company. In such cases, the investor is happy when a good and strong legal system is in place that can compensate them for any damage resulting from such planning. What to do when the legal system of a country is weak or even downright corrupt?

Few cases are legitimate

The first question that needs to be asked is: how often do such cases occur? The answer is: not very often. According to a study by Aisbet and Poulsen[6], the cases where foreign firms appear to be discriminated against by local courts "could very well be the exception rather than the rule." They argue that in many developing countries host state governments treat foreign firms at least as well, and often better, than comparable domestic firms, due to the more desperate need for foreign investment, the lower level of expertise when dealing with multinationals and the stronger foreign lobby.

An additional problem is, that there is no easy definition of what a legitimate case is. We vehemently oppose the notion that a sole expectation of profit, as some trade agreements allow, constitutes a legal ground for damages compensation. While we acknowledge the need for a fair process, and recognize that a recovery of made costs may be in order, extra compensation for forecasted profits is unacceptable.

We also reject that a country should be made to pay compensation if it formulates non-discriminatory policies that are enacted in order to promote public welfare. The height of the claims is another contentious point. How can a country be said to formulate independent and democratically legitimized policies if it faces claims that are higher than its national budget for healthcare, for instance?

It is hard to come up with cases that everyone agrees are legitimate. That makes the issue rather academic. Should we install a massive, costly and controversial system for perhaps just a handful of cases?

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[5] https://www.tni.org/en/publication/investment-court-system-put-to-the-test

[6] https://www.geg.ox.ac.uk/publication/geg-wp-2016122-relative-treatment-aliens-firm-level-evidence-developing-countries

Foreign direct investment does not require ISDS

The second question that arises is, even if there are many arguments against ISDS and there are few cases in which ISDS seems to have a legitimate basis, it may still be a decisive contribution to an investment climate that is needed for sufficient foreign investment. The proof for that statement is rather flimsy.

In 2018 the OECD studied the societal benefits and costs of International Investment Agreements[7]. They found that the impact of ISDS on foreign direct investment (FDI) is non-existent or small. There are other factors, such as the quality of institutions, the level of political risk, or the development of the financial sector, which are much more important.

The International Institute for Sustainable Development[8] compared various studies, and found that "the majority suggest that investment treaties do have some positive impact of FDI inflows, while a significant minority reach the opposite conclusion". Among the former, "different studies reach contradictory findings about the circumstances in which investment treaties are likely to have a positive impact on FDI."

That finding is substantiated by major industrialized countries that do without ISDS. There is no bilateral investment treaty between the USA and China, even though China is the main recipient of USA's foreign direct investment among developing countries. Brazil receives substantial foreign direct investments, yet this country has only 1 BIT currently in force. It has developed a new model without ISDS[9] and has recently concluded treaty negotiations on the basis of this model with a number of African countries — an approach that definitely merits further study. On the other hand, several African countries have ratified BITS, but without substantial positive effect on their economies.

There are alternatives

ISDS has evolved from a marginal tool in a world where the colonial spirit of "rights for the investor and obligations for the colony" was still very much alive, to a booming billion dollar business today. Yet ISDS is not the only instrument an investor can demand or a country can offer in order to have some sort of safety net when things go differently than agreed upon.

The first alternative is the use of a risk insurance, provided it is a private contract between an investor and an insurer, without the insurer shifting the costs of the insurance onto the host state. As we have seen with the banks, the approach of *private profit, public risk* takes away the incentive to minimize investor risks. As Rönnelid 2018[10] argued, that would make risk insurance very similar to ISDS.

A second solution is state to state dispute settlement (SSDS). Established organisations such as the World Trade Organisation have a long tradition of state

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[7] https://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements_e5f85c3d-en

[8] https://www.iisd.org/library/assessing-impacts-investment-treaties-overview-evidence

[9] https://link.springer.com/chapter/10.1007/978-3-319-76210-4_13

[10] https://www.guengl.eu/issues/documents/report-an-evaluation-of-the-proposed-multilateral-investment-court-system/

to state arbitration, but countries can also agree on bilateral agreements. SSDS requires an intermediary role for the investor's home state. Because the intervention has to be weighed against the diplomatic relations that the home state has, the claims have to comply with the requirements of being fair and reasonable.

Moreover, a substantive reform of BITs could mean a serious improvement if they would include binding obligations for investors, and avenues for affected communities and third parties to enforce these obligations. In this light, we see the inclusion of human rights clauses in trade and investment agreements as a positive trend that must be pushed forward by, for example, reinforcing their capacity to sanction in case of non-compliance.

Another way in which states can cooperate to ensure that the most protective human rights standards available are respected, is the inclusion in States' laws of binding due diligence obligations for businesses that operate on a transnational level.

All of these solutions work towards more transparency, a smaller bias for foreign investors, and a more proportionate approach. They make a firm argument against the need for ISDS.

3. Towards a fair arbitration system

UNCITRAL working group III strives for an evaluation of ISDS, and possibly a reformulation of it. In the first half of this paper, we have stated our objections against ISDS: against the serious flaws in the current system and with major reservations about the doubtful claims regarding its necessity. We have also offered ample alternatives. However, assuming that there are sufficient cases to make it worth wile, assuming that a country needs investment protection of a sort in order for it to be interesting for foreign investors, assuming we can find a definition of what makes a legitimate claim, should a persistent will exist to have a standing investment court, then we should like to offer some pertinent requirements.

First of all, it is good to realise that the nature of investment disputes has changed over the years, and therefore the protection of it should as well. ISDS originated in a time when old colonial relations were hardly questioned. Now, ISDS clauses are also included in investment treaties between developed countries. That makes their effect a lot more tangible for developed countries at the receiving end of arbitration cases, and the remedy should be tailored to these needs.

Second, helping countries strengthening their domestic legal systems is the best thing we can do for the country as well as the foreign investor. A stable legal system strengthens the legal position of the investor, it weakens the need for arbitration, and it guarantees that the democratically established national laws are taken into consideration. A clause to exhaust national remedy first, should be included in any bilateral investment treaty.

Third, an arbitration court should fit the following qualifications:

- it should fall under the auspices of an independent multilateral body, such as the United Nations;
- judicial independence of its arbitrators should be statutory, functional and financial;
- it should be transparent in its appointments and proceedings;
- International human rights treaties should be part of applicable law
- It should be a court of last resort, i.e. insist on the exhausting of national remedy;
- It should do more than just offer pecuniary compensations, but rather it should insist on a solution of the causes.