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What's the Big Deal?
Understanding the Trans-Pacific Partnership

Foreign investor protections in the Trans-Pacific Partnership

Gus Van Harten

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Foreign investor protections in the Trans-Pacific Partnership

Extraordinary investor protections, high public costs

Like most of Canada's trade agreements, but unlike the World Trade Organization's multilateral trade agreements, the Trans-Pacific Partnership (TPP) would give foreign investors special rights to protect their assets by suing countries for compensation when they are affected by laws, regulations, and other decisions that the foreign investor thinks are unfair. Nothing like these rights exists for other actors in international law, whether they are other foreign nationals, domestic investors, or citizens—even in the most extreme situations of mistreatment.

Why should foreign investors have this special status and, in effect, a generous public subsidy for assuming economic risks of democracy and regulation that apply to everyone? Promoters of agreements like the TPP often assert that foreign investors need special protection for one or another reason, but in my experience the assertions do not come, as they should, with compelling evidence of a corresponding benefit *for the public*.

What is investor–state dispute settlement (ISDS)?

"The investor-state dispute settlement (ISDS) mechanism is a non-judicial 'arbitration' process that is used to protect rights and privileges of foreign investors under trade and investment agreements such as NAFTA and the proposed Trans-Pacific Partnership. Foreign investors are not required to try to resolve a complaint through the domestic courts of the host country before launching an ISDS claim and they do not need to seek consent from their home government.

"Multinational companies have used ISDS to challenge a wide range of laws, regulations, and policies, including measures related to public health, environmental protection, financial regulation, and resource management. The risk of an ISDS claim can also give foreign investors a powerful tool to deter policies they don't like.

"ISDS cases are usually decided by tribunals of three members: one chosen by the foreign investor, one by the challenged government, and the third by mutual agreement or, failing that, by an outside appointing authority. Tribunal decisions are subject to limited or no review in any court, whether domestic or international. Yet their awards of public compensation to foreign investors are directly enforceable in domestic courts.

"Since the mid-1990s, when ISDS was included in NAFTA and many other agreements, its use has soared from virtually no known cases to about 50 cases annually today. Canada has been sued 39 times under NAFTA's ISDS process, nearly always by U.S. investors, and has paid over $190 million in compensation in known awards or settlements. This record makes Canada the most-sued developed country in the world. The number of ISDS claims and the amount of ordered compensation continues to grow worldwide."

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Foreign investors have used their special rights to attack legitimate laws and policies in Canada as well as other countries. Prominent cases include the Philip Morris challenges to anti-tobacco measures in Australia and Uruguay, the Pac Rim claim against mining restrictions in water-stressed El Salvador, and the Vattenfall claim against Germany's nuclear phase-out, for example.

In Canada, foreign investors — and the lawyers, sitting as arbitrators, who decide the investors' claims — have used similar provisions in NAFTA in expansive or dubious ways. Examples include the Lone Pine Resources challenge to fracking restrictions in Quebec, the Clayton/Bilcon claim against an environmental assessment process in Nova Scotia, the Mobil Investments/Murphy Oil challenge to the regulatory structure for offshore oil development in Newfoundland and Labrador, the Eli Lilly claim against federal court decisions on Canadian patent law, the S.D. Myers challenge to a

In what areas have investors sued countries?

Foreign investors have invoked their special rights in many areas of public decision-making, but some areas are more prominent than others. In a study of 196 ISDS claims by foreign investors, 34 cases were found to have involved conflicts over natural resources including oil and gas, gold, lumber, fisheries, and water.[2]

A total of 40 cases arose from government decisions on health or environmental protection. The health theme was evident in cases involving health insurance, drinking water, food safety, pharmaceuticals, pesticides regulation, and anti-tobacco measures. The environmental theme involved decisions about water, land and biodiversity conservation, pollution control, mining remediation, hazardous waste disposal, and liability for environmental contamination.

A smaller number of cases involved planning or approvals decisions by local governments. Other common themes included the administration of justice, taxation, economic policy, and financial regulation.

federal ban on PCB waste exports (after the U.S. briefly allowed PCB waste imports), and the Ethyl claim against a federal ban on a gasoline additive.[1]

In these NAFTA cases, foreign investor rights were used to challenge and seek public compensation for good faith decisions that emerged from democratic or court processes in Canada. With the TPP, many more such claims will become possible, even if the sued country (the "respondent state") has already successfully defended against a very similar ISDS claim in the past.

