

To change a BIT is not enough



On the need to create sound policy frameworks for investment

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TABLE OF CONTENT

Introduction: page **4**

Box 1: International investment agreements at a glance: page **6**

Private investments for public development: page **6**

Box 2: ISDS cases that challenged the regulation of harmful chemical substances: page **10**

Box 3: The mining industry lobby in Indonesia: page **11**

Box 4: a BIT that challenges land rights in Paraguay: page **12**

The way forward: page **15**

Table 1: page **18**

INTRODUCTION

The international legal system that governs international investment flows is shaped by a network of about 3000 Bilateral Investment Treaties (BITs) and other International Investment Agreements (IIAs). This system no longer serves its purpose and needs to be changed profoundly. Not only is it questionable whether IIAs at all encourage international investment flows in support of sustainable development, but the current generation of IIAs has also failed to address the uneven balance of rights and responsibilities between foreign investors and host governments. Foreign investors enjoy numerous legal rights without needing to worry about corresponding responsibilities. This reality, and especially the fact that 60% of all Investor-to-State Dispute Settlement (ISDS) claims are brought against developing countries (see below), has serious repercussions for poverty reduction, inclusive growth and sustainable development.

At the UN Sustainable Development Summit in New York (25-27 September 2015), the international community agreed on the Sustainable Development Goals (SDGs) that replace the Millennium Development Goals which expired in 2015. The SDGs, like the MDGs, are a set of internationally agreed targets relating to future international development¹. The reform of international investment policies is one of the tasks the international community has given itself in order to achieve SDG 1: 'To end poverty in all its forms everywhere.' In order to live up to this goal it has been agreed to 'Create sound policy frameworks at the national, regional and international levels, based on pro-poor and gender-sensitive development strategies, to support accelerated investment in poverty eradication actions' (SDG 1b). This policy briefing paper aims to contribute to an urgently needed international debate on how to reshape the international policy framework and rules for investment in order to ensure that these indeed support the globally agreed ambition of inclusive and sustainable development for all by 2030.

BOX 1

INTERNATIONAL INVESTMENT AGREEMENTS AT A GLANCE

The term International Investment Agreement (IIA) refers to agreements between states that establish *binding and enforceable* rules on investment-related policies and especially

investment protection policies. The primary forms of IIAs are bilateral investment treaties (BITs) and BIT-like investment chapters in regional and bilateral free trade agreements (FTAs). The main difference between BITs and FTAs is that BITs focus on investment issues only, while FTAs are more comprehensive, including a wide range of trade and trade-related

issues involving goods, services, agriculture and investments. The term IIAs is also used for binding agreements between groups of countries. Examples are the North American Free Trade Agreement (NAFTA) between Canada, Mexico and the USA, and the Energy Charter Treaty (ECT), which establishes a multilateral framework for cross-border cooperation in the energy industry.

PRIVATE INVESTMENTS FOR PUBLIC DEVELOPMENT

The role that private sector investment can play in contributing to development and poverty reduction is gaining attention on the international agenda. Given that high-income countries fail to scale up public development aid, the role of private investment is considered increasingly relevant and important. The new SDG framework includes private sector actors as indispensable, alongside governments, civil society and the UN, in the global partnership for sustainable development. This trend, which is certainly not without its controversies, is not entirely new. The first International Conference on Financing for Development (Mexico, 2002) was a landmark in this respect, as representatives from the business community for the first time joined the discussions and actively supported the Monterrey Consensus, which dedicated a special chapter to foreign direct investment and other private flows as international resources for development². Developing countries were given a clear responsibility and ever since it has been emphasized that in order "to attract and enhance inflows of productive capital, countries need to continue their efforts to achieve a transparent, stable and predictable investment climate, with proper contract enforcement and

respect for property rights" and that "special efforts are required in such priority areas as economic policy and regulatory frameworks for promoting and protecting investments"³. While these are reasonable demands, there is a growing concern about the concrete measures governments have taken in their efforts to create an attractive investment climate for foreign investors. A well-known contentious issue is the practice of offering generous tax incentives to foreign companies. Less known, but increasingly controversial, are the International Investment Agreements (IIAs) that are signed to protect foreign investments.

The trouble with International Investment Agreements

IIAs establish binding rights of foreign investors under international law. At the national level, legislators are faced with the difficult task of finding the appropriate balance between the rights of foreign investors on the one hand, and the national public policy objectives and international commitments and obligations, especially in the areas of environmental protection and human rights, on the other hand. The international legal system that has emerged through the current network of 2,923 BITs and 345 other IIAs⁴ makes it near impossible to find the right balance. Below we discuss six

main problems with IIAs and BITs in particular.

One issue that is particularly problematic is that the majority of IIAs contain an Investor-to-State Dispute Settlement Mechanism, shorthand ISDS. An ISDS allows foreign investors who believe that the treaty obligations have been violated by the host state, to sue the state directly before an international arbitral tribunal⁵. This allows foreign investors to challenge a wide range of national government measures and policies in a final and binding internationally enforceable arbitral decision.

While the first BIT that included an ISDS was already signed in 1968 (between the Netherlands and Indonesia), the ISDS mechanism was hardly ever used. Until 1997, there were only 19 known cases of foreign investors suing their host state. However, from the late 1990s onward, this has changed dramatically. By 2007, there were nearly 300 known cases. By the end of 2014, the number of known ISDS claims had cumulated to 608; 250 of these were still pending⁶. Worldwide, 101 governments are known to have been sued in at least one ISDS case; 32 countries faced new claims in 2014. Since the beginning of 2015, at least one new ISDS case gets published every week⁷. In 2014, 60% of all known cases were brought against developing countries and countries in transition⁸.



