215 Pennsylvania Avenue, SE • Washington, D.C. 20003 • 202/546-4996 • www.citizen.org

FR: Mariana Lopez, Public Citizen, Global Trade Watch division
DT: March 31, 2021
RE: **Recommendations for UN Working Group on Business and Human Rights**

Public Citizen, a leading U.S. civil society organization with 500,000 members, has engaged in extensive monitoring and analysis of the international investment agreement (IIA) regime, particularly in the context of U.S. IIAs enforced by Investor-State Dispute Settlement (ISDS). We are responding to a request made by the United Nations (UN) Working Group on Business and Human Rights for submissions of relevant information pertaining to human rights-compatible IIAs for its 2021 report to the UN General Assembly. We are of the view that **IIAs are inherently incompatible with the protection of human rights**.

The ISDS system included in various international trade and investment agreements fundamentally shifts the balance of power among investors, States and the general public, creating an enforceable global governance regime that formally prioritizes corporate rights and undermines governments' ability to regulate in the public interest.

As the Working Group acknowledges, ISDS gives foreign corporations alone greater procedural and substantive rights than domestic firms or other societal actors by providing foreign firms access to extrajudicial tribunals and by enabling them to obtain compensation for government policies and actions protecting the public interest that apply equally to domestic firms and that would not be deemed to violate domestic property rights protections. The ISDS regime undermines the rule of law by empowering extrajudicial panels of private sector attorneys to contradict domestic court rulings, including those in which countries' highest courts interpret domestic constitutions and laws, in decisions not subject to any substantive appeal.

Not only have governments been ordered to pay billions to corporations and investors for such claims, but ISDS cases have also resulted in the watering down of environmental, health and other public interest policies, and chilled the establishment of new ones: The mere threat of an ISDS case against an existing or proposed policy raises the prospect that a government will need to spend millions in tribunal and legal costs to defend the policy, even if the corporation ultimately does not win the case. Thus, increasingly, investors are employing the filing of ISDS cases as a form of "hard bargaining."

In a letter submission to UNCITRAL's Working Group III, a group of independent human rights experts appointed by the UN Human Rights Council, wrote that IIAs "and their ISDS mechanism have often proved to be incompatible with international human rights law and the rule of law."[1] The human rights experts noted:

> The inherently asymmetric nature of the ISDS system, lack of investors' human rights obligations, exorbitant costs associated with the ISDS proceedings and extremely high amount of arbitral awards are some of the elements that lead to undue restrictions of States' fiscal space and undermine their ability to regulate economic activities and to realize economic, social, cultural and environmental rights. The ISDS system can also negatively impact affected communities' right to seek effective

remedies against investors for project-related human rights abuses. In a number of cases, the ISDS mechanism, or a mere threat of using the ISDS mechanism, has caused regulatory chill and discouraged States from undertaking measures aimed at protection and promotion of human rights.[2]

The COVID-19 crisis reinforced the urgency of transformations in the current IIA regime to protect States' policy space. Even during the COVID-19 pandemic, the ISDS regime empowers corporations to threaten policies that prioritize human health and safety. Various law firms that have profited greatly from the ISDS system, have touted to multinational corporations the opportunities to use ISDS to challenge government actions during the pandemic.[3] The law firms have specifically targeted pandemic policies such as restrictions on business activities to limit the spread of the virus and protect workers, requirements for manufacturers to produce ventilators, mandatory relief from mortgage payments or rent for households and businesses, measures to ensure access to clean water for hand washing and sanitation and more.

While the costs of ISDS are clear, the benefits remain elusive, as does evidence that ISDS draws increased foreign direct investment. Numerous studies have examined whether countries have seen an increase in FDI as a result of being willing to sign pacts with ISDS enforcement. Summarizing the studies' contradictory results, the United Nations Conference on Trade and Development (UNCTAD) concluded, "[T]he current state of the research is unable to fully explain the determinants of FDI, and, in particular, the effects of [IIAs] on FDI."[4] UNCTAD delivered that synopsis alongside its own study finding that "results do not support the hypothesis that [IIAs] foster bilateral FDI."[5] Additionally, governments that have withdrawn from the ISDS system have reduced their liability and protected policy space without experiencing adverse impacts on investment or development.[6]

As it has become clear that the ISDS system prioritizes corporate profits over human rights, environmental protection and other public interest concerns, a growing chorus of government officials from across the political spectrum, small business organizations and businesses, academics, jurists, civil society organizations and trade unions around the world have publicly proclaimed opposition to ISDS and urge governments to exit it.[7] This opposition has made it more politically feasible for governments to eliminate ISDS from their investment policy frameworks. Even the U.S. government, which has historically promoted ISDS, is now exiting the regime. In the context of the United States Mexico Canada Agreement (USMCA), or the revised North American Free Trade Agreement (NAFTA), the United States eliminated ISDS with Canada and replaced U.S.-Mexico ISDS with a new approach that eliminates extreme investor rights. President Joe Biden also has denounced the inclusion of ISDS in any future trade agreements.[8] **In the absence of U.S. pressure to adopt and expand ISDS, states should not further entrench themselves in this system, but should instead work toward the elimination of ISDS and its extreme investor rights.**

Many of the questions the Working Group asked as a part of this open call for submissions refer to mechanisms and exceptions meant to remedy human rights violations under IIAs. **However, technical reforms to IIAs would not protect states from liability nor rectify the system's inherent conflicts of interest.**

The very structure of the ISDS regime gives rise to conflicts of interest that would not be remediated by enhancement of weak "conflict of interest" rules for tribunalists. The entire structure of ISDS creates a biased incentive system in which tribunalists, whose incomes rely on being selected to serve on panels, can boost their caseload by issuing broad interpretations of investors' rights to rule in favor of corporations and against governments. And transparency rules are necessary but not sufficient: They cannot hold accountable tribunals that remain unrestrained by precedent, States' opinions or substantive appeals.