In short, the TPP's rights for foreign investors carry major risks for voters and taxpayers in TPP countries while delivering unjustified benefits, at significant public expense, to foreign investors. As I explain later, the financial benefits of these foreign investor rights have thus far gone overwhelmingly to very large multinationals and very wealthy individuals.

Protection beyond domestic law and other areas of international law

There is a simple reason why ISDS lawyers have encouraged foreign investors to use treaties like the TPP to attack countries' decisions, even at a potentially high cost in legal and arbitration fees for both the foreign investor and the sued country. The reason is that the treaties give advantages for foreign investors that are not available to them, or to anyone else, in domestic law and other areas of international law.

The following list illustrates some of the special legal benefits that ISDS provides for foreign investors and, in turn, how it privilege foreign investors over everyone else:[3]

- There is no right of a government or any other affected party to bring a claim against a foreign investor in ISDS. Instead, foreign investors have been granted the most powerful rights and protections that exist for any private actor in international law, without any corresponding and actionable duties to respect labour standards, the environment, public health, anti-corruption rules, etc.

- Foreign investors can challenge directly any decision of a country — even by its highest legislature, government body, or court — at the international level. Typically, international disputes are resolved among countries and their governments, as at the World Trade Organization (WTO), for example.

- Foreign investors can be awarded uncapped amounts of compensation as the primary remedy for sovereign conduct that is deemed by the arbitrators to have been unlawful. This is an extraordinarily powerful and highly unusual aspect of the treaties. It can create major challenges for legislatures and governments attempting to plan for the cost of their decisions. In effect, corporate lawyers and lobbyists working for foreign investors can use this aspect of ISDS to put an unknown price tag on proposed law or other decision when a deep-pocketed foreign investor objects to the proposal.

- There is no general doctrine of deference or balancing in the ISDS arbitrators' review of legislatures and courts, in contrast to the domestic law of Canada and other countries such as France, the United Kingdom, and the United States. These doctrines of deference or balancing were developed historically to accommodate the role of legislatures as elected bodies and the role of governments in dealing with complex or urgent policy questions.

- The provisions that describe the rights and protections of foreign investors — such as "fair and equitable treatment" or "indirect expropriation" or "de facto discrimination" — are very broadly worded. As a result, they give immense power to the lawyers who sit as arbitrators and decide foreign investor claims. The core power of the arbitrators is to interpret the ambiguous rights and to award public money to foreign investors, with no monetary cap on the amounts that can be awarded. In past cases, the amounts that countries have been ordered to pay have ranged from tens of thousands to billions of dollars per case.

- The foreign investor directly controls or influences half of the make-up of the arbitration tribunal's membership. Normally, judges would be appointed by a public body and as a part of a publicly accountable process.

- The lawyers appointed as arbitrators in each case, especially the "core" arbitrators who have been appointed over and over, stand to profit from their own decisions. Because they do not have secure tenure and are paid a (lucrative) daily or hourly rate, the arbitrators have an evident interest to encourage claims, which can be brought only by one side (the foreign investors), and to stretch out the proceedings. Due to the absence of conventional safeguards of judicial independence, a range of conflicts of interest arise in the system, typically favouring deep-pocketed potential claimants, i.e., multinational companies and very wealthy individuals.

- There is no opportunity — or a very limited opportunity depending on the rules under which a foreign investor chooses to bring the ISDS claim — for review of the arbitrators' decisions in any court, whether domestic or international. Instead, review of the arbitrators' awards is done on limited grounds by another tribunal of for-profit arbitrators or by a domestic court in a place that is typically chosen by the arbitrators themselves. In this way, the power of the arbitrators over public money is de-linked from the courts as well as legislatures and governments.

- The arbitrators' awards are widely enforceable against a country's assets located in other countries. Corporate lawyers have adopted creative strategies to chase assets in this context by attempting to seize warships, public art on loan to foreign galleries, or cultural properties — let alone more conventional commercial assets such as money owed by the customers of a country's state-owned companies.

- No right of "standing" is allowed in ISDS arbitration proceedings for other affected parties, besides the foreign investor and the state's national government. For a legal proceeding to be fair, all parties whose legal interests are affected by the process should be given a right of standing to the extent of their interest.