"It will be important to avoid a situation where the threat of litigation on the basis of BITs and other investment protection agreement has a "chilling effect" on government efforts to promote human rights and a healthy environment" *Report of the High Commissioner for Human Rights of the United Nations 2003*

PROBLEM 1: THE HIGH COSTS OF ISDS CASES

When foreign investors make use of their right under ISDS to sue their host government, the Bilateral Investment Treaty, meant to benefit the host country by attracting foreign investment, instead confronts the government with high costs. The worst scenario is when a government loses an ISDS case. The damages are payable out of public budgets, which in developing countries can have a severe impact on the funds available for public policy. The amounts involved can be substantial. In 2012, an investment tribunal ordered Ecuador to pay US\$1.77 billion in compensation to US company Occidental Petroleum

for the revocation of an oil concession. Including interest and legal costs, Ecuador will have to pay US\$2.4 billion. This amount roughly equals Ecuador's annual health care budget for 7 million people⁹.

Defenders of the current system of IIAs argue that a significant percentage of ISDS cases are settled between the two parties in advance of an arbitral ruling. The reported percentage of settled cases varies between 28-46%. While settlements often tend to be interpreted as a positive outcome for the state, they can still cost taxpayers a lot of money. The largest amount known paid by an EU member state was a result of a settlement agreement. In August 2005, Poland settled to pay over € billion in a dispute over an insurance enterprise¹⁰.

Even in the situation that arbitrators rule in favor of governments in an ISDS case, the government's legal costs can be considerable. International investment lawyers are known to charge up to US\$1,000 per hour for their services. The OECD has calculated that legal and arbitration costs in ISDS arbitration cases average over US\$8 million, exceeding US\$30 million in some cases¹¹.



While termination of BITs by mutual consent was rare in the past (only two known cases up to 2008), by the end of 2014, over a third of all known terminated BITs happened via mutual consent

¹ UNITED NATIONS, outcome document of the United Nations Summit for the adoption of the post-2015 development agenda, Transforming our world: the 2030 Agenda for Sustainable Development, 11 Aug 2015 available here <https://sustainabledevelopment.un.org/post2015/transformingourworld> and here https://sustainabledevelopment.un.org/content/documents/7891_Transforming%20Our%20World.pdf

² Section B in Chapter 2 of The final text of agreements and commitments adopted at the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002, United Nations, 2003.

³ Quote taken from paragraph 21 of the Monterrey Consensus.

⁴ UNCTAD, Recent trends in IIAs and ISDS, IIA issue No. 1, 2015, http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf

⁵ These arbitral tribunals usually consist of three arbitrators that are appointed on a case-by-case basis. For a more specific critique of this arbitration mechanism see Pia Eberhardt and Cecilia Olivet, Profiting from injustice-How law firms, arbitrators and financiers are fuelling an investment arbitration boom, Published by Corporate Europe Observatory and the Transnational Institute, November 2012, <http://corporateeurope.org/international-trade/2012/11/profitting-injustice>

⁶ UNCTAD, Recent trends in IIAs and ISDS, IIA issue No. 1, 2015, http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf

⁷ This number is based on the data provided by the ICSID as available on 20 Aug 2015. Based on current trends the real number should be expected to be 30-80% higher.



PROBLEM 2: BITS AND SOVEREIGN DEBT RESTRUCTURING

In addition to causing considerable fiscal problems for governments, Bilateral Investment Treaties may also have serious implications for sovereign debt restructuring. This is what happened in the case *Abaclat and others v. the Argentine Republic*¹². The International Centre for Settlement of Investment Disputes (ICSID) at the World Bank ruled that the BIT between Italy and Argentina had jurisdiction over Argentina's restructuring of its sovereign debt in the wake of its 2001 financial crisis. When Argentina restructured its debt in 2005, bondholders filed a claim for approximately US\$4.3 billion. While some of those investors agreed on a settlement in 2010, the remaining Italian bondholders together still seek more than US\$2 billion in compensation from Argentina at the ICSID.

Similar BIT cases have now been brought to ICSID against Cyprus¹³ and Greece¹⁴. While Argentina's restructuring concerned a bilateral matter between Argentina and its Italian creditors, the debt restructuring in Greece and Cyprus was negotiated by the IMF, ECB and EU. This shows that private investors can use IIAs even to challenge decisions taken by multilateral institutions.

PROBLEM 3: BITS SERVE TO CHALLENGE NATIONAL LAWS

In 2014, Williams published the first results of her comprehensive study of 490 known ISDS investment cases¹⁵. Her study revealed that after 'cancellation of agreements or permits' and 'direct expropriation or nationalization' it is 'regulatory changes' by governments that are most frequently taken to arbitration by foreign investors. Changes to regulations that govern a specific industry are those challenged most

frequently (40%). This includes health-related matters such as new requirements for plain cigarette packaging (see below), the withdrawal of subsidies or the pricing of utilities. More than a third of all known ISDS cases challenged changes in national tax laws or regulations (38%). 15% of the regulatory changes that were brought to arbitration address a ban of industrial activity, including government measures related to nuclear phase-out or bans on wind farm expansion and fracking. The last 6% of the regulatory changes that were brought to arbitration included bans on specific substances (such as toxic PCBs) that had been introduced in response to health-related or environmental concerns (see box 2).

PROBLEM 4: THE 'CHILLING EFFECT' OF BITS

International Investment Agreements give far-reaching rights of protection to foreign investors. Most BITs allow investors to claim that national policy changes constitute an 'illegal indirect expropriation', or that they violate their right under the treaty to a 'stable regulatory environment', their entitlement to 'fair and equitable treatment' or the protection of

their 'legitimate expectations' regarding their investments. There is a growing concern that BITs may deter governments and legislators to introduce or implement new public policy out of fear for the legal response by foreign investors.

