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Evaluation by the Confederation of German Trade Unions:

Investment Protection in TTIP & Other International Agreements

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Confederation of German Trade Unions

Department for Economic, Fiscal and Tax Policy

Nora Rohde & Florian Moritz
International and European Economic Policy Unit

Nora.Rohde@dgb.de

Phone: +49 30-24 060-248
Henriette-Herz-Platz 2
D-10178 Berlin

www.dgb.de

In the public discussions concerning the EU trade agreements with the USA (TTIP) and Canada (CETA), the planned regulations for the protection of foreign investors have emerged as a major focus of criticism.

Special international investment treaties or the inclusion of relevant chapters in international agreements is of course nothing new: over 3000 investment protection agreements are already in existence worldwide. EU countries alone have concluded around 1400; Germany more than 130. However, firstly, such an agreement between the USA and the EU would create a completely new dimension in investor protection, as this would be the largest economic area in the world. Secondly, due to the public interest in the TTIP negotiations, for the first time in a long time it has become possible to highlight the problems involved in such investment protection treaties.

In this light, a debate regarding reform has also been set in motion.

I) Problems With Previous Investment Treaties

1.) Fundamental Problems

The basic purpose of investment protection agreements is to improve the position of investors in their relationship with countries. They safeguard investors' rights (particularly property rights) or define additional rights. They do not contain any obligations (for example, regarding adherence to labour, social or environmental standards etc.), nor do they in any way regulate the rights and entitlements of employees or the interests of other groups.

From our point of view, it can be assumed that the protection of property rights for investments should in fact be sufficient in most countries, especially in countries with highly developed legal systems. The member states of the EU, as well as the USA and Canada, protect property rights sufficiently.

At an early stage in the proceedings, the Confederation of German Trade Unions (Deutscher Gewerkschaftsbund [DGB]) pointed out – both in terms of the decision made by the DGB Federal Congress and also in a joint paper together with the German Federal Ministry for Economic Affairs (Bundeswirtschaftsministerium [BMWi]) – that no investment

protection regulations were necessary for TTIP.[1] The high level of mutual transatlantic direct investment shows that investors do not feel that their investment safety is under threat. Moreover, there is a lack of empirical evidence showing a direct connection between foreign investment and the corresponding investment protection mechanisms that would justify the inclusion of such chapters.[2]

It is fundamentally problematic that of all things the rights of investors are strengthened through additional international rights and procedures when, in our opinion, other problems require solutions more urgently: for example, improved international implementation of workers' rights. Questions must also be asked as to the nature of the relationship between the international protection of investors' rights and respective national protection, and whether national jurisdiction is circumvented by the international arbitration bodies. This is particularly applicable when one appreciates that national legal systems have grown over time and that they therefore ought properly to be considered in their entirety. As is well known, the German Constitution, for example, not only protects individuals from arbitrary or compensation-free expropriation; it also regulates the social responsibility of property – something that can also be observed in the context of the welfare state principle that is entrenched in the Constitution. In addition to this, contradictions between international investment protection regulations and national (or European) law can arise.[3]

The special status of *foreign* investors is fundamentally problematic. In the investment protection agreements it is not simply the case that the protection of property rights or investments is lifted up to an international level; these additional protection rights and the means for their implementation apply exclusively to foreign investors. Those within the country itself cannot make use of these rights; they can "only" invoke national protection rights. The DGB and its member trade unions categorically reject such special rights and special jurisdiction.

As well as these fundamental problems, previous investment protection treaties are to be criticised because they make it possible for foreign investors to override sensible national regulation to an inappropriate degree. As described in the following, this is due to rights granted to the investors by these agreements, and the system that enforces the resulting claims. This system leads to lawsuits brought against regulation by investors having a good chance of success; to governments being confronted with high legal costs (more than $8 million per case, according to OECD estimates) and damage payments (sometimes running

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[1] Decision from the 20th General DGB Federal Congress: http://bundeskongress.dgb.de/++co++9981f15e-cebd-11e3-a119-52540023ef1a (Motion 001); joint position paper DGB and BMWi: http://www.dgb.de/themen/++co++683203bc-3f12-11e4-9551-52540023ef1a

[2] http://www.euractiv.com/section/trade-society/news/positive-effects-of-ttip-tribunals-for-investment-unclear/

[3] In 2013, an arbitration court ordered Romania to pay damages because the country had cancelled subsidies that had initially been promised to the Romanian owners of a Swedish company. But the cancellation of these subsidies was one of the prerequisites for Romania joining the EU. Therefore, the European Commission is demanding that the Romanian government not pay the damages imposed by the international arbitration body, since they would be deemed "illegal aid". Romania is resisting the demand made by the European Commission, as if it were not to comply with the arbitration court's decision, it would run the risk of Romanian state property abroad being seized. The action that the Commission subsequently initiated against Romania has not yet been concluded.

into billions), and to regulation being dispensed with from the very outset in order to avoid legal processes and penalties.

