Investor-State Dispute Settlement process (ISDS): latest evidence
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In recent years, number of ISDS cases has increased to 942 reported cases in 2018 and more evidence has come to light about the flaws in the ISDS system. The critical debate has affected all sides of politics, more governments are withdrawing from ISDS arrangements, and the EU and the US are now negotiating agreements without ISDS.

What is ISDS?

All trade agreements have government-to-government dispute processes to deal with situations in which one government alleges that another government is taking actions which are contrary to the rules of the agreement. ISDS gives additional legal rights to a single foreign investor (rights not available to local investors) to sue governments for damages in an international tribunal if they can claim that a change in national law or policy will harm their investment. Because ISDS cases are very costly, they are mostly used by large global companies that already have enormous market power, including tobacco, pharmaceutical, agribusiness, mining and energy companies.

Background and history

ISDS originated in the post-World War Two decolonisation period and was originally designed to compensate for nationalisation or expropriation of actual property, through bilateral investment treaties between industrialised and developing countries.

But over the last half century, the ISDS system has developed concepts like “indirect” expropriation, “minimum standard of treatment” and “legitimate expectations” which do not involve taking of property and do not exist in most national legal systems. These concepts enable foreign investors to sue governments for millions and even billions of dollars of compensation if they can argue that a change in domestic law or policy has reduced the value of their investment, and/or that they were not consulted fairly about the change, and/or that it did not meet their expectations of the regulatory environment at the time of their investment.

The World Trade Organisation does not recognise or include ISDS in its trade agreements, and it has only become a feature of other regional and bilateral trade agreements since the North American Free Trade Agreement in 1994.

There have been increasing numbers of cases against health, environment other public interest laws and policies.

ISDS Tribunals not independent, no precedents or appeals

Many experts including Australia’s former High Court Chief Justice French and investment law experts have noted that ISDS tribunals are not independent or impartial and lack the basic standards of national legal systems. ISDS has no independent judiciary. Tribunals are organised by one of two institutions, the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank International Centre for Settlement of Investment Disputes (ICSID). Tribunals for each case are chosen by investors and governments from a pool of investment lawyers who can continue to practice as advocates, sitting on a tribunal one month and practising as an advocate the next. In Australia, and most national legal systems, judges cannot continue to be practising lawyers because of obvious conflicts of interest

ISDS has no system of precedents or appeals, so the decisions of arbitrators are final and can be inconsistent. In Australia, and most national legal systems, there is a system of precedents which judges must consider, and appeal mechanisms to ensure consistency of decisions.

Leading international investment law expert and practitioner George Kahale has recently criticized ISDS in an April 2018 lecture at the Brooklyn Law School titled **"The wild, wild west of international arbitration law".**

Kahale uses examples from his own experience representing governments in ISDS cases to argue that the ISDS system based on commercial arbitration principles is not fit to arbitrate cases in which international companies seek compensation from governments for changes in health, environment or other public interest laws.

Kahale says, "It's one thing to have party-appointed arbitrators negotiate a decision to settle a commercial dispute having no particular significance beyond the case at hand ... it is quite another to decide fundamental issues of international law and policy that affect an entire society" (Kahale 2018: 7).

Adding "there really are no hard and fast rules" in ISDS, he cites examples of claims of billions of dollars based on false documents, methodologies for calculations of future corporate income which are unacceptable in World Bank accounting practice, and similar claims before different tribunals resulting in inconsistent decisions (Kahale 2018: 14).

He notes the growth of third-party funding of ISDS cases, in which speculative investors fund cases in return for a share of the claimed compensation, and argues they fuel the growth of "surrealistic" claims and are "more about making money than obtaining justice" (Kahale 2018:17).

Recent ISDS cases on medicines, environment, carbon emissions reduction, Indigenous land rights, minimum wage

The most comprehensive figures on known cases, compiled by the United Nations Conference on Trade and Development, show that there has been an explosion of known ISDS cases in the last 20 years, from less than 10 in 1994 to 300 in 2007 to 942 in 2018. Most cases are won by investors or settled with concessions from governments.