Already in 2003, the UN High Commissioner for Human Rights warned that the threat of litigation on the basis of BITs and other investment protection agreements may have a 'chilling effect' on government efforts to promote human rights and a healthy environment¹⁶. The *Newmont* case against Indonesia (see box 3) is just one example showing that the 'chilling effect' is not a mere theoretical concern. Another example are the efforts of Philip Morris to prevent the introduction of new cigarette packaging laws that are meant to discourage especially young people to take up smoking¹⁷. In 2010, Philip Morris International Inc. (PMI) initiated international arbitration proceedings against Uruguay, claiming that the country had violated the BIT between Uruguay and Switzerland. PMI claims that the 80% Health Warning Requirement implemented by Uruguay in 2009 (which increased the cigarette package health warning label coverage from 50% to 80%)¹⁸ breaches the



"Countries that have signed such investment agreements have paid a high price. Several have been subject to enormous suits – and enormous payouts. There have even been demands that countries honor contracts signed by previous non-democratic and corrupt governments, even when the International Monetary Fund and other multilateral organizations have recommended that the contract be abrogated." *Joseph E.*

Stiglitz, Nobel laureate in economics and former Senior Vice President and Chief Economist of the World Bank.



More than a third of all known investment cases that challenged changes of national laws or regulation were tax related (38%).

protection of 'intellectual property' and 'ongoing business' guaranteed by the BIT and damages the company's investments in the country. One year later, in June 2011, Philip Morris Asia brought an ISDS case against Australia similarly challenging the country's tobacco plain packaging legislation¹⁹.

The ISDS cases against Uruguay and Australia are still pending, but have already had a 'chilling' effect in both New Zealand and Malaysia. The governments of both countries have delayed the introduction of similar plain packaging legislation, while New Zealand expressed the decision to first "wait and see what happens with Australia's legal cases"^{20 - 21}.

Another example of a 'chilling effect' comes from NAFTA. Its investment protection chapter has the longest track record of government policies that have been challenged under ISDS. Four years after the first ISDS case ruled against Canada, a former government official in Ottawa shared his frustration in the press: "I have seen the letters from the New York and DC law firms coming up to the Canadian government on virtually every new environmental regulation and proposition in the last five years. They involved dry-cleaning chemicals, pharmaceuticals, pesticides, patent law. Virtually all of the new initiatives were targeted and most of them never saw the light of day"²².

⁸ Recent trends in IIAs and ISDS, IIA issue No. 1, 2015.

⁹ Wallach L, Beachy B, 'Occidental v. Ecuador award spotlights perils of investor-state system', Public Citizen, Memorandum, November 21, 2012.

¹⁰ Friends of the Earth Europe, The hidden cost of EU trade deals: Investor-state dispute settlement cases taken against EU member states, December 2014.

¹¹ OECD, Investor-State Dispute Settlement. Public Consultation: 16 May – 23 July 2012, p.19.

¹² ICSID Case No. ARB/07/5

¹³ ICSID Case No. ARB/13/27

¹⁴ Two separate cases ICSID Case No. ARB/13/8 and ICSID Case No. ARB/14/16

¹⁵ See e.g. Zoe Phillips Williams Risky Business or Risky Politics: What Explains Investor-State Disputes? August 12, 2014 Investment Treaty News.

¹⁶ Report of the High Commissioner for Human Rights, United Nations Economic and Social Council E/CN.4/Sub.2/2003/9, 2 July 2003.

¹⁷ "Big Tobacco Ignites Legal War", 27 June 2011, The Australian, <http://www.theaustralian.com.au/national-affairs/big-tobacco-ignites-legal-war/story-fn59niix-1226082403380>

¹⁸ Philip Morris Company Statements "Uruguay Bilateral Investment Treaty (BIT) Litigation" http://www.pmi.com/eng/media_center/company_statements/pages/uruguay_bit_claim.aspx# (visited 20 Aug 2015)

¹⁹ Australian Government Attorney-General's Department, "Tobacco plain packaging—investor-state arbitration" <https://www.ag.gov.au/tobaccoplainpackaging> (visited 20 Aug 2015)

²⁰ Release on the government website of New Zealand, "Government moves forward with plain packaging of tobacco products" 13 Feb 2013, <http://www.beehive.govt.nz/release/government-moves-forward-plain-packaging-tobacco-products> (visited 20 August 2015) full quotation of the relevant section "There is a risk that tobacco companies will try and mount legal challenges against any legislation, as we have seen in Australia. In making this decision, the Government acknowledges that it will need to manage some legal risks. As we have seen in Australia, there is a possibility of legal proceedings. To manage this, Cabinet has decided that the Government will wait and see what happens with Australia's legal cases, making it a possibility that if necessary, enactment of New Zealand legislation and/or regulations could be delayed pending those outcomes." Hon. Tariana Turia, Associate Minister of Health, New Zealand.

²¹ Knottnerus, et al, Socialising losses, privatising gains: how Dutch investment treaties harm the public interest, Briefing by SOMO, Both ENDS, Milieudefensie, and TNI, January 2015. <http://www.bothends.nl/en/Publications/document/134/Socialising-losses,-privatising-gains-how-Dutch-investment-treaties-harm-the-public-interest>

²² Quotation of anonymous former Canadian government official in Greider, William: The Right and US Trade Law. Invalidating the 20th Century, The Nation, 17 November 2001.



BOX 2

ISDS CASES THAT CHALLENGED THE REGULATION OF HARMFUL CHEMICAL SUBSTANCES

MMT (Methylcyclopentadienyl manganese tricarbonyl)

MMT is a toxic gasoline additive used to improve engine performance²³. Ethyl Corporation, a US chemical company, filed an ISDS complaint over the Canadian government's ban on MMT. Canada initially claimed that the arbitrators had no jurisdiction to decide on the case. Once the arbitration panel rejected this claim, the government decided to settle with the company. On 20 July 1998, Canada reversed its ban on MMT and paid US\$13 million in legal fees and damages to the Ethyl Corporation.