- There is no requirement for a foreign investor to use a country's domestic courts before resorting to ISDS, no matter how fair and independent the domestic courts are. This anomalous situation arises because the TPP does not apply the usual requirement in international law that a foreign national must go to a country's own courts first, where they are reasonably available and offer justice, before bringing an international claim against the country. Thus, implicitly, agreements like the TPP operate from the position that the courts in all countries cannot be relied on to protect foreign investors. Foreign investors are not required to use the courts, or even to demonstrate that the courts are inadequate in some way, before bringing an ISDS claim. Yet the courts in Canada and many other countries are clearly more independent and more fair than ISDS itself.

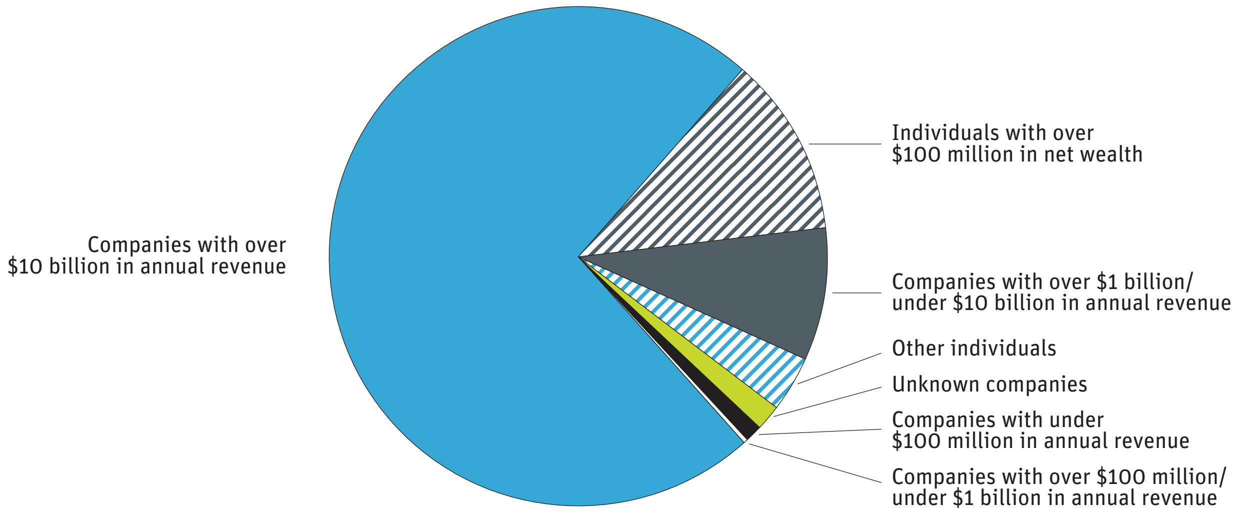
To repeat, in these and other ways, the TPP gives special privileges to foreign investors. No other system of international protection, beyond other trade and investment agreements that allow for ISDS, comes close to delivering such a powerful legal position for anyone, even in the most extreme situations of mistreatment. By adding to existing agreements that cover far fewer foreign-owned assets, the TPP would vastly expand this lopsided arrangement in which the largest and wealthiest actors in society are given special access to public compensation for risks that apply to everyone and against which no one else has these special protections.

Who has benefited financially from ISDS?

Overwhelmingly, the foreign investors that have benefited financially from the rights in agreements like the TPP have been very large companies and very wealthy individuals. Some of these individuals have used legal manoeuvres to make themselves legally "foreign" in order to sue their own country.

To illustrate, in a recent study it was found that over 90% of ordered compensation in foreign investor claims against countries went to corporations with over US$1 billion in annual revenue — most had over US$10 billion — or to individuals with over US$100 million in net wealth.[4] The distribution of ordered compensation, by size and wealth of claimant, is indicated in *Figure 1*.

