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

FR: Melanie Foley, Public Citizen, Global Trade Watch division
DT: July 15, 2019
RE: **Recommendations for UNCITRAL ISDS Discussions**

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 have participated in several meetings of UNCITRAL's Working Group III on ISDS reform. Our key recommendations for these discussions are:

- Based on Public Citizen's analysis of ISDS awards and jurisprudence that demonstrates the ISDS regime's significant and growing policy and financial liabilities and the body of research showing no correlation between countries having ISDS-enforced pacts and obtaining increased foreign direct investment (FDI), [1] we have urged governments to not sign new ISDS-enforced IIAs and to exit or renegotiate existing agreements that include ISDS.

- **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 protect governments from mounting ISDS liability and expansive, over-reaching and vague substantive investor rights or eliminate the structural unfairness and conflicts of interest inherent in the system**

- It has become even more politically feasible for governments to eliminate ISDS from their investment policy frameworks. Even the U.S. government, which historically promoted ISDS, is now exiting the regime. In the context of North American Free Trade Agreement (NAFTA) renegotiations, the U.S. has eliminated ISDS with Canada and replaced U.S.-Mexico ISDS with a new approach that eliminates the extreme substantive investor rights.

- 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.[2]

- Interests seeking to save the ISDS regime have promoted procedural reforms while expanding investors' substantive rights. This approach, seen in the so-called International Court System (ICS) of the Comprehensive Economic and Trade Agreement (CETA) and in the EU's multilateral investment court (MIC) proposal, do not address the fundamental structural problem inherent to ISDS. The fundamental unfairness of ISDS is that one already powerful class of interests – multinational investors/corporations – is granted extraordinary commercial rights not available in domestic legal systems and is elevated to equal status with sovereign nations to privately enforce public treaties in extrajudicial venues. The "reform" proposals create new dangers for governments by institutionalizing problematic substantive investor rights. **These discussions should instead focus on the sorts of limits on substantive rights seen in the revised NAFTA. A mechanism to facilitate this and provide an orderly change in countries' previous obligations should be a priority.**

- 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 "minimum standard of treatment" (MST) and related "fair and equitable treatment" (FET) rights as well as compensation related to limits on transfers of capital and performance requirements 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.

<u>Exiting the Unnecessary, Damaging Investor-State Dispute Settlement System</u>

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

ISDS gives multinational corporations alone greater procedural and substantive rights than domestic firms or other societal actors by providing only foreign firms access to extrajudicial tribunals and by enabling them to obtain compensation for government policies and actions 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 by domestic court systems.

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" to try to escape environmental, health and other public interest obligations established in host countries' domestic policies.

Public Citizen, along with partners around the globe, has documented the mounting costs of the ISDS regime to public interest policymaking, rule of law, democratic governance and development.[3] As the number of ISDS cases being filed annually has grown rapidly, and the policies and government actions being attacked expand, governments have rightly begun to reject further expansion of this controversial system and to exit or renegotiate IIAs that include ISDS.

Various technical reforms to ISDS procedures do not address the fundamental, structural imbalances or conflicts of interest inherent in the ISDS regime. 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 and expansive, over-reaching and vague substantive investor rights or to eliminate the structural unfairness and the inherent conflicts of interest in the system.

Additionally, technical reforms would do nothing to address this system's crisis of legitimacy. The public outcry that spurred UNCITRAL to begin discussions on reform was not about lack of diversity among arbitrators or the duration of cases. It was and still is about the core imbalance of a system that privileges the profits of foreign investors over the laws protecting people's health, safety and environment. If states do not use this opportunity to address these core concerns, we will see the same outcry again.

The United States, Once a Leading Promoter of ISDS, Is Scaling Back Extreme Investor Rights

The revised NAFTA text that was signed in November 2018 eliminates Chapter 11-B – the Investor-State provisions – of the original NAFTA. ISDS between the United States and Canada is terminated. After a three-year phase-in, U.S. and Canadian investors in the other country would only have recourse to domestic courts or administrative bodies to settle investment disputes with the other government.

With respect to Mexico, ISDS is replaced by a new approach. Annex 14-D, "Mexico-United States Investment Disputes," eliminates the extreme investor rights relied on for almost all ISDS payouts. Altogether eliminated are the Minimum Standard of Treatment and the related Fair and Equitable Treatment standard, Indirect Expropriation, Performance Requirements, Transfers and pre-establishment "rights to invest."