2.) Investors' Entitlements

One problem is the partially very loose or unclear definitions found in the investment protection agreements. Even the term "investment" is controversial; in the broad definition used in CETA, for example, it encompasses not only traditional direct investments (such as the purchase of real estate or the construction of production facilities), but also purely financial investments (such as the purchase of bonds and the acquisition of concessions). This can lead to purely financial involvement (such as the acquisition of government bonds)[4] being granted the same level of protection as the construction of a factory ("greenfield investment") or participation in companies ("brown field investment").

It has until now also been possible to interpret the entitlements accorded to investors in investment protection agreements in a very loose sense. Of particular concern are the unclear definition of the protection from "indirect expropriation" and the assurance of "fair and equitable treatment". The lack of clarity in the definition of these terms means that many different national regulations can be viewed as violations – for example, that investors can deem democratically created environmental laws to be "indirect expropriation" and institute proceedings for damages accordingly.

Furthermore, in some cases, explicit "legitimate" (profit) expectations on the part of investors are taken into consideration as a relevant dimension for damage payments.[5] A comprehensive list precisely defining what 'legitimate' expectations are is lacking from the agreements.

3.) The Arbitration Court Procedures

If foreign investors feel that their aforementioned entitlements have been violated, they do not have to approach general jurisdiction courts, but can instead sue their host country for damages at international arbitration courts, without having previously taken national legal action. The reason being that the investment protection treaties create a parallel legal system in the form of investor-state dispute settlement (ISDS).

This system is problematic for several reasons: the structural problems of ISDS to date include a lack of transparency during trials, the absence of a court of appeal as well as

[4] This was how a claim by a US American hedge fund prevented the necessary debt restructuring of Argentinian government bonds, as the claimants insisted on full repayment of the bond debt at the expense of other creditors. Argentina had to declare insolvency, which caused rating agencies to reduce Argentina's credit rating.

[5] The Handelsblatt newspaper reported on the following case: in 2013, a businessman who had invested the relatively small sum of five million dollars in a tourism project in Libya was awarded damages of 935 million dollars plus interest. There was nothing strange about the reimbursement of the five million dollar investment sum. The 30 million dollars compensation for the damage to reputation suffered by the individual with respect to his business partners was quite unusual. But the 900 million dollars plus interest which he received for lost profits was truly staggering. The tribunal simply flouted the previous case law, which demanded that the claimant prove a history of profit in this context.

potential conflicts of interests on the part of the arbiters. The three-person tribunal consists of arbiters who work primarily in private legal chambers and who are designated by the disputing parties.

Since a new tribunal is convened for each case, it has often been the case that the same person has participated in several procedures in different roles: at times as an arbiter and at other times as a legal representative of one of the parties (a private investor or a country). Since the private chambers earn money from the procedures regardless of the result, they have a vested interest in there being as many procedures as possible on the part of companies.

II) Reforms and Proposals For Reform

The large amount of public protest over the past two years against investment protection regulation has led to various options for reform being put forward. However, the majority of the proposals concentrate too heavily on the structural organisation of the mediation and neglect problems pertaining to the material protection standards granted to investors, which are too broad in scope.

1.) Investment Protection in CETA

Investment protection as embedded in the EU trade agreement with Canada (CETA) – the negotiation of which is officially regarded as complete – already includes several detailed improvements compared with previous investment protection agreements. But these are not sufficient to prevent problems from arising: for example, progress was made in the establishment of procedural transparency and attempts were also made to define investor entitlement to "fair and equitable treatment" and damages in the case of "indirect expropriation" more precisely, but these have not been sufficient. In CETA, it remains unclear how an arbiter of one procedure in which an investor is taking action would be forbidden from legally representing the same investor in another procedure at another time. CETA makes no provision for a second instance in which arbitration awards could be examined and altered. It merely states that the establishment of such a second instance should be assessed. The scope of application selected for the investment protection in CETA is wide, which dramatically increases the number of potential ISDS cases; an asset-based investment definition has been chosen here rather than, for example, an enterprise-based one.

This means that it is not only traditional direct investments that are protected (holdings of at least 10% and usually 25% in enterprises, which also includes the founding of new enterprises) but also portfolio investments, i.e. pure "financial investments". The definition of an investor is admittedly restricted to investors who display "substantial business activities". However, it remains unclear what is meant by "substantial business activities".