In response to massive public opposition to ISDS in the European Union, the European Commission has included language in its recent free trade agreement (FTA) negotiations that includes some procedural "reforms" to the ISDS system and renames ISDS as an "Investment Court System" (ICS), as included in the Comprehensive Economic and Trade Agreement (CETA). The European Commission has further received a mandate from its member states to pursue a "multilateral investment court" (MIC) at the global level. On the one hand, the European Commission's ISDS reform proposals demonstrate its recognition that the status quo ISDS is politically untenable. Unfortunately, however, the Commission's proposals fail to address the fundamental concerns about the ISDS regime that have been repeatedly raised by civil society and governments. It is not surprising that the proposal, which promotes some procedural changes on the margins, has been widely rejected by civil society, the European Association of Judges, the German Magistrates Association and the Transatlantic Consumer Dialogue, among many others.

The ICS and MIC proposals would continue to empower foreign corporations and foreign investors alone to obtain extraordinary commercial rights and a system to enforce such rights as against governments. Investors and corporations alone would continue to be empowered to challenge government policies before international tribunals related to many issues of public interest, including control of toxic products and substances, food safety and labelling, affordable access to medicines, and more. Investors and corporations would have no obligations to host countries or their populations with respect to human rights, the environment or other public interests. Simply renaming a system that allows one class of interests — foreign investors — to attack public interest policies that apply to domestic and foreign entities alike in international tribunals does not remedy the fundamental structural problems of the EU's proposal or any other ISDS regime. Such public interest policies simply should not be vulnerable to such challenges.

The EU's reform proposals do not address fundamental critiques of substantive rights granted to foreign investors by the current ISDS system. In the CETA "reforms," the definition of investment remains extremely broad, which enables challenges to a wide array of public interest policies and allows firms that have made no real, productive investment to launch a case. The proposals also do not address the concern that the definition of investor allows firms located outside a pact's signatory country to launch cases under the pact.

Furthermore, critics have consistently raised concerns about the vague, broadly interpreted substantive rights such as "minimum standard of treatment"(MST), including the right to "fair and equitable treatment" (FET) and a prohibition of "indirect expropriation." These standards have proven dangerously elastic and favorable to foreign investors in a series of ISDS decisions in which governments have been ordered to pay compensation for non-discriminatory public interest policies.

Purported safeguards and explanatory annexes added to some IIAs in recent years have failed to prevent ISDS tribunals from exercising enormous discretion to impose on governments obligations that they never undertook when signing agreements. The U.S. government's attempt to "include stricter definitions … of what is required for successful claims"[9] in recent pacts has failed to stop tribunals from using increasingly expansive interpretations of foreign investors' rights to side with corporations in ISDS challenges to public interest policies. In the U.S.-Central America Free Trade Agreement (CAFTA), the Parties inserted an annex[10] that attempted to narrow the vague obligation for States to guarantee foreign investors a "minimum standard of treatment," which a litany of tribunals had interpreted as an obligation for the government to not frustrate investors' expectations, for instance by improving environmental or health laws after an investment was established. However, in two of the first investor-state cases brought under CAFTA — *RDC v. Guatemala* and *TECO v. Guatemala* — the tribunals simply ignored the annex's

narrower definition of "minimum standard of treatment." They also paid little heed to the submissions of the governments that negotiated CAFTA, which argued that the "minimum standard of treatment" obligation should be narrowly defined according to State practice.[11] Instead, the *RDC* and *TECO* tribunals both skipped any examination of State practice and relied on an expansive interpretation of that standard, concocted by a previous investor-state tribunal, which included an obligation to honor investors' expectations.[12] [13] Both ISDS tribunals ruled that Guatemala had violated the expanded obligation, and ordered the government to pay millions.[14] [15] [16] [17]

In addition to the MST/FET and indirect appropriation standards, other investment treaty substantive provisions, such as prohibitions on non-discriminatory performance requirements, most-favored nation clauses, and the broad scope of the definition of investment beyond real property, have also exposed States to problematic ISDS claims. Hence, reform efforts that focus on procedural changes to the process of arbitration will not adequately address the concerns about ISDS that have been raised by governments and civil society. Instead, removing ISDS and these damaging substantive standards is the wisest course of action.

Recommendations:

Moving away from ISDS altogether is the wisest course for governments, because (1) states have not received tangible benefits from ISDS agreements, while costs have been tangible and substantial, and (2) proposed procedural "reforms" would not be sufficient to protect governments from mounting ISDS liability or to eliminate the inherent conflicts of interest in the system.

Discussions of ISDS "reform," including at the UN Human Rights Working Group, should instead focus on the sorts of limits on substantive rights seen in the revised NAFTA. To adequately protect policy space for legitimate public interest regulation, IIAs must not grant investors rights beyond compensation for direct expropriation of real property. Terms providing "indirect expropriation" compensation rights and a guaranteed MST and related FET rights must be eliminated — as must enforcement mechanisms that empower foreign investors to avoid exhausting local remedies in domestic courts and instead bring claims in extra-judicial international arbitration venues.