With respect to the ability to peruse any claim using the remaining investor rights, the new process requires investors to exhaust domestic remedies. Only after doing so may a review be filed and only for Direct Expropriation and post-establishment discrimination (National Treatment or Most Favored Nation). Direct Expropriation is defined as when "an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure."

The new U.S. approach makes explicit that the expansive substantive rights found in other trade or investment pacts may not be brought back into NAFTA via Most Favored Nation (MFN) claims, and also that the MFN treatment required is limited to actual policies and practices of a country with respect to other foreign investors and "excludes the provisions in other international trade or investment agreements…"

The new U.S approach also includes significant procedural reforms, such as requiring exhaustion of domestic remedies for 30 months, and prohibiting tribunalist double-hatting. The approach in this annex represents a significant scale back of investor power relative to governments.

However, one element of the revised NAFTA remains highly problematic. A secondary annex that covers certain forms of investment between the United States and Mexico should not be replicated. It carves traditional NAFTA-style ISDS back in for companies that have federal government contracts in certain listed sectors. This carve-in was designed to protect U.S. oil and gas firms holding contracts with Mexico's Hydrocarbons Authority from cancellation of their contracts without cause or compensation were Mexico's new government to cancel the contracts related to the previous government's energy privatization. Despite listing several sectors and applying to both U.S. and Mexican firms, in practice, only 13 specific contracts held by nine US investors operating in Mexico would be covered. (Neither government uses contracts on the federal level to make concession agreements in the other sectors, and the United States does not do so for oil or gas.) Still, this carve-in is unacceptable, as it exposes the Mexican government to liability far beyond compensation for cancelled contracts given MST claims could be used to attack Mexican environmental and health policies related to the oil and gas concessions. This carve-in undermines what is otherwise a significant improvement in limiting extreme investor rights and protecting governments' right to regulate.[4]

Yet, even with this flaw, this improved U.S. government attitude toward ISDS — a system that U.S. Trade Representative Robert Lighthizer has called "troubling"[5] — is also reflected in the negotiating objectives for potential agreements with Japan, the European Union and the United Kingdom. ISDS is notably absent from these objectives. **Especially 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.**

States Do Not Receive Tangible Benefits From ISDS Agreements

The purported benefit of ISDS – increased foreign direct investment – remains elusive. 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."[6] UNCTAD delivered that synopsis alongside its own study finding that "results do not support the hypothesis that [IIAs] foster bilateral FDI."[7] A survey of the 200 largest U.S. corporations corroborated these results, finding that leading U.S. firms were relatively unfamiliar with bilateral investment treaties (BITs) and considered such treaties to be relatively unimportant in their foreign investment decisions.[8] While countries bound by ISDS pacts have not seen significant FDI increases, countries without such pacts have not lacked for foreign investment. Brazil, for example, has consistently rebuffed IIAs with ISDS provisions,[9] yet remains in the world's top 10 most popular destinations for FDI and the leading destination for FDI in Latin America, where most other countries have signed numerous pacts with ISDS terms.[10]

Governments that have withdrawn from the ISDS system have reduced their liability and protected policy space without experiencing adverse impacts on investment or development. As promised benefits of ISDS have proven illusory while tangible costs to taxpayers and safeguards have grown, an increasing number of governments have begun to reject the investor-state regime. After South Africa conducted a three-year reassessment of its ISDS-enforced investment treaties and found no correlation to increased FDI flows but growing liabilities from ISDS challenges, in 2010 it decided to cancel all existing BITs.[11] In 2014, Indonesia announced plans to terminate all 67 of its bilateral investment treaties.[12] After already terminating 10 BITs,[13] Ecuador conducted an audit of its remaining pacts, which determined they were not in the national interest, and subsequently terminated the rest.[14] India gave notice in early 2016 that it would terminate 58 BITs.[15] Bolivia has terminated 11 BITs thus far.[16] Venezuela, Ecuador and Bolivia have also withdrawn from the World Bank forum where most investor-state cases are tried.[17]