There are growing numbers of cases against health, environment (including laws to address climate change), Indigenous land rights and other public interest laws. Recent cases include the following:

- The US Philip Morris tobacco company shifted assets to Hong Kong and used ISDS in a Hong Kong investment agreement to claim billions in compensation for Australia's plain packaging law. It took over 4 years and $24 million in legal costs for the tribunal to decide that Philip Morris was not a Hong Kong company, and the case was an abuse of process, and the government only recovered half the costs. See more on p.5.
- US Pharmaceutical company Eli Lilley used the ISDS provisions of NAFTA to claim compensation for a Supreme Court decision that found a medicine was not sufficiently different from existing medicines to deserve a patent, which gives monopoly rights for at least 20 years. Canada has a higher standard of patentability than the US and some other countries. The Canadian government won the case after six years and $15 million in costs, but the tribunal decision was ambiguous on some key points about Canada's right to have distinctive patent laws.

- Swiss Pharmaceutical company Novartis threatened an ISDS dispute against the Colombian government under the Switzerland-Columbia bilateral investment treaty over plans to reduce prices on a patented treatment for leukemia.
- The US Bilcon mining company won millions in compensation from Canada because its application for a quarry development was refused for environmental reasons. The exact amount is still being determined.
- The US Westmoreland mining company is suing the Canadian government over the decision by the Alberta province to phase out coal-powered energy as part of its emission reduction strategy.
- The Canadian Bear Creek mining company recently won $26 million in compensation from the government of Peru because the government cancelled a mining license after the company failed to obtain informed consent from Indigenous land owners about the mine, leading to mass protests. The tribunal essentially rewarded the company despite the fact that it had violated its obligations in the ILO Convention on Indigenous Peoples to which Peru is a party.
- The French Veolia Company sued the Egyptian Government over a contract dispute in which they are claiming compensation for a rise in the minimum wage. This claim eventually failed.

Note that these examples include cases against court decisions and government laws and policies at national, state and local levels.

ISDS cases cost governments millions to defend, even if they win

Companies and governments fund the arbitration costs and their own legal costs. ISDS arbitrators and advocates are paid by the hour, which prolongs cases at government expense. A 2012 OECD Study found ISDS cases last for three to five years and the average cost to governments for defending cases was US$8 million per case, with some cases costing up to US$30 million. A more recent UNCITRAL paper indicated that ISDS costs are still a major concern.

ISDS tribunals have discretion about whether they decide to award some or all costs to the winning party, and applying for costs to be awarded prolongs the duration and costs of the case.

This differs from national systems. The Australian Government defeated the Philip Morris tobacco company's High Court claim for billions in compensation, and the High Court ordered the company to pay all of Australia's costs. The case and costs decision took less than a year.

Contrast this with the ISDS experience. Australia also won the 2011 Philip Morris ISDS case against our plain packaging law in 2015, but the costs were not awarded until 2017. Only half of Australia's almost A$24 million in legal and arbitration costs were awarded to Australia, despite the fact that the tribunal found that Philip Morris had abused the process.

Critics of ISDS range across the political spectrum and across economic and legal institutions

Critics of ISDS are spread across the political spectrum, and across economic and legal institutions. They include the Productivity Commission, the Australian Competition and Consumer Commission, former Chief Justice Robert French, former Australian Solicitor-General Justin Gleeson and the US conservative Cato Institute thinktank.

United Nations criticism of ISDS: not compatible with human rights

In September 2015, United Nations Human Rights independent expert Alfred de Zayas launched a damning Report which argued strongly that trade agreements should **not** include ISDS.

The Report says ISDS is incompatible with human rights principles because it "encroaches on the regulatory space of States and suffers from fundamental flaws including lack of independence, transparency, accountability and predictability".

In April 2019, seven UN special rapporteurs on human rights wrote an open letter identifying similar fundamental flaws in the ISDS system, and arguing for systemic change.

Governments are withdrawing from ISDS

Brazil has never endorsed ISDS. India, South Africa and Indonesia have cancelled existing ISDS arrangements without negative impacts on levels of investment, and have developed alternative investment protection frameworks.