2.) The European Commission's Proposal: the Investment Court System (ICS)

Due to the massive amount of public criticism of traditional ISDS witnessed within the debate on TTIP, a public consultation was initially carried out.[6] Following the publication of the results, proposals for reform were presented by several member states; these established the idea of an international investment court. The German Federal Ministry for Economic Affairs (BMWi) commissioned the international law expert Markus Krajewski to create a concrete "Model investment protection agreement with investor-state dispute settlement for industrial countries taking into consideration the USA".[7]

In autumn 2015, the European Commission presented its own proposal, which was also presented to the US negotiation partners as a framework for further discussions on investment protection within TTIP at the 11th round of negotiations.[8]

According to these new proposals, the ISDS system in place up until now would be replaced by a new, permanent bilateral Investment Court System (ICS), where decisions would be made regarding investment disputes relating to TTIP. Expanding on this, the Commission's current trade strategy for Europe (2015)[9] develops the idea of a permanent, multilateral investment court that, in the long term, would replace possible bilateral courts.

The DGB continues to believe that the international legal safeguarding of unilateral investor-state rights of action is unnecessary. The current public discussion of these procedures is long overdue. We must find a new balance between the rights and obligations of investors.

The DGB's requests include the following:

- that investors be required to exercise due diligence regarding human rights, and that a failure to do so would lead to sanctions and, in the case of damages, liability regarding the affected party;
- that countries' abilities to create laws for the good of the public and to change existing regulation is not compromised (right to regulate);
- that a loose interpretation of protection standards such as fair and equitable treatment and indirect expropriation be prevented;
- that the relevant procedures meet all the requirements relating to constitutional legal processes in terms of transparency, verifiability and independence and particularly that the independence of the arbiters be guaranteed;
- that there be the possibility to appeal verdicts;

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[6] The textual basis for the consultation was the relevant chapter of CETA. A detailed assessment of the reforms in the CETA draft can thus be found in the DGB statement at: http://www.dgb.de/themen/++co++9eeb9142-05ca-11e4-993c-52540023ef1a. (For a slightly less detailed version, see the DGB CETA statement at: http://www.dgb.de/themen/++co++0d26d074-7eb9-11e4-854b-52540023ef1a).

[7] http://www.bmwi.de/BMWi/Redaktion/PDF/M-O/modell-investitionsschutzvertrag-mit-investor-staat-schiedsverfahren-gutachten,property=pdf,bereich=bmwi2012,sprache=de,rwb=true.pdf

[8] http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf

[9] http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf;

- that the national legal process be strengthened vis-à-vis the international arbitration procedure.

In light of these aspects, the new proposal by the European Commission is evaluated below.

a) Judicial Proceedings

With respect to dispute resolution (Section 3, Sub-section 4), the new system exhibits improvements in several elements compared to the old ISDS system. Under the new system, a first instance tribunal consisting of 15 publicly appointed arbiters and an appeal tribunal with 6 arbiters is to be formed.

The judges are appointed by the USA and the EU and are to be taken in equal numbers from the EU, the USA and third countries. An array of innovations is also planned to help guarantee the independence and impartiality of the arbiters (e.g. the introduction of fixed compensation, code of conduct). However, Markus Krajewski's most recent analysis[10] shows that these improvements continue to allow loop-holes that endanger arbiter independence. There is a lack of concrete "institutional, financial and qualification-related parameters".[11]

Another new aspect is that third parties are granted intervention rights (Art. 23). Any outsider (natural or legal person) can have access to the documents pertaining to the dispute and participate in the proceedings and in doing so support one of the two disputing parties. However, a direct interest in the result of the dispute must be demonstrated.

The relationship with national legal protection continues to be problematic. ICS also does not stipulate that the national legal process must be exhausted before a lawsuit can be filed at the investment court. It is true that a "No U-turn" clause is included (Section 3, Sub-section 5, Art. 14). However, this merely states that all procedures on the national level must be terminated as soon as a lawsuit is filed at the investment court. Krajewski writes, "Doubled lawsuits concerning the same national measures are indeed barred, but the national legal process and the role of national jurisdictions are not strengthened."[12]

b) Investor Entitlements

Regrettably, in other areas, in particular regarding the material protection standards granted to foreign investors, the reform proposal remains true to the previous investment protection.