Developing countries that have decided to terminate their IIAs have not faced adverse impacts on FDI inflows. Indeed, even during the period of exiting the system, some countries experienced growth in FDI. For the five countries that have undertaken the bulk of BIT terminations thus far – India, Indonesia, South Africa, Ecuador and Bolivia – in the 32 cases of BIT termination for which official FDI statistics are available, more than half of the time (18) the country experienced *larger investment inflows* from the former BIT-partner country after termination as compared to prior to termination.[18] Total FDI stock in Indonesia grew from $228 billion in 2014 to $240 billion in 2016 after it announced plans to terminate all BITs.[19] FDI flows to Indonesia have increased for four out of the seven partners with cancelled BITs whose investors no longer have recourse to ISDS through any agreement.[20] Indonesia terminated its BIT with the Netherlands in June 2015, and thereafter investment from the Netherlands increased from an average annual $715 million net *outflow* before termination to a $1.7 billion net *inflow* after termination.[21] Similarly for Ecuador, overall FDI stock has increased by 38 percent after it began terminating BITs in 2008.[22] And after Ecuador terminated a BIT with Uruguay in January 2008, FDI from Uruguay increased 420 percent, from an annual average of $6.3 million prior to termination to $32.6 million after termination.[23]

<u>Technical Reforms to IIAs Would Not Protect States From Liability or Rectify the System's Inherent Conflicts of Interest</u>

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"[24] 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[25] 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.[26] 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.[27] Both ISDS tribunals ruled that Guatemala had violated the expanded obligation, and ordered the government to pay millions.[28]

The U.S, government also included a "safeguard" provision in recent pacts to dispense with frivolous investor-state claims. The relevant language in the 2012 U.S. model BIT provides for expedited consideration of arguments from the government that a case should be terminated because the legal claim used by the foreign corporation to attack its policies is not permitted under the treaty's sweeping investor protections.[29] One problem is that tribunalists with financial incentives to continue cases are the ones who decide whether to accept such arguments for termination. Another problem is that many investor-state claims *do* in fact fall within the wide ambit of the investor privileges found in U.S. IIAs. That is because the pacts grant broad rights to investors and give ample discretion to tribunals to interpret those rights as far-reaching restrictions on States' prerogative to regulate in the public interest.

The very structure of the ISDS regime gives rise to conflicts of interest that would not be remediated by enhancement of the weak "conflict of interest" rules for tribunalists. The actual conflict of interest rules that apply under many pacts containing ISDS are notably weak. But there are more fundamental problems. The entire structure of ISDS has created a biased incentive system in which tribunalists, whose incomes rely on being selected to serve on panels, can boost their caseload by using broad interpretations of foreign investors' rights to rule in favor of corporations and against governments. As well, given that tribunalists are paid by the hour in contrast to salaried judges, they can boost their earnings by dragging cases out for years, including those they may ultimately dismiss. ISDS is neither fair nor neutral, not because of a few compromised tribunalists, but due to core design flaws.

Under ISDS rules, only foreign investors can launch cases and also select one of the three tribunalists. (By contrast, in U.S. domestic courts, judges are assigned to a case, not hired by the plaintiff.) Thus, ISDS lawyers that create novel, expansive interpretations of foreign investors' rights while serving as a tribunalist in one case can increase the number of investors interested in launching new cases and enhance the likelihood of their selection by investors for future tribunals. (While governments can also select one of the tribunalists, these individuals do not have the same structural conflict of interest; Interpreting investors' rights narrowly may curry favor with governments, but it would diminish the number of firms interested in launching ISDS claims in the first instance.) This helps explain why a few lawyers are repeatedly picked as ISDS tribunalists; Just 15 lawyers have been involved in 55 percent of all public ISDS cases.[30] The absence of any system of precedent for ISDS rulings, or of governments' rights to appeal the merits of cases, further enables tribunalists to concoct ever more fanciful interpretations of ISDS-enforced agreements and order compensation for breaches of obligations to which signatory governments never agreed.

Transparency rules cannot hold accountable tribunals that remain unrestrained by precedent, States' opinions or substantive appeals. Transparency is a necessary, but not sufficient, condition for reining in investor-state tribunals' ability to fabricate new obligations for States and then rule against public interest policies as violations of the novel obligations. As investor-state documents have become more publicly available, tribunals have not indicated greater hesitance to use overreaching interpretations of investors' rights. Documents were generally made available in the recent *Occidental v. Ecuador* case brought under the U.S.-Ecuador BIT. That includes the publicly-available 2012 award in which the tribunalists concocted a new obligation for Ecuador to respond proportionally to Occidental's breach of the law, deemed themselves the arbiters of proportionality, and ordered the government to pay $2.3 billion for violating the creative obligation.[31] Ecuador filed for annulment of the award by contesting the tribunal's decision to grant jurisdiction in the first instance. An annulment committee rejected Ecuador's arguments, but, noting a dissenting tribunalist's logic about ordering the country to pay for the full future earnings of an investment only partially held by the claimant, reduced damages to $1.4 billion. Ecuador was ordered to pay $1.4 billion for breaching an obligation to which it never agreed in its BIT to an investor that breached a contract term to which it had agreed, knowing that doing so would forfeit its investment.