PCB (Polychlorinated Biphenyls)

PCBs are fluids used in electrical apparatus, classified as organic pollutants and banned under

the Stockholm Convention on Persistent Organic Pollutants²⁴. PCBs have known toxic and mutagenic effects by interfering with hormones in the body. When Canada introduced an export ban on PCBs to fulfill its obligations under the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal²⁵, SDMyers, an Ohio-based waste treatment company challenged this ban. The tribunal agreed that the ban breached Canada's obligations under NAFTA and ruled that the firm was entitled to US\$4.8 million in compensation from the Canadian treasury.

Lindane

Lindane is a neurotoxin that has been used as a pesticide. In 2009, the production and agricultural use of Lindane was banned under the Stockholm Convention. In 2001, the US-based company Chemtura Corporation challenged the Canadian government's ban

on canola (an oil seed used for the production of cooking oil) treated with Lindane. After nearly nine years of arbitration, the tribunal rejected all claims of the company.

MTBE (Methyl Tertiary Butyl Ether)

MTBE is gasoline additive that has been linked to neurotoxicological and carcinogenic health impacts²⁶, but is mostly known as a water polluter. The American Water Works Association has estimated that it will cost about US\$25 billion to clean up US public water systems contaminated with MTBE²⁷. When the state of California in March 1999 announced a ban on the use of MTBE starting in 2002, Methanex, a Canadian corporation that produces methanol - a chemical used for the production of MTBE - sued the US government for US\$970 million. The tribunal finally rejected the claim, arguing that California's MTBE ban did not have a sufficient connection to the company's methanol production to qualify Methanex for protection under NAFTA's investment chapter.



"When I wake up at night and think about arbitration, it never ceases to amaze me that sovereign states have agreed to investment arbitration at all [...]

Three private individuals are entrusted with the power to review, without any restriction or appeal procedure, all actions of the government, all decisions of the courts, and all laws and regulations emanating from parliament." Juan

Fernández-Armesto, arbitrator and former President of the Spanish Securities and Exchange Commission



BOX 3

THE MINING INDUSTRY LOBBY IN INDONESIA

In response to the environmental impact of mining activities on forest areas, the government of Indonesia in 1999 passed a new forestry law (Act No. 41/1999)²⁸. The law forbids open-pit mining in protected forest areas. International mining companies already active in those forests strongly opposed the implementation of the new law. Faced with the legal threats and substantive compensation claims by the mining companies, the then Minister for the Environment agreed to allow mining companies that had been granted contracts prior to the passing of the new law to continue their open-pit operations in protected forest areas²⁹. Close to nothing is known about the lobby activities undertaken by the mining companies to change the regulations in their favor. Ten years later, the government of Indonesia passed another law that affected the operations of mining companies in the country. The Mineral and Coal Act 4/2009 meant to make the Indonesian economy less dependent on the export of unprocessed raw materials and to encourage the development of national processing industries. The law obliged mining companies to refine and process minerals inside the

country prior to export. This was to increase the state's income from extractive industries and to create jobs for the Indonesian workforce. In early December 2013, the Minister of Finance estimated that the implementation of the Mining Law 4/2009 would increase state revenues from US\$4.9 billion in 2013 to US\$9 billion in 2015. However, by the end of the same month, after intensive lobbying by mining companies, the Indonesian government agreed to amend the regulations. The minimum threshold of mineral concentration for export was decreased (e.g. in the case of iron ore from 90% to 58%) and the obligation to build mineral processing capacities was postponed³⁰. One of the lobbyists, Newmont Mining Corporation, judged these amendments were not enough. In July 2014, the company brought a case against Indonesia at the International Centre for the Settlement of Investment Disputes³¹. Newmont claimed that the government's plans violated the BIT between Indonesia and the Netherlands. On 25 August 2014, Newmont withdrew its case but only after it had reached an agreement with the Indonesian government that gave the company special exemptions from the 2009 mining law. The details of the agreement have not been made public, however, it has been reported that the export tax that Newmont is required to pay has been decreased from 25% to 7.5%³².

²³ MMT is considered a dangerous hazardous neurotoxin to humans animals and plants. and serious source of pollution to the environment. see e.g. Fishman BE, et al in Toxicology. 1987 Aug;45(2):193-201. <http://www.ncbi.nlm.nih.gov/pubmed/3603584>

²⁴ The Stockholm Convention on Persistent Organic Pollutants is an international environmental treaty that aims to eliminate or restrict the production and use of persistent organic pollutants (POPs). <http://chm.pops.int/default.aspx>

²⁵ the Basel Convention, is an international treaty that was designed to reduce the movements of hazardous waste between nations, and specifically to prevent transfer of hazardous waste from developed to less developed countries <http://www.basel.int/>

²⁶ see e.g. Keller, Arturo, et. al, Health & Environmental Assessment of MTBE, Vol. 1, Summary & Recommendations, Nov. 1998, abstract available at <http://people.eri.ucsb.edu/~keller/papers/offline/Abstract20.pdf>

²⁷ See American Water Works Association, "A Review of Cost Estimates of MTBE Contamination of Public Wells," June 21, 2005, at S-1. Available at: https://clu-in.org/download/contaminantfocus/mtbe/AWWA_MTBECostEstimates_06202005.pdf

²⁸ For the text of the Act No. 41/1999 about Forestry, see http://theredddesk.org/sites/default/files/uu41_99_en.pdf and <http://www.flevin.com/id/lgso/translations/Laws/Law%20No.%2041%20of%201999%20on%20Forestry%20%5BE%20Elucidation%5D.pdf>

²⁹ Nabeli Makarim Agrees with Mining in Protected Forests, Koran Tempo, 14 June 2002 (translated by JATAM) <http://www.minesandcommunities.org/article.php?a=7737>



"This is so tough. Many kinds of pressures."

Muhammad Hatta Rajasa coordinating minister of economy Indonesia, on the lobby of Freeport and Newmont against Mineral and Coal Act 4/2009

BOX 4

A BIT THAT CHALLENGES LAND RIGHTS IN PARAGUAY

Bilateral Investment Treaties that include an Investor-to-State Dispute Settlement mechanism can have a negative impact on people's development opportunities even if the treaty is never used for arbitration. Its mere existence can serve as a threat to the authorities. This has been the case with the BIT between Germany and Paraguay³⁹.