FIGURE 1 Compensation by Size/Wealth of Claimant



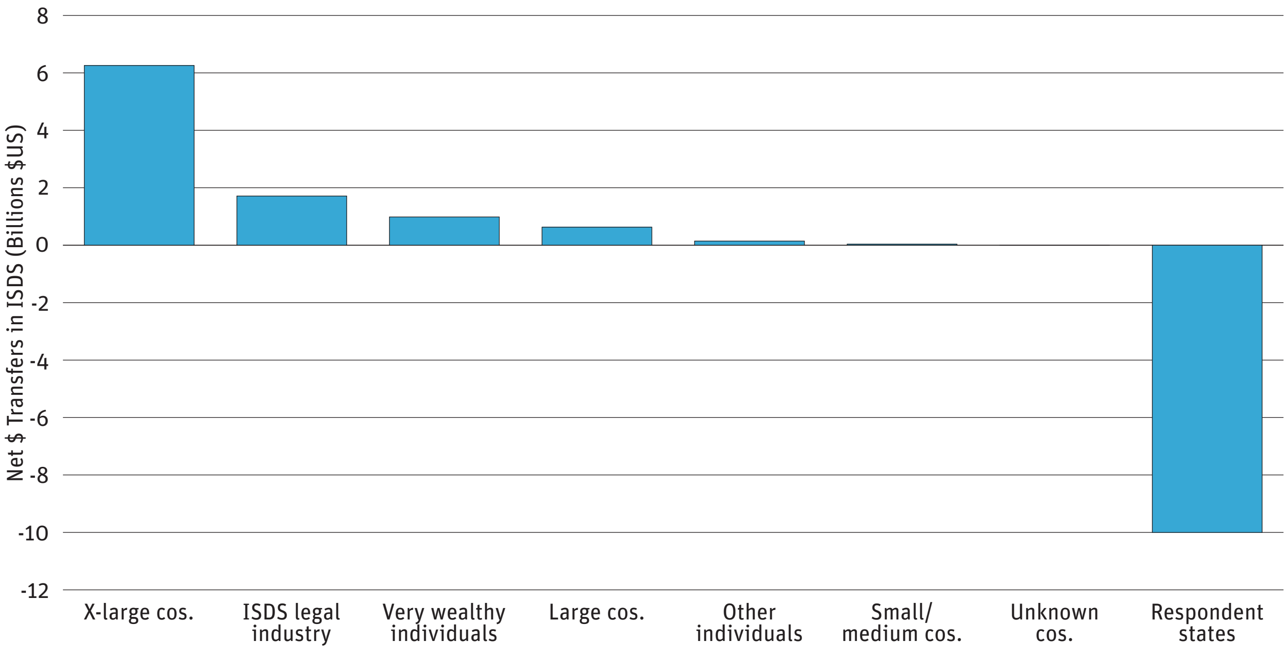
By following the money in this way, we find that the clearest financial impact of foreign investor rights has been to require billions of dollars in public money to be paid to multinationals and the very wealthy. For other foreign investors, the money typically spent on lawyers and arbitrators, whose fees amount to about $8 million per case on average, appeared to outpace any financial award to the investor, even in cases where compensation was awarded.[5] Accounting for the factor of legal and arbitration fees, the ISDS system has greatly enriched investment lawyers and arbitrators, who have earned well over $1 billion in fees.

Figure 2 gives an approximate sense of the financial winners and losers in known ISDS cases, measured by ordered compensation and adjusted for estimated fees paid to lawyers, arbitrators, and other professionals in ISDS.

Looking at another measure, the success rates of the largest multinationals — with over $10 billion in annual revenue — has greatly exceeded those of other foreign investors in known ISDS arbitrations. In 71% of the 48 cases they initiated, these companies were successful in having their claim heard and in arguing that the respondent country had violated one or more of their investment treaty rights. In contrast, the success rate for other foreign investors across the 166 ISDS cases they brought was 42%.

Perhaps most troubling is the pressure that ISDS allows foreign investors to put on governments behind the scenes. Governments in Canada have responded to the threat of NAFTA ISDS lawsuits from U.S. investors by de-

FIGURE 2 Financial Winners and Losers from Foreign Investors' Special Rights (Billions of USD)



veloping processes to vet regulatory proposals internally. In a study of the impact of ISDS for environmental decision-making in Canada (based on confidential interviews with government officials, especially in Ontario), it was found that government ministries have changed their decision-making in order to account for ISDS and other trade litigation risks, that government lawyers play a key role in assessing the risks, and that a ministry's concern for the risks was more acute after the ministry was drawn into a NAFTA case, although institutional learning about ISDS also appeared variable and intermittent.[6] Officials typically declined to discuss specific cases, but referred occasionally to situations in which ISDS or other trade concerns were considered and, in some cases, where they led to changes to a proposal.