The US and Canada have excluded ISDS from the revised US Mexico Canada Agreement.

Following decisions of the Court of Justice of the European Union that ISDS was not compatible with EU law, the 28 EU member states decided in January 2019 to terminate all Bilateral Investment Treaties between themselves by December 6, 2019. The EU has also excluded ISDS from negotiations with other countries, including the EU-Australia FTA currently under negotiation (see more detail below).

The Australian experience of ISDS

Previous Australian policy on ISDS

After a public debate about the experience of US companies using ISDS to sue Canada and Mexico in the North American Free Trade Agreement, the Howard Coalition government did not include ISDS in the US-Australia Free Trade Agreement in 2004.

In 2010 a Productivity Commission study found that ISDS gives additional legal rights to foreign investors not available to domestic investors and lacked evidence of economic benefits. The study recommended against the inclusion of ISDS in trade or investment agreements on the grounds that it poses "considerable policy and financial risks" to governments. The then ALP government developed a policy against ISDS during the years 2011-2013.

A June 2015 Productivity Commission study of ISDS confirmed the findings of its 2010 study.

The Philip Morris case against Australia's tobacco plain packaging law

The US Philip Morris tobacco company lost its claim for compensation for Australia's 2011 plain packaging legislation in the Australian High Court, and was ordered to pay all of the government's costs.

The company could not sue under the Australia-US Free Trade Agreement because the Howard government had not agreed to include ISDS in that agreement. The company moved some assets to Hong Kong, claimed to be a Hong Kong company and used the 1993 Hong Kong-Australia Investment Agreement to sue the Australian government. It took over four years for the ISDS tribunal to decide in December 2015 that Philip Morris was not a Hong Kong company and that its case was an "abuse of process."

The Australian government applied for, and was awarded a proportion of the costs by the tribunal in 2017, but the total costs and proportion awarded to Australia were blacked out of the tribunal decision. It took another two years and two FOI cases to reveal that the legal and arbitration costs were almost A$24 million, but Australia was awarded only half of its costs, with the cost to taxpayers remaining at almost A$12 million.

The substantive issue of whether the company deserved billions of dollars of compensation because of the legislation was not tested.

Even so, the case had a freezing effect on other governments' introduction of plain packaging legislation. The New Zealand government delayed introducing its own legislation pending the tribunal decision.

International corporations are well aware of this freezing effect and use ISDS to attempt to prevent public interest regulation. The Canadian Chevron Company has lobbied for ISDS to be included in EU trade agreements as a deterrent against environmental protection laws.

In short, ISDS is an enormously costly system with no independent judiciary, precedents or appeals, which gives increased legal rights to global corporations which already have enormous market power, based on legal concepts not recognised in national systems and not available to domestic investors. They have been used to claim compensation for new public interest regulation and to deter governments from introducing such regulation, including regulation to address climate change and to improve the minimum wage.

These are both areas of action proposed by a future Australian Labor government.

EU and US governments are retreating from ISDS

Both the EU and the US governments have in the past been major proponents of ISDS. However, recently there have been increasing numbers of cases taken against changes to EU and US government laws and policy decisions, and there has been an enormous growth in public opposition to ISDS. Opposition has been expressed by legal experts, state and provincial governments, court decisions and the general public**.** Both the EU and the US are now retreating from ISDS in trade negotiations.

The EU

The use of ISDS by the Swedish company Vattenfall to sue the German government over the phasing out of nuclear energy, and the inclusion of ISDS in proposed trade agreements with Singapore, Canada and the US prompted fierce public debate. In 2014, the European Commission launched an online public consultation on ISDS. The consultation received over 150,000 submissions, the majority of which were critical of ISDS.

The ongoing debate about ISDS has led to several EU court cases in which national governments have challenged the ability of the EU to make collective commitments on ISDS on behalf of national governments without such commitments being subject to democratic processes in each country.

On 16 May 2017, the Court of Justice of the European Union issued a landmark opinion on the investment and ISDS clauses in the EU-Singapore free trade agreement. It found that most of the agreement fell under the EU's powers, and that the EU could ratify it on behalf of member countries, except for some investment provisions, including ISDS. The court found that EU Member States' national and regional parliaments and the European Parliament must vote on provisions regarding investors, particularly ISDS.