The Palmital case

An agrarian reform law in Paraguay stipulates that land that does not meet its social function is sold by the owners or, if the owners refuse to sell, is expropriated. The implementation of the law has been slow and as a consequence, peasants suffering of undernourishment occupy idle estates rather than waiting indefinitely for land to be distributed to them. Palmital is a settlement of 120 landless families on a 1000 hectares idle estate that is owned by German citizens. The Palmital families applied for a transfer of the land titles under the agrarian reform law. The Senate, however, refused to give its consent arguing that expropriation of the German

owners would violate the 1993 BIT with Germany. The police violently expelled the families from their settlement several times, but each time they returned to the estate. Apparently, the German Embassy in Paraguay had referred to the BIT in the Palmital context, suggesting that expropriation would be a violation of the treaty. In the end the landless peasants, the German owners and the state of Paraguay reached an out of court settlement that allowed the families to stay on the land.

The Sawhoyamaxa case

At the end of the 19th century, foreigners acquired lands in Paraguay that traditionally belonged to the Sawhoyamaxa indigenous community. The Sawhoyamaxa were marginalized, had to enter into paid employment and were subjected to degrading work conditions imposed by the new farm owners. Their access to the lands that for centuries they had used to hunt and fish, to produce medicines and to exercise their cultural rituals was severely limited. Since 1991, community leaders have addressed complaints to the Paraguayan administrative and judicial authorities demanding the restitution of their lands. However, the state remained reluctant to

protect their traditional rights and the Sawhoyamaxa were forced to live on the border of the road in abominable living conditions. The Sawhoyamaxa, represented by the NGO Tierra Viva, brought the case to the Inter-American Court of Human Rights (ICHR). Paraguay argued that since the current owner of the land is a German citizen, expropriation of the land would breach the BIT between Paraguay and Germany. On 29 March 2006, the ICHR dismissed this argument and declared the Paraguayan state in violation of the human rights to property, judicial protection, life and juridical personality before the law. It ordered the state to return the ancestral lands to the community within three years. Paraguay failed to follow through on this obligation and years of legal tug-of-war ensued with complaints filed even at the Constitutional Chamber of Supreme Court of Justice. In October 2014, the Supreme Court unanimously rejected the estate owners claims that the decision to expropriate 14,404 hectares and give them back to Sawhoyamaxa was 'unconstitutional'. It is not known whether the German investors have decided, or already proceeded, to use the German BIT with Paraguay to challenge this final decision of the national courts of Paraguay.



"So, if Exxon feels its operations there have been badly treated by the Venezuelan government, it can use the ISDS mechanism to have recourse to an international tribunal. However, if a small Venezuelan dry cleaner is being subject to governmental abuse, it's just out of luck. To me, that seems problematic. Focusing on the wealthy seems like a fundamentally unbalanced way to protect property rights." Simon Lester, trade policy analyst of the conservative Cato Institute in the United States

PROBLEM 5: THE LACK OF TRANSPARENCY IN ISDS CASES

Most IIAs allow for fully confidential arbitration, which means that neither the actual number of ISDS cases nor their content or the companies and countries involved are publicly known. Most known statistical data and cases come from the International Centre for Settlement of Investment Disputes at the World Bank³³. The ICSID Convention and Arbitration Rules do not contain a generic rule on confidentiality or transparency. While ICSID has the stated objective to publish all awards, the parties in the dispute need to give their consent for publication and can thus determine the actual level of confidentiality about the arbitration outcomes³⁴. The ICSID does publish information on the registration of requests for arbitration and maintains registers of all proceedings.

ISDS cases that are brought to arbitration at other institutions are shrouded in total secrecy. The International Chamber of Commerce (ICC) website even advertizes the fact that the ICC does not disclose any information as one of the "Ten good reasons to choose ICC arbitration"³⁵.

In December 2014, the United Nations General Assembly adopted the UN Convention on Transparency in Treaty-based Investor-State Arbitration, or the 'Mauritius Convention on Transparency'. The Convention provides a set of rules for making information about Investor-State arbitrations that arise from IIAs publicly available³⁶. In theory, this considerably improves the transparency about ongoing ISDS cases between a signatory state and an investor from another signatory country³⁷. However, despite governments' public support for improved transparency of ISDS cases, at the time of writing only 11 countries had signed the Convention³⁸, while Mauritius so far is the only country that has also ratified it.

³⁰ Bosman Batubara, Indonesian government continues to serve extractive companies, Stiftung Asien Haus 2014

³¹ For more details on the Newmont case, see: Hilde van der Pas & Riza Damanik, Netherlands – Indonesia Bilateral Investment Treaty rolls back implementation of new Indonesian mining law, Briefing EU-ASEAN FTA network, IGJ and TNI, November 2014, EU-ASEAN FTA network, IGJ and TNI, online : <https://www.tni.org/files/download/newmont-indonesia-case-4.pdf>

³² Newmont gets export permit despite pending smelter fund, Jakarta Post, 20 September 2014, <http://www.thejakartapost.com/news/2014/09/20/newmont-getsexport-permit-despite->

³³ See <https://icsid.worldbank.org/apps/ICSIDWEB/Pages/default.aspx>

³⁴ See <https://icsid.worldbank.org/apps/ICSIDWEB/process/Pages/Confidentiality-and-Transparency.aspx>

³⁵ International Chamber of Commerce, Ten good reasons to choose ICC arbitration, <http://www.iccwbo.org/Products-and-Services/Arbitration-and-ADR/Arbitration/Introduction-to-ICC-Arbitration/Ten-good-reasons-to-choose-ICC-arbitration/> as (visited on 19 Aug 2015)

³⁶ http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency.htm

³⁷ The UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency.html

³⁸ On 19 Aug 2015 the convention had been signed by Canada, Finland, France, Germany, Italy, Mauritius, Sweden, Switzerland, Syrian Arab Republic, United Kingdom and United States of America. An updated overview can be found at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency_Convention_status.html

³⁹ The two cases presented were discussed in Right to Food Quarterly Vol.2 No.1 (2007). We present them here in an only slightly edited form. The description of the Palmital case is based on a text by Rolf Künnemann, the Sawhoyamaya case is based on a text by Ana Maria Suárez-Franco.