<u>Bilateral or Multilateral Reforms That Attempt to Address the Procedural Shortcomings of the System Are Not Sufficient</u>

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 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 environmental and climate policies, control of toxic products and substances, food safety and labelling, regulation of emerging technologies, financial protections for consumers, protecting consumers' privacy rights, affordable access to medicines, the safety of drug and medical devices, affordable quality services, and tobacco regulation. Investors and corporations would have no obligations to host countries or their populations with respect to human rights, the environment or other public interests. Governments would have no rights to access extra-judicial venues to obtain compensation from investors or corporations for wrongdoing. 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," including the right to "fair and equitable treatment" 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. The ICS and MIC proposals do not address these concerns. Lawyers that represent investors in ISDS cases have praised the EU's inclusion of language that makes explicit what formerly investors had to convince a tribunal of on a case by case basis: that a tribunal can take into account whether the investor's expectations were frustrated. And the expropriation definition, in combination with the broad definition of investment, would allow for findings of expropriation violations that would not pass muster in many domestic courts. Annex language allows for non-discriminatory public interest policies to constitute expropriation violations in "the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive." This "rare circumstance" language gives the tribunal undue discretion in this area.

The ICS and MIC proposals partially address some of the most egregious aspects of the procedures under which ISDS tribunals have functioned, but do not address fundamental concerns. Partial procedural improvements include an appeals system, a roster of tribunalists that would be randomly assigned to cases instead of appointed by the disputing parties, and prohibiting tribunalists from participating in cases presenting conflicts of interest or serving as counsel in investment disputes. However, these partial improvements do not address the fundamental concerns about formally prioritizing corporate rights over the right of governments to regulate. And, if a more formalized "court" were instituted to enforce such problematic and vague substantive rights for foreign investors, governments' sovereign right to regulate may be further undermined than it is under the current system.[32]

Eliminating Problematic Substantive Investor Rights and Standards

The "minimum standard of treatment" (MST) clause and its "fair and equitable treatment" (FET) standard is the most relied upon and successful basis for ISDS claims, especially against legitimate public interest regulation. It would be most prudent to eliminate, rather than attempt to "fix" this clause, in order to fully protect policy space. Of the known U.S. FTA/BIT cases that a government lost, 74 percent were MST/FET violations.[33] As explained in previous sections, treaty negotiators from the United States, European Union, and elsewhere have tried *and failed* to limit the elasticity of vague MST/FET language and tribunals' ever-expanding interpretations by altering the legal language in agreements.

For instance, since CAFTA, U.S. trade agreements have included several annexes that were promised to narrow vague MST/FET obligations. By defining these foreign investor rights as derived from Customary International Law that "results from a general and consistent practice of States that they follow from a sense of legal obligation," one annex attempted to constrain the MST and FET obligations to the terms to which the signatory governments agreed and considered themselves bound, such as the provision of due process and police protection.[34] But, as described previously, in both CAFTA cases in which tribunals have ruled on investors' use of such provisions, the tribunals ignored the reformed language and the annexes.

The approach taken by the European Union to "fix" the FET standard in the CETA text explicitly lists new rights for investors, which would formalize the extraordinary rights that past ISDS tribunals have granted to foreign firms. Rather than constrain FET to basic rights such as due process and police protection, the FET language in the CETA investment chapter explicitly lists an array of broader rights that foreign firms could claim as part of FET.[35] For example, the FET definition in the CETA states that a government can be found to violate FET for "manifest arbitrariness," an open-ended term that ISDS tribunals have interpreted as part of FET to rule against domestic measures taken in the public interest. In *S.D. Myers v. Canada*, an ISDS case brought by a U.S. firm under NAFTA, the tribunal interpreted FET as including a prohibition of "arbitrary" treatment.[36] Using this definition, the tribunal ruled that Canada had violated its FET obligation by banning the export of a hazardous waste called polychlorinated biphenyls (PCB) that is proven to be toxic to humans and the environment.[37] Though the PCB export ban was enacted to comply with Canada's obligations under the Basel Convention, a multilateral environmental treaty,[38] the tribunal ordered the Canadian government to pay millions to the U.S. firm.[39]