The findings indicate that governments have changed their decision-making in favour of foreign investors in order to avoid financial and political risks of ISDS, apparently at the expense of anyone who has a conflicting interest. Yet, for various reasons, we clearly do not have a full picture of the impacts of ISDS on governments, even with extensive investigative research.

The TPP goes beyond NAFTA

The TPP's rights for foreign investors mimic other trade and investment agreements, but they also go beyond such agreements. First, the TPP would expand vastly the range of foreign investors who enjoy these special rights. Indeed, only two existing agreements — NAFTA and the Energy Charter Treaty — are comparable in scope to the TPP, and only then because those two agreements are the rare cases that currently allow foreign investor claims among western developed economies.

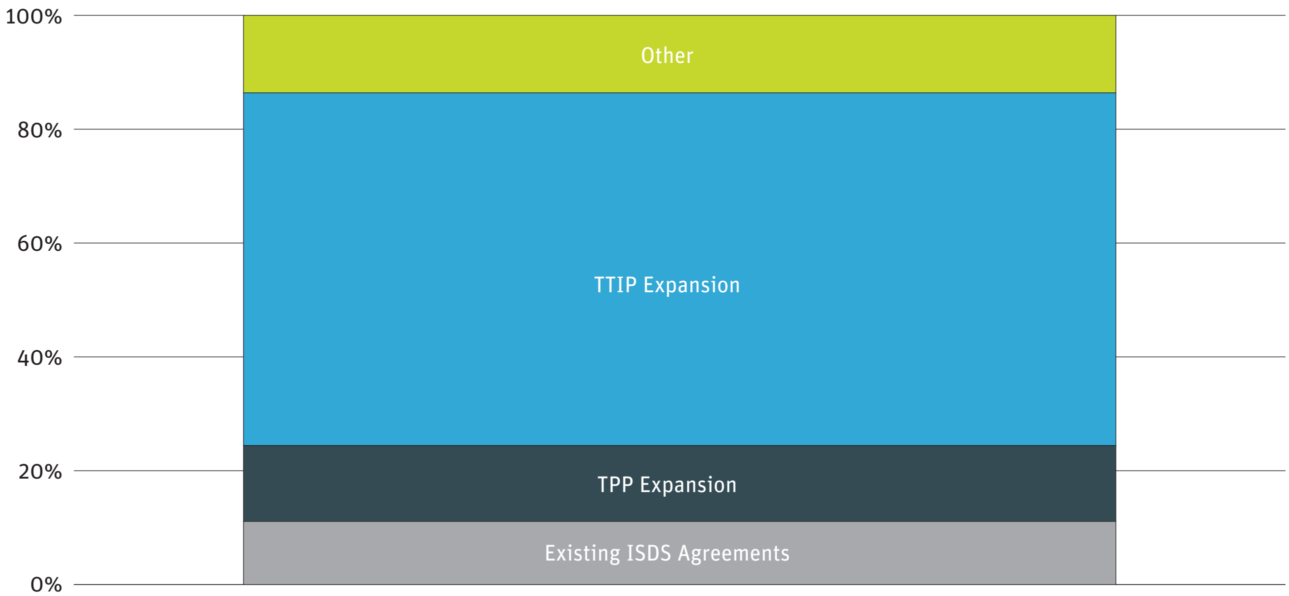
As it happens, Canada has the unique position under NAFTA of being the only western developed country that has agreed to these foreign investor rights with the U.S. The TPP would expand Canada's ISDS exposure (to a reasonable prospect of foreign investor claims) from, at present, U.S. investors under NAFTA and Chinese investors under the 2014 Foreign Investment Promotion and Protection Agreement (FIPA) to include, most notably under the TPP, companies and wealthy individuals from Australia, Japan, and Malaysia.

The TPP is even more important for how it would expand ISDS at a global level. To illustrate, *Figure 3* uses the U.S. economy as a proxy to show how the TPP would expand foreign investor rights worldwide.[7] It compares the amount of foreign-owned assets (i.e., inward foreign direct investment stock) in the U.S. economy that is presently covered by existing ISDS agreements to the amount that would be covered under the TPP. The chart also indicates the expansion that would come from a related trade agreement currently under negotiation: the U.S.–European Union Transatlantic Trade and Investment Partnership (TTIP).