PROBLEM 6: THE MYTH THAT BITS ATTRACT FOREIGN INVESTMENT

The primary purpose of Bilateral Investment Treaties is to attract foreign investment. However, already in 2003, World Bank research concluded that BITs fail to deliver on this promise⁴⁰. To explain this remarkable finding, certain business lobby groups have argued along the lines that 'BITs will have to give more rights to investors to make them work'. A study by the World Trade Organization (WTO) however showed this argument is invalid⁴¹. While there are still many staunch proponents of the system of BITs, even they increasingly admit that there is no consensus on whether BITs really help to attract foreign investment. How can it be explained that BITs fail to serve their primary purpose? It appears that, first of all, BITs play no significant role in the decision making process of foreign investors. Following the example of a study done at the Oxford University in 2010⁴², we interviewed four BIT negotiators including three from capital exporting countries not covered in the prior study. All interviewees confirmed that they received requests from investors about BITs only after the investment decision had already been taken⁴³. Meanwhile it is known that other questions, such as about the national laws or tax treaties that pertain to an investment contract, are considered prior to the investment decision.

Secondly, BITs also appear to play no significant role in the decisions that investment insurance agencies take about whether or not to cover a certain investment⁴⁴. The risks covered by BITs and investment insurances are very similar. The German Political Risk Insurance provider (PRI) Euler Hermes, for example, covers not only losses resulting from nationalization or expropriation but also "sovereign acts which in their effects are equivalent to expropriation", as well as losses

resulting from war, other armed conflicts or "civil disturbance" and problems related to transferring funds to the home state of the investor. One would expect that that the existence of a BIT is an important factor in the pricing of risks by investment insurance agencies. However, PRIs such as Euler Hermes or MIGA (Multilateral Investment Guarantee Agency) of the World Bank Group do not require a BIT as a precondition to provide investment insurance for a specific host state. Misinformation on this issue is persistent. Even the chief BIT negotiator of a Latin American country interviewed as part of this research, was convinced both PRI's require a BIT as a condition for insurance eligibility. Euler Hermes, however, states that insurance cover can be granted if "the internal legal system of the country ensured adequate legal protection"⁴⁵ and that "subject to verification at the time of the decision on a warranty claim" guaranties can be granted for investment in Brazil, the Dominican Republic, Colombia and Taiwan, which all are countries that have no BIT with Germany⁴⁶. As for MIGA, this agency considers no less than 57 rating factors when determining the pricing of the insurances. Only 1 of 57 factors relates to the existence of an investment protection agreement. The absence of a BIT is never in itself sufficient reason for MIGA to withhold a guarantee⁴⁷. An OECD analysis of the political risk assessment practice of government-backed investment guaranty agencies found that only 25% of the agencies take the existence of investment protection agreements into account⁴⁸.

Thirdly, another important reason why BITs fail to attract foreign investment, paradoxically, may be that

few investors would be keen to invest large sums of money if they believed there might be a serious chance that they needed to make use of the BIT's ISDS mechanism in the future. For most investors, legal security is only one important factor in investment decisions. In particular for large green field investment (i.e. when investors start a new venture in a foreign country which involves constructing new operational facilities such as factories, power plants or plantations) the much wider and general support of the host state government is important. For them, to take a positive investment decision requires a level of mutual trust that goes far beyond what the signature of a BIT could achieve. What is more, the signing of a BIT may have the effect of sounding the alarm bell for potential investors, who may question why a host state is willing to waive part of its state sovereignty in the hope to attract foreign investment. Some governments may see the signing of a BIT as a 'quick fix' that can relieve them from the much more difficult task of implementing deeper national reforms to gain the confidence of potential foreign investors. Reality shows, however, that this 'quick fix' is rarely a sufficient strategy to convince investors.

Plenty problems, but no easy exit

Based on the growing evidence of the malfunction of BITs as tools to attract foreign direct investment (FDI) and the risk they entail for the policy space of governments and parliaments, more and more nations seek to revise or terminate the IIAs they signed in the past. However, it proves very difficult to withdraw from an IIA once it has been ratified. BITs are designed in such a way that



Since the beginning of 2015, at least one new ISDS case gets published every week



they frustrate governments' ability to unilaterally terminate their treaty obligations. Firstly, all BITs contain 'Termination clauses' that define how and when a country can withdraw from the treaty. While some BITs allow denunciation of the treaty at any time, the majority of BITs contain an 'end-of-period' model. For an initial fixed term a country cannot unilaterally withdraw from the treaty. After this period, the treaty automatically gets renewed for further fixed periods (typically 10-15 years). Failure to adhere to the specified notification period (usually 6 or 12 months prior to the expiry date) will lock the parties into another multi-year treaty period.

But even after a successful termination, the 'survival clauses' that are a near universal feature of IIAs ensure that the rights granted to investors remain protected and enforceable under international law for a period of 10 to 20 years after a state's unilateral withdrawal from the treaty. Survival clauses are only applicable when treaties are terminated unilaterally by one country. When an existing IIA is replaced by a new one, or if all parties mutually agree to terminate the treaty, the survival clause ceases to have an effect⁴⁹. While termination of BITs by mutual consent was rare in the past (only two known cases up to 2008), by the end of 2014, over a third of all known terminated BITs happened via mutual consent (see table 1).