The example shows how tribunals had to generate creative interpretations of FET under past ISDS-enforced agreements to claim that FET included such broad obligations as the prohibition of "arbitrary" policies. But under the FET language in the CETA investment chapter, such broad FET obligations would already be spelled out for tribunals. Indeed, veteran ISDS tribunalist Todd Weiler expressed appreciation for the European Commission's new approach: "We used to just have fair and equitable and we had to argue what that meant. And now we have this great list. I just love it when they try to explain things."[40]

Similarly, the CETA investment chapter explicitly allows ISDS tribunals to consider a foreign investor's "legitimate expectation" in deciding whether the government has violated its FET obligations.[41] The obligation to not frustrate investors' expectations has been one of the most expansive interpretations of FET, frequently used to challenge nondiscriminatory domestic policies. For an ISDS tribunal to consider frustrated expectations as a potential FET violation, the European Commission's definition only requires that the foreign firm relied on a "specific representation" from the government, which was later frustrated, in deciding to invest.[42]

The right to compensation for an "indirect expropriation" has proved to be expansive and problematic for States as well. Removing the right for investors to obtain compensation for "indirect expropriation" is the most prudent action for governments. ISDS tribunals have ordered governments to compensate investors for actions that neither result in government control of a property (an expropriation) nor extinguish an investment's value (indirect expropriation), but rather that reduce an investment's value or limit an investor's expected use. This standard has thus allowed compensation for regulatory decisions and policies that would not be subject to claims for compensation in domestic law and thus provide foreign investors with greater rights than domestic investors and persons. UNCTAD lists 51 ISDS awards based on indirect expropriation.[43] Most common are disputes over contractual rights. In general, under domestic law in the United States and elsewhere, contractual rights are only subject to expropriation claims if the government "appropriates" contract rights, not if it simply "frustrates" them.

An example of an egregious indirect expropriation case is *Metalclad v. Mexico*, in which a U.S. waste management firm challenged the denial by the city of Guadalcazar of a construction permit for a toxic waste facility unless the firm cleaned up existing toxic contamination. The Mexican firm from which Metalclad had acquired the facility previously was denied the permit unless and until the same condition was satisfied. The tribunal ruled that denial of the permit constituted an "indirect" expropriation and that the process leading up to the decision violated MST/FET requirements, because the firm was not granted a "clear and predictable" regulatory environment. One factor the tribunal relied on was that Mexican federal officials encouraged the U.S. firm to invest and advised that obtaining the local permit would not be a problem, despite the Mexican operator having been denied the same permissions by the local government. Rather than recognizing what the investor knew – that the local government held the permitting authority – the tribunal effectively imposed an obligation on Mexico not found in NAFTA to ensure that all officials at all levels provided the same advice to foreign investors.

Moreover, the tribunal defined expropriation in broader terms than expansive U.S. property rights protections: "[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State." Under this expansive interpretation of indirect expropriation, whether or not a government action resulted in government control of property short of outright seizure or possession is irrelevant. Also irrelevant is whether a government action extinguished all value of an investment. Instead, the tribunal imposed its assumptions about what an investor's reasonable expectations of gain would be, and then concluded that regulation that interfered with the investor's intended use and thus undermined the expected benefit was an indirect expropriation.

In addition to the MST/FET and indirect appropriation standards, other investment treaty substantive provisions, such as prohibitions on performance requirements and the regulation of capital transfers, open-ended most-favored nation clauses, the broad scope of the definition of investment beyond real property, and terms applying substantive right to pre-establishment 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.

ENDNOTES

[1] Public Citizen report, Termination of Bilateral Investment Treaties Has Not Negatively Affected Countries' Foreign Direct Investment Inflows. Available at: www.citizen.org/sites/default/files/pgcw_fdi-inflows-from-bit-termination_finaldraft.pdf

[2] Public Citizen memo, *Selected Statements and Actions Against Investor-State Dispute Settlement (ISDS)*. Available at: https://www.citizen.org/system/files/case_documents/selected_statements_and_actions_against_isds_3.pdf

[3] These conclusions are supported by Public Citizen reports: *Myths and Omissions: Unpacking Obama Administration Defenses of Investor-State Corporate Privileges*, October 2014. Available at: http://www.citizen.org/documents/ISDS-and-TAFTA.pdf and *Case Studies: Investor-State Attacks on the Public Interest.* Available at: http://www.citizen.org/documents/egregious-investor-state-attacks-case-studies.pdf