In March 2018, in a separate case brought by the government of Slovakia, the Court of Justice found that ISDS between EU governments is incompatible with EU law. The Court found that damages awarded to a Dutch private health insurance company against Slovakia by an ISDS tribunal breached EU law.

The 28 EU member states decided in January 2019 to terminate all Bilateral Investment Treaties between themselves by December 6, 2019.

Following the court decisions, the European Commission has developed a "fast track" process for agreements without ISDS for non-EU countries, which would enable them to be approved by the European Commission alone, without seeking approval from national parliaments. Such agreements cannot include ISDS. The EU is now excluding ISDS from its current deals, including the EU-Australia FTA now being negotiated, but is pursuing longer-term but equally controversial proposals for a multilateral investment court.

The US

In 2014, the Chief Justice of the United States Supreme Court, Chief Justice John Roberts, warned that ISDS arbitration panels hold the alarming power to review a nation's laws and "*effectively annul the authoritative acts of its legislature, executive, and judiciary*". ISDS arbitrators, he continued, "*can meet literally anywhere in the world" and "sit in judgment*" on a nation's "*sovereign acts*".

Over the last two years, there has also been strong public opposition expressed in the US to the inclusion of ISDS in trade agreements from state governments and legal experts, which has influenced state and national governments.

In February 2016 the National Conference of State Legislatures declared that it "will not support Bilateral Investment Treaties (BITs) or Free Trade Agreements (FTAs) with investment chapters that provide greater substantive or procedural rights to foreign companies than U.S. companies enjoy under the U.S. Constitution. Specifically, NCSL will not support any BIT or FTA that provides for investor/state dispute resolution. NCSL firmly believes that when a state adopts a non-discriminatory law or regulation intended to serve a public purpose, it shall not constitute a violation of an investment agreement or treaty, even if the change in the legal environment thwarts the foreign investors' previous expectations".

In October 2017, more than 200 prominent law professors and economists signed an open letter arguing that ISDS undermines the rule of law and urging the US government to oppose ISDS in its renegotiation of the North American Free Trade Agreement (NAFTA). Signatories included Nobel laureate Joseph Stiglitz, former Labor Secretary Robert Reich, former California Supreme Court Justice Cruz Reynoso and Columbia University professor and UN Senior Advisor Jeffrey Sachs.

The United States in 2018 put forward a proposal to withdraw from the ISDS provisions in NAFTA, and the US and Canada have since excluded ISDS from the revised US Mexico Canada Agreement.

Ongoing reviews conducted by ISDS institutions reflect community concerns about ISDS

Growing community concern about ISDS has also had an impact on the two institutions that oversee ISDS arbitration systems, the United Nations Commission on International Trade Law (UNCITRAL) and the World Bank International Centre for Settlement of Investment Disputes (ICSID), both of which are conducting ongoing reviews of the system.

The UNCITRAL review involving member states began in 2017, is ongoing and identified the following issues to be addressed:

- Concerns pertaining to consistency, coherence, predictability and correctness of arbitral decisions by ISDS tribunals
- Concerns regarding the independence and impartiality of tribunal members
- Concerns regarding lengthy and costly proceedings, third party funding, the allocation of costs by tribunals, difficulties faced by successful respondent states in recovering costs and the lack of mechanisms to address frivolous or unmeritorious claims.

UN Human Rights Rapporteurs and hundreds of civil society groups have made submission to the UNCITRAL review criticising the fundamental imbalance of power in the ISDS system, as have sixty-five academics from around the globe. A recent paper from the South Centre says there is a growing international consensus to fundamentally reform ISDS, and that developing countries are under-represented in the UNCITRAL process. The UN Conference on Trade and Development also recognises that there is a new trend to limit companies' access to ISDS, by omitting ISDS from trade and investment treaties altogether, limiting treaty provisions subject to ISDS and excluding policy areas from ISDS coverage

In October 2016, the Secretariat of ICSID initiated a consultation with its Member States, which identified some similar areas of concern for review. The review is ongoing.