THE WAY FORWARD

A new generation of investment policies is needed. BITs and investment protection in other trade agreements have been propagated as important tools to attract foreign direct investment, but have failed seriously. While breaking their promise to increase investment flows, they moreover prove to have serious negative implications for governments that strive to regulate the economic activities of investors for the benefit of their population. As shown, IIAs can have detrimental effects for the vulnerable and the poor even if investors never make use of the ISDS mechanism and the possibility to bring a case to arbitration (see box 4). While the defenders of BITs and investment protection agreements suggest lukewarm reforms, such as minor changes on the technical level of current BIT text⁵⁰, more and more governments are working on an exit strategy. To do this unilaterally, however, is not an easy task since the architecture of BITs has been designed with the very purpose to frustrate the ability of governments to terminate their treaty obligations.



"If there are investors who stay away because they feel that we don't have old-style, dated, antiquated bilateral investment treaties in place, I can assure you there are plenty of other investors from other parts of the world who are happy to come and don't insist on this".

Rob Davies, Trade and Industry, Minister of South Africa

⁴⁰ Mary Hallward-Driemeier, Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit ... and They Could Bite, August 2003, World Bank Policy Research. See also: Emma Aisbett, "Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation", CUDARE Working Papers University of California, Berkeley, 2007.

⁴¹ Axel Berger, Matthias Busse, Peter Nunnenkamp, Martin Roy; "More Stringent BITs, Less Ambiguous Effects on FDI? Not a Bit!", World Trade Organization, Geneva, Switzerland.

⁴² 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)

⁴³ Not-for-attribution face to face interviews, (October 2014) with BIT negotiators from four countries, three of them were not covered in the publication referred to in footnote 42, two were from the EU and one was from a capital exporting country in Western Asia.

⁴⁴ 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)

⁴⁵ The exact formulation in German is: "Dies ist grundsätzlich dann der Fall, wenn mit dem Anlageland ein wirksamer Investitionsförderungs- und -schutzvertrag (IFV) besteht bzw. die innerstaatliche Rechtsordnung des Anlagelandes hinreichenden Rechtsschutz gewährleistet. "See: <http://www.agaportal.de/pages/dia/grundlagen/garantievoraussetzungen.html#> (as visited on 18 August 2015)

We see two opposite trends happening simultaneously. On the one hand, momentum is growing for governments to implement reforms in IIAs. UNCTAD reported that at least 45 countries and 4 regional integration organizations are currently revising or have recently revised their model for investment agreements⁵¹. Brazil, for example, has recently started to sign Investment Cooperation and Facilitation Agreements (CFIA). While these agreements also provide for dispute prevention and dispute resolution mechanisms, they are not based on the controversial Investor-to-State Dispute Settlement mechanism. South Africa has chosen a different approach by introducing a new national law. The Promotion and Protection of Investment Bill seeks to promote investment while achieving a balance between the rights and obligations of all investors in South Africa, both national and foreign. The Bill, which does not include an ISDS mechanism, confirms that foreign and domestic investors and their investments are protected under the Constitution of the Republic of South Africa. In Europe, the European Commission has initiated infringement proceedings against five EU Member States requesting them to terminate the BITs between them⁵². Italy, be it without much public notice, created a precedent when in January 2015 it delivered its official notice of withdrawal from the Energy Charter Treaty (ECT)⁵³.

On the other hand, while the above examples show that the need for change is slowly being recognized, the political reality globally is not changing considerably or even confirming the status quo. New BITs and IIAs are still being negotiated. Worldwide, 27 new IIAs were concluded in 2014 alone, this means that a new IIAs got signed every 2 weeks. In Europe, the question whether new EU trade agreements should include an investment protection agreement and ISDS is



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slowly drawing attention, but appears to be limited to discussions about the Transatlantic Trade and Investment Partnership (TTIP) with the USA and the Comprehensive Economic and Trade Agreement (CETA) with Canada. The EU trade and investment agreement with Singapore (EUSFTA), which is expected to be the first EU ISDS treaty to be put before the EU parliament, is not considered as part of the ongoing debate. The same is true for other ongoing EU negotiations about new ISDS treaties with countries such as Myanmar, Vietnam, Japan and China.

At the United Nations, there is a growing recognition that the international legal system on foreign investment reflects an asymmetry between rights and obligations of Transnational Cooperation (TNCs). On 26 June 2014, the United Nations Human Rights Council decided to establish an Open-

ended Intergovernmental Working Group for a new international treaty on transnational corporations and human rights. At its first meeting, the Working Group underlined the existing gaps in the international legal framework when it comes to the duty to protect human rights in business activities. It emphasized that existing instruments in this respect are all concentrated in 'soft law', meaning non-binding regulations such as the OECD's Guidelines for Multinational Enterprises⁵⁴. Chairperson of the UN Working Group, Maria Fernanda Espinosa, stated: "While TNCs are granted rights through hard law instruments, such as bilateral investment treaties and investment rules in free trade agreements, and have access to a system of Investor-State Dispute Settlement, there are no hard law instruments that address the obligations of corporations to respect human rights".



"While Trans National Corporations are granted rights through hard law instruments, such as bilateral investment treaties and investment rules in free trade agreements, and have access to a system of investor-State dispute settlement, there are no hard law instruments that address the obligations of corporations to respect human rights." Maria Fernanda Espinosa, Chairperson of the UN working group for a treaty on transnational corporations and human rights

If indeed foreign investors are meant to start playing a more significant role in development finance - as appears to be the path taken, witnessed also in the new Sustainable Development Goals - then the rules regulating foreign investment flows urgently need to change. The international debate should shift from a focus on the question which mechanisms are best suited to protect the rights of foreign investors, to the question how other stakeholders that are for good or bad impacted by investment decisions can get a stronger say in the decision making process. Investment projects that receive direct financial support from government institutions are increasingly bound to rules and safeguard mechanisms to ensure their positive impact on development and to prevent them from doing harm to the environment and local stakeholders. The same kind of safeguards and enforcement mechanisms are urgently needed for privately financed investment projects. At the moment, there is simply no binding international legal framework that governs this vital issue. When the international community starts a serious debate on this subject, we hope they will not shy away from posing the most pressing question: Is it necessary and responsible that foreign investors are granted special privileges and rights under international agreements in the first place?