[4] Public Citizen report, Analysis of the NAFTA 2.0 Text Relative to the Essential Changes We Have Demanded to Stop NAFTA's Ongoing Damage, Nov. 2018. Available at: https://www.citizen.org/wp-content/uploads/nafta_text_analysis_-_how_the_new_nafta_text_measures_against_the_essential_changes_we_have_demanded_to_stop_naftas_ongoing_damage.pdf

[5] Public Citizen memo, *Selected Statements and Actions Against Investor-State Dispute Settlement (ISDS)*. Available at: https://www.citizen.org/system/files/case_documents/selected_statements_and_actions_against_isds_3.pdf

[6] The report further advised, "Thus developing-country policymakers should not assume that signing up to BITs will boost FDI. Indeed, they should remain cautious about any kind of recommendation to actively pursue BITs." United Nations Conference on Trade and Development, *Trade and Development Report, 2014*, (New York: United Nations, 2014), at 159. Available at: http://unctad.org/en/PublicationsLibrary/tdr2014_en.pdf.

[7] United Nations Conference on Trade and Development, *Trade and Development Report, 2014*, (New York: United Nations, 2014), at 159. Available at: http://unctad.org/en/PublicationsLibrary/tdr2014_en.pdf.

[8] Jason Webb Yackee, "Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence," *Virginia Journal of International Law*, 51:2, 2011. Available at: http://www.vjil.org/assets/pdfs/vol51/issue2/Yackee.pdf.

[9] While Brazil has signed various BITs, none have been ratified or entered into force. United Nations Conference on Trade and Development, "Full list of Bilateral Investment Agreements concluded: Brazil," UNCTAD factsheet, June 1, 2013. Available at: http://unctad.org/Sections/dite_pcbb/docs/bits_brazil.pdf.

[10] Among UN-recognized countries, Brazil has ranked between fourth and eighth in FDI inflows between 2012-2016.United Nations Conference on Trade and Development, "Inward and outward foreign direct investment flows, annual, 1970-2016," UNCTADStat, 2017. Available at: http://unctadstat.unctad.org/TableViewer/tableView.aspx.

[11] Quoting Xavier Carim, Deputy Director General of the South African Department of Trade and Industry, at the WTO Public Forum in Geneva, Sept. 25, 2012, on the rationale for South Africa's decision: "The spike in international investment arbitrations that followed the financial crisis in 2001 laid bare that bilateral investment agreements can pose profound and serious risks to government policy… Our own experience demonstrated that that there was no clear relationship between signing BITs and seeing increased inflows of FDI… The review identified a range of concerns associated with expansive interpretations on the provisions usually found in BITs: definitions of investment and of investor, national treatment, fair and equitable treatment, most favoured nation clause, expropriation, compensation, transfer of funds etc. The review also identified difficulties with respect to international arbitration... This, in our view, opens the door for narrow commercial interests to subject matters of vital national interest to unpredictable international arbitration outcomes and is a direct challenge to constitutional and democratic policy-making…" Public Citizen, "Selected Statements and Actions Against Investor-State Dispute Settlement (ISDS)," Public Citizen Factsheet, March 9, 2018. Available at: https://www.citizen.org/sites/default/files/selected_statements_and_actions_against_isds_0.pdf. *See* also Xavier Carim, "Lessons from South Africa's BITs Review," Columbia FDI Perspectives No. 109, Nov. 25, 2013. Available at: http://ccsi.columbia.edu/files/2013/10/No_109_-_Carim_-_FINAL.pdf.

[12] Ben Bland and Shawn Donnan, "Indonesia to Terminate More Than 60 Bilateral Investment Treaties," *Financial Times*, March 26, 2014. Available at: https://www.ft.com/content/3755c1b2-b4e2-11e3-af92-00144feabdc0.

[13] Latin Arbitration Law, "Ecuador Evaluates Investment Treaty Framework," LAL brief, 2014, accessed September 5, 2014. Available at: http://www.latinarbitrationlaw.com/ecuador-evaluates-investment-treaty-framework/.

[14] IISD, "Ecuador denounces its remaining 16 BITs and publishes CAITISA audit report" *Investment Treaty News*, June 12, 2017. Available at: https://www.iisd.org/itn/2017/06/12/ecuador-denounces-its-remaining-16-bits-and-publishes-caitisa-audit-report/.

[15] Amiti Sen, "India's Bilateral Investment Pacts Under Cloud," *The Hindu BusinessLine*, Jan. 15, 2018. Available at: http://www.thehindubusinessline.com/economy/indias-bilateral-investment-pacts-under-cloud/article9625580.ece.