In order to counter the problem of an assault on national regulation that would be detrimental to general public interests, the Commission's proposal guarantees countries a

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[10] Krajeswki, M.; Hoffmann, R. (2016): *The European Commission's proposal for investment protection in TTIP.* http://library.fes.de/pdf-files/wiso/12379.pdf

[11] Krajewski/Hoffmann (2016): p.14

[12] Krajewski/Hoffmann (2016): p.15

national 'right to regulate' (Section 2, Art. 2). The Commission asserts that 'legitimate' national measures may not be the subject of an investment lawsuit. For illustrative purposes, several measures regarded as 'legitimate' are listed (e.g. for the protection of public health, environment, consumers etc.); an explicit mention of measures relating to workers' rights is not among them. It is admittedly the case that this is an open list, meaning that the protection of employees can still be considered 'legitimate'. However, according to Krajewski, a specific mention of such measures would provide more legal clarity.

Furthermore, the legal content of the article on the 'right to regulate' in this version is very unclear.[13] The choice of words in Article 2 fails to express clear legal consequences. The word 'legitimate' constitutes a further difficulty. As, in order to determine legitimacy, a necessity test is required. However, a sizeable margin of discretion evolves at this point regarding the question of which measures are deemed necessary and which are deemed not to be necessary.

'Fair and equitable treatment' and 'indirect expropriation' are certainly defined more clearly than in other agreements (Section 2, Art. 3 and 5). Specific criteria are stipulated for when treatment can be regarded as unjust or unfair. However, this clarification is then undone in the next step, where reference is made to the 'legitimate expectations' of the investors. These should be taken into consideration when host countries have made a specific promise on which expectations have been based.[14]

Indirect expropriation is defined more precisely in a dedicated appendix. According to this definition, the implementation of legitimate policy objectives, defined in a similar fashion to as found in the section on the right to regulate, may not be regarded as indirect expropriation. However, this does not apply for "manifestly excessive" measures, which again opens up room for interpretation. Here again, examples of legitimate policy objectives are listed and, again, measures relating to tariff provisions, labour protection etc. are lacking. In our view, it is also problematic that the possibility exists for investors to protect themselves, for example against long-lasting strike action, by appealing for the full protection of their investments because they feel that the security of their investment is endangered. Certain forms of co-determination – for example, the power of co-decision in supervisory boards – could be considered indirect expropriation.[15]

III) Conclusion and the DGB's Position

The DGB and its member trade unions reject investment protection in agreements between countries with highly developed legal systems. The EU, the USA and Canada – the contractual partners of the TTIP and CETA agreements – provide comprehensive protection

[13] Krajewski/Hoffmann (2016): p.9
[14] Krajewski/Hoffmann (2016): p.11
[15] Krajewski/Hoffmann (2016): p.16

of property rights. The high level of mutual transatlantic direct investment shows that investors do not view their investment safety as being under threat.

From a trade union perspective, the Commission's proposal for a new investment protection chapter for TTIP and CETA also does not constitute a solution for the fundamental problems these exhibit. A special role for foreign investors and the increasing relocation of investor protection to the international level is to be viewed critically, since it is only investors' rights and their implementation that are being regulated and not their obligations.

In contrast, in Germany, the protection of property rights is embedded in a legal system that also acknowledges the welfare state principle (see Point I 1.) We therefore request that CETA is reworked as even the reforms in TTIP achieve little if CETA continues to exist in its current state. Since a large proportion of US firms also have offices in Canada, they would be granted precisely these controversial rights via CETA. Due to this investment protection chapter, as well as for other reasons, CETA in its current form cannot be endorsed from a trade union perspective and its ratification must be rejected.

In the opinion of the DGB, there must be a far greater international focus on investor obligations – such as the adherence to and support of the employment, social and environmental standards that have been created in other international forums – and less focus on the extension of investor rights. The international implementation of decent working conditions and the promotion of human rights in an economic context are fields of action for which binding mechanisms should be created.

The ICS remains a tool that can only be used by foreign investors. For example, if an investor violates employment law, environmental law or consumer law, domestic investors, countries, individuals and civil society organisations would not be able to file a lawsuit with the newly formed investment court. This imbalance is a significant point of criticism for trade unions and is not resolved through the right of intervention granted to third parties. As this right admittedly makes external influence on an investment dispute possible, but the ability to initiate a lawsuit remains the exclusive privilege of foreign investors.

From a trade union perspective, the Commission's proposal does also not constitute a sufficient improvement beyond TTIP and CETA. In agreements with countries whose legal systems are not as well-established, the primary aim should be to further develop these systems within their cultural and historical context so that comparable levels of protection for investors and for the population can be created. This is particularly the case for several Eastern European countries that currently have great interest in a reformed investment protection agreement within TTIP that can replace the bilateral agreements with the USA in their 'traditional' format. Therefore, trade agreements – even those with countries with less developed legal systems – must not contain regulation for investment protection that could lead to an impairment of workers' rights or limit the country's capacity to create sensible regulation in the interest of the population or the environment.