⁴⁶ The exact formulation in German is: "Bei einigen Anlageländern besteht kein bilateraler IFV; der erforderliche Rechtsschutz wird dennoch durch die innerstaatliche Rechtsordnung des Anlagelandes als gewährleistet erachtet. Vorbehaltlich einer Überprüfung im Zeitpunkt der Entscheidung über einen Garantierantrag trifft dies gegenwärtig zu auf: Brasilien Dominikanische Republik, Kolumbien, Taiwan".

⁴⁷ Lauge Skovgaard Poulsen "Political risk insurance and bilateral investment treaties: a view from below", Vale Columbia Center 2010.

⁴⁸ Kathryn Gordon, "Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development", OECD INVESTMENT POLICY PERSPECTIVES, 2008.

⁴⁹ See e.g. T.S. Voon et al Parting Ways: The Impact of Investor Rights on Mutual Termination of Investment Treaties (2014) 29(2) ICSID Review - Foreign Investment Law Journal 451-473 December 10, 2013.

⁵⁰ See for example a response by the pan European Seattle to Brussels network to the recent reform proposals of the Directorate-General for Trade of the European Commission.

⁵¹ UNCTAD, Recent trends in IIAs and ISDS, IIA issue No.1, 2015, http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d1_en.pdf

⁵² European Commission - Press release, Commission asks Member States to terminate their intra-EU bilateral investment treaties, Brussels, 18 June 2015.

⁵³ The National Law Review, Italy Withdraws from Energy Charter Treaty, April 21, 2015.

⁵⁴ The term "soft law" refers to quasi-legal instruments which do not have any legally binding force, or whose binding force is somewhat "weaker" than the binding force of traditional law, often contrasted with soft law by being referred to as "hard law", https://en.wikipedia.org/wiki/Soft_law

TABLE 1

Overview of terminated BITs and IIAs that have not been replaced by others

| TERMINATION DATE | SHORT TITLE | TERMINATION TYPE |
|------------------|--|------------------|
| 01-01-01 | Indonesia - Norway BIT (1991) | unilateral |
| 09-07-02 | Bolivia - Spain BIT (2001) | unilateral |
| 01-01-04 | Malaysia - Norway BIT (1984) | unilateral |
| 01-05-04 | Czech Republic - Slovakia BIT (2002) | by consent |
| 23-02-05 | Malta - Switzerland BIT (1965) | unilateral |
| 25-05-05 | Ecuador - Guatemala BIT (2002) | unilateral |
| 26-06-07 | Israel - Slovenia BIT (1998) | unilateral |
| 26-06-07 | Hungary - Israel BIT (1991) | unilateral |
| 10-01-08 | Hungary - Italy BIT (1987) | by consent |
| 18-01-08 | Ecuador - Honduras BIT (2000) | unilateral |
| 18-01-08 | Ecuador - Nicaragua BIT (2000) | unilateral |
| 18-01-08 | Dominican Republic - Ecuador BIT (1998) | unilateral |
| 18-01-08 | Cuba - Ecuador BIT (1995) | unilateral |
| 18-01-08 | Ecuador - El Salvador BIT (1994) | unilateral |
| 18-01-08 | Ecuador - Paraguay BIT (1994) | unilateral |
| 18-01-08 | Ecuador - Uruguay BIT (1985) | unilateral |
| 10-06-08 | El Salvador - Nicaragua BIT (1999) | unilateral |
| 01-09-08 | Italy - Slovakia BIT (1998) | by consent |
| 01-09-08 | Ecuador - Romania BIT (1996) | by consent |
| 01-11-08 | Netherlands - Venezuelaf BIT (1991) | unilateral |
| 02-03-09 | Italy - Latvia BIT (1997) | by consent |
| 02-03-09 | Italy - Lithuania BIT (1994) | by consent |
| 30-04-09 | Czech Republic - Italy BIT (1996) | by consent |
| 09-05-09 | Estonia - Italy BIT (1997) | by consent |
| 10-06-09 | Italy - Slovenia BIT (2000) | by consent |
| 10-06-09 | Czech Republic - Slovenia BIT (1993) | by consent |
| 01-11-09 | Bolivia - Netherlands BIT (1992) | unilateral |
| 18-11-09 | Czech Republic - Denmark BIT (1991) | by consent |
| 14-03-10 | Italy - Romania BIT (1990) | by consent |
| 09-05-10 | Bulgaria - Italy BIT (1988) | by consent |
| 30-09-10 | Czech Republic - Malta BIT (2002) | by consent |
| 09-12-10 | Ecuador - Finland BIT (2001) | unilateral |
| 20-02-11 | Czech Republic - Estonia BIT (1994) | by consent |
| 01-12-11 | Czech Republic - Ireland BIT (1996) | by consent |
| 10-06-12 | Bolivia, United States of America BIT (1998) | unilateral |
| 07-09-12 | (Belgium-Luxembourg) - South Africa BIT (1998) | unilateral |
| 31-03-13 | Austria - Cape Verde BIT (1991) | by consent |
| 13-05-13 | Bolivia - Germany BIT (1987) | unilateral |
| 11-06-13 | Croatia - Italy BIT (1996) | unilateral |
| 01-07-13 | Austria - Bolivia of BIT (1997) | unilateral |
| 04-07-13 | Bolivia - Sweden BIT (1990) | unilateral |
| 01-11-13 | South Africa - Switzerland BIT (1995) | unilateral |
| 01-11-13 | Netherlands - South Africa BIT (1995) | unilateral |
| 23-12-13 | South Africa - Spain BIT (1998) | unilateral |
| 11-10-14 | Austria - South Africa BIT (1996) | unilateral |
| 22-10-14 | Germany - South Africa BIT (1995) | unilateral |

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