[16] Investment Policy Hub, "International Investment Agreements Navigator," U.N. Conference on Trade and Development (UNCTAD), undated, accessed Jan. 26, 2018. Available at: http://investmentpolicyhub.unctad.org/.

[17] Sergey Ripinsky, "Venezuela's Withdrawal From ICSID: What it Does and Does Not Achieve," International Institute for Sustainable Development article, April 13, 2012. Available at: http://www.iisd.org/itn/2012/04/13/venezuelas-withdrawal-from-icsid-what-it-does-and-does-not-achieve.

[18] Public Citizen, "Termination of Bilateral Investment Treaties Has Not Negatively Affected Countries' Foreign Direct Investment Inflows," PC Report, April 2018. Available at: https://www.citizen.org/article/termination-of-bilateral-investment-treaties-has-not-negatively-affected-countries-foreign-direct-investment-inflows/.

[19] UNCTADStat, "Foreign Direct Investment: Inward and Outward Flows and Stock, Annual, 1970-2016," U.N. Conference on Trade and Development. Available at: http://unctadstat.unctad.org/. The latest available data is from 2016.

[20] Invest in ASEAN, "ACIA-ASEAN Comprehensive Investment Agreement," accessed April 12, 2018. Available at: http://investasean.asean.org/index.php/page/view/acia-reservation-list. UNCTAD, "ASEAN-China Investment Agreement," Investment Policy Hub, accessed April 12, 2018. Available at: http://investmentpolicyhub.unctad.org/IIA/country/97/treaty/3272. ASEAN has also signed an investment agreement with India, but it has not entered into force. UNCTAD, Investment Policy Hub, "Agreement on Investment under the Framework Agreement on Comprehensive Economic Cooperation between the Association of Southeast Asian Nations and the Republic of India." Available at: http://investmentpolicyhub.unctad.org/IIA/country/97/treaty/3503.

[21] Central Bank of Indonesia, "V. 33 Direct Investment Flows in Indonesia by Country of Origin," Indonesian Financial Statistics – External Sector, undated, accessed March 13, 2008. Available at: https://www.bi.go.id/en/statistik/seki/terkini/eksternal/Contents/Default.aspx.

[22] "Foreign Direct Investment: Inward and Outward Flows, Annual, 1970-2016," United Nations Conference on Trade and Development, accessed Jan. 26, 2018. Available at: http://unctadstat.unctad.org/TableViewer/tableView.aspx.

[23] Banco Central del Ecuador, "Inversión Extranjera Directa por País de Origen," 2017, accessed April 11, 2018. Available at: http://www.bce.fin.ec/index.php/component/k2/item/298-inversi%C3%B3n-extranjera-directa.

[24] Office of the U.S. Trade Representative, "The Facts on Investor-State Dispute Settlement: Safeguarding the Public Interest and Protecting Investors," USTR blog post, March 27, 2014. Available at: http://www.ustr.gov/about-us/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors.

[25] Dominican Republic – Central America – United States Free Trade Agreement, ch. 10 (Annex 10-B), August 5, 2004, Pub. L. No. 109-53, 119 Stat. 462 (2005), at 10-27.

[26] The U.S. government attempted to make clear the narrowness of the "minimum standard of treatment" standard in its official submission in the RDC case, stating, "These provisions [in the CAFTA annex] demonstrate the CAFTA-DR Parties' express intent to incorporate the minimum standard of treatment required by customary international law as the standard for treatment in CAFTA-DR Article 10.5. Furthermore, they express an intent to guide the interpretation of that Article by the Parties' understanding of customary international law, i.e., the law that develops from the practice and opinio juris of States themselves, rather than by interpretations of similar but differently worded treaty provisions. The burden is on the claimant to establish the existence and applicability of a relevant obligation under customary international law that meets these requirements." *Railroad Development Corporation v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Submission of the United States of America (January 31, 2012), at para. 3. Available at: http://italaw.com/sites/default/files/case-documents/ita0709_0.pdf.

[27] *Railroad Development Corporation v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Award (June 29, 2012), at para. 219. Available at: http://italaw.com/sites/default/files/case-documents/ita1051.pdf. *TECO Guatemala Holdings, LLC v. Republic of Guatemala*, ICSID Case No. ARB/10/23, Award (December 19, 2013), at para. 455. Available at: http://italaw.com/sites/default/files/case-documents/italaw3035.pdf.