As we can see, the TPP and TTIP would together vastly expand the scope of foreign investor rights from what is presently still an exceptional role in the international economy.

Second, for Canada, the TPP would expand foreign investors' rights, especially the rights of U.S. investors, beyond Canada's current agreements. For example, the TPP would allow foreign investors to claim compensation for violations of "investment agreements" (i.e., contracts) with the federal government.[8] Canada has never before given this added right to foreign investors in a trade or investment agreement. Instead, Canada has held to the sensible position that disputes about a foreign investor's contractual rights should be resolved according to the agreed terms of the contract, including its terms on dispute settlement.

FIGURE 3 ISDS Coverage of U.S. Inward FDI Stock



The situation on this point is legally complex, but essentially, by allowing foreign investors to bring international claims for "investment agreements," the TPP would expand the risks for Canadian taxpayers when governments enter into contracts with multinationals to supply goods and services or to deliver or operate privatized services and infrastructure. Federal government contracts would become uniquely enforceable, by foreign companies only, outside Canadian courts if that is what the foreign company preferred, even if the underlying contract referred disputes to Canadian courts. That is risky for taxpayers because, among other things, it allows ISDS arbitrators, who we should recall have a financial interest to encourage foreign investor claims, to award public money to disgruntled foreign companies. The change has potentially wide-ranging implications because procurement contracts or public-private partnerships in Canada would otherwise typically refer disputes to Canadian courts.

By this expansion of foreign investor rights, the TPP would distort the marketplace further in favour of multinationals, by giving them an advantage when they compete for government business. Domestic companies would have to live with the terms of their contracts, while foreign investors, based on the expansive interpretations of ISDS arbitrators on this issue, would have a new TPP right to skirt those terms and resort to their TPP rights instead.

Third, while the TPP mostly reproduces NAFTA's flaws, in situations where the TPP's version of ISDS could provide more regulatory space to countries the reforms are virtually meaningless for Canada because NAFTA is maintained alongside the TPP. Put differently, anything that is new and apparently better in the TPP (such as its exception for some types of anti-smoking measures) is very likely lost because the TPP adds onto, instead of replacing, existing agreements like NAFTA. In this way, the TPP has been designed to create the best of possible legal worlds for foreign investors and the worst for governments, voters, and taxpayers in TPP countries.

To explain further, unlike other treaties in which countries agree explicitly to replace earlier agreements, the TPP "affirms" and thus adds on to existing trade and investment agreements among TPP countries.[9] As a result, for Canada, anything that is apparently better in the TPP compared to NAFTA will very likely be lost in practice because a U.S. investor can bring a claim under NAFTA instead of the TPP. Also, anything worse in the TPP would not be displaced by NAFTA because a foreign investor could choose to bring a claim under the TPP. If a foreign investor was unsure which agreement offered the best chance to win compensation, it could bring a claim under the TPP and NAFTA, making a different argument under each and getting compensation if it won under either. I am not being outlandish here; this sort of manoeuvring is common in ISDS.

For this reason, claims by TPP promoters that the deal is more "progressive" than other agreements are highly misleading. The TPP does not replace other agreements no matter how comparably "regressive" they might be. It affirms and adds on to them.

Considering these factors, if it is adopted, the TPP would vastly expand the role of ISDS as a global institution.

The TPP would make it harder to regulate the financial sector

If one compares the TPP to NAFTA, the TPP has more rights for global banks in ISDS. Once again, these added rights come at a potentially huge cost to the public. It appears that TPP negotiators decided that big banks need more, not less, protection from financial regulation.

Specifically, the TPP's financial services chapter allows foreign banks to bring claims for compensation that would not be permitted under NAFTA. Unlike NAFTA, the TPP allows such claims based on the TPP's so-called min-

Prudential Regulation and NAFTA

"Certain NAFTA investment protections, such as the controversial 'minimum standard of treatment', do not apply in the financial sector. NAFTA also allows financial regulators to take measures to ensure the integrity and stability of the financial system, even if these regulations violate NAFTA's investment protection rules. This 'prudential carve-out' can be used to block ISDS claims. The TPP, on the other hand, gives ISDS tribunals more power to award public compensation to foreign investors who are allegedly mistreated by financial regulations.