[28] *TECO Guatemala Holdings, LLC v. Republic of Guatemala*, ICSID Case No. ARB/10/23, Award (December 19, 2013), at para. 780. Available at: http://italaw.com/sites/default/files/case-documents/italaw3035.pdf. *Railroad Development Corporation v. Republic of Guatemala*, ICSID Case No. ARB/07/23, Award (June 29, 2012), at para. 219. Available at: http://italaw.com/sites/default/files/case-documents/ita1051.pdf. For more information, see Lori Wallach and Ben Beachy, "CAFTA Investor-State Ruling: Annex on Minimum Standard of Treatment, Proposed for TPP, Proves Insufficient as Tribunal Ignores Customary International Law Standard, Applies MST Definition from Past NAFTA Award to Rule against Guatemala," PC memo, July 19, 2012. Available at: http://www.citizen.org/documents/RDC-vs-Guatemala-Memo.pdf. And see Lori Wallach and Ben Beachy, "Rebutting Misleading Claims Made by Industry with Respect to RDC v. Guatemala Award: CAFTA Tribunal Rejected CAFTA Parties' and CAFTA Annex 10-B's Definition of CIL Based on State Practice, Imported Past Tribunal's MST Standard," PC memo, November 17, 2012. Available at: http://www.citizen.org/documents/rdc-v-guatemalarebuttal.pdf.

[29] 2012 U.S. Model Bilateral Investment Treaty, U.S. Department of State, 2012, at Article 28. Available at: http://www.state.gov/documents/organization/188371.pdf.

[30] Pia Eberhardt and Cecilia Olivet, "Profiting from Injustice," Transnational Institute and Corporate Europe Observatory report, November 2012, at 38. Available at: http://www.tni.org/sites/www.tni.org/files/download/profitingfrominjustice.pdf.

[31] *See* Lori Wallach and Ben Beachy, "*Occidental v. Ecuador* Award Spotlights Perils of Investor-State System: Tribunal Fabricated a Proportionality Test to Further Extend the FET Obligation and Used 'Egregious' Damages Logic to Hit Ecuador with $2.4 Billion Penalty in Largest Ever ICSID Award," PC memo, November 21, 2012. Available at: http://www.citizen.org/documents/oxy-v-ecuador-memo.pdf.

[32] *See* Trans Atlantic Consumer Dialogue, *Response to the European Commission's Investor-State Dispute Settlement "Reform" Proposal*, January 2016. Available at: http://tacd.org/wp-content/uploads/2015/02/TACD-resolution-ICS-proposal.pdf

[33] Lori Wallach, "Fair and Equitable Treatment" and Investors' Reasonable Expectations", PC Memo, September 5, 2012 Available at: https://www.citizen.org/sites/default/files/mst-memo.pdf

[34] Dominican Republic – Central America – United States Free Trade Agreement, ch. 10 (Annex 10-B), August 5, 2004, Pub. L. No. 109-53, 119 Stat. 462 (2005), at 10-27.

[35] European Commission, Consolidated CETA Text, September 26, 2014, at 158. Available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

[36] *S.D. Myers, Inc. v. Government of Canada*, Second Partial Award, Ad hoc—UNCITRAL Arbitration Rules (2002), at para. 263.
[37] 59 FR 62785, 62877 (Dec. 6, 1994).
[38] Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal Adopted by the Conference of the Plenipotentiaries on Mar. 22, 1989
[39] *S.D. Myers, Inc. v. Government of Canada*, Second Partial Award, Ad hoc—UNCITRAL Arbitration Rules (2000), at para. 311. Available at: http://italaw.com/sites/default/files/case-documents/ita0752.pdf.
[40] Todd Weiler, comments at "The Investor-State Dispute Settlement Mechanism: An Examination of Benefits and Costs," CATO Institute, May 20, 2014. Available at: http://www.cato.org/events/investor-state-dispute-settlementmechanism-examination-benefits-costs.
[41] European Commission, Consolidated CETA Text, September 26, 2014, at 158. Available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf. See European Commission, "Public consultation on modalities for investment protection and ISDS in TTIP," March 2014, at 22. Available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.
[42] European Commission, Consolidated CETA Text, September 26, 2014, at 158. Available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf. See European Commission, "Public consultation on modalities for investment protection and ISDS in TTIP," March 2014, at 22. Available at: http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.
[43] UNCTAD. Breaches of IIA provisions alleged and found, Investment Policy Hub. Accessed January 11, 2018. Available at: http://investmentpolicyhub.unctad.org/ISDS/FilterByBreaches.