"To illustrate, foreign financial institutions have used ISDS to seek compensation in the context of Europe's financial crisis. In 2008, a Chinese financial services company sued Belgium under a 2005 Belgium–China investment treaty. Ping An, the largest single shareholder in the Belgian-Dutch bank Fortis, alleged that it lost US$2.3 billion when government authorities, who stepped in to rescue the financial giant, later sold off assets over the objections of minority shareholders.

"While the tribunal ruled against Ping An in May 2015, it did so on jurisdictional grounds and not the merits of the claims of unfair treatment and expropriation. Foreign investors have filed similar ISDS claims against Greece and Cyprus to recover losses incurred under financial restructuring programs."

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imum standard of treatment for foreign investors.[10] This supposedly "minimum" standard incorporates far-reaching rights for foreign investors to be compensated where they do not receive "fair and equitable treatment" and "full protection and security" from a country. These vaguely worded rights have become notorious after being interpreted expansively by ISDS arbitrators.

By going beyond NAFTA in this way, the TPP would give ISDS arbitrators even more power to award public compensation to banks in a financial crisis, where a government regulates to protect the stability of the financial system. Thus, the TPP would make it harder for financial regulators to predict what arbitrators will decide, years down the road, when a TPP ISDS award is issued. This uncertainty in turn would give banks more leverage behind the scenes to resist regulations when they are devised, at the expense of anyone who may benefit from financial regulation but lacks the power to threaten a costly international claim against the country.

Overall, this change in the TPP is a win for global banks and a loss for financial regulators, and anyone protected by them, in TPP countries (see box: Prudential Regulation and NAFTA).

Not fair, not independent

Apart from the details of how the TPP goes beyond NAFTA, there are more fundamental questions at stake in the TPP's expansion of ISDS. The TPP's arbitration process to protect foreign investors contradicts basic principles of judicial independence and fair process. For this reason, it is not compatible with the rule of law.[11]

In particular, the TPP gives for-profit lawyers — sitting as arbitrators — the power to decide what sovereigns can do, and then to award potentially vast amounts of public money to foreign investors. TPP arbitrators are "for profit" because they are paid by the day or by the hour. Unlike judges, they do not have institutional safeguards to remove the evident financial interest to encourage claims by foreign investors. Unlike other kinds of arbitrators, ISDS arbitrators' decisions are subject to little or no scrutiny in any court.

The financial interest of the arbitrators is uniquely present in ISDS arbitration because only one side (the foreign investors) can bring the claims that lead to the arbitrators' appointments and remuneration. Repeat arbitrators in particular have a unique incentive to interpret the law in ways that encourage foreign investors to bring more claims. Missing are the judicial safeguards of a set salary, secure tenure, an objective method of case assignment, a prohibition on working on the side as a lawyer or arbitrator, and so on.

Worse, the TPP arbitration process is procedurally unfair because, with the exception of the foreign investor and national government of the sued country, it denies full standing to other parties who have a legal interest in the process. That is, anyone else who has a legal interest in the case is not give full rights to access documents, submit evidence, and make arguments.

This concern about unfairness is not hypothetical. In various ISDS cases, parties have been affected directly by the arbitration, such as where a provincial government's decision is challenged and its reputation questioned, where an Indigenous community's land claim overlaps with a foreign investor's, or where an individual is accused of involvement in corrupt activities.[12] All of these parties have a direct interest in the proceedings, but no right to standing.

From the perspective of judicial independence and fair process, these are serious flaws in the ISDS process laid out in the TPP.

The price tag on democracy and regulation

The TPP would take us in the wrong direction and be very difficult to reverse. It would expand the transfer of power to ISDS arbitrators from legislatures, governments, and courts. The arbitrators would not be accountable like a legislature. They would not be capable of regulating like a government. They would not be independent or fair like a court.

At the core of the TPP's threat to democracy and regulation is the uncertain and potentially huge price tag that its ISDS process would put on any law or regulation that is opposed by a large multinational company or a billionaire investor. The problem is not that foreign investors would be too big to fail; it is that the TPP would make the biggest and richest ones too risky to regulate.

The TPP was an opportunity for countries to step back from and reform the flawed system of foreign investor rights and ISDS. Instead, the TPP would expand the system massively. That decision is reason enough to reject the TPP in order to protect the established institutions of democracy, sovereignty, and the rule of law in TPP countries.

Notes

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