

# ISDS threatens privacy and reform of copyright and patent law

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On 3 December 2013, the Dutch Parliament asked for research on investor-to-state dispute settlement (ISDS). (Parliament, 2013) On 17 April 2014 companies and civil society organisations met at the Ministry of Foreign Affairs to discuss the ongoing “ISDS - TTIP study”. The ministry invited participants to send in further comments. The Foundation for a Free Information Infrastructure (FFII) invites the government to carefully consider the following.

## 0 Summary

This note concludes that the EU commission’s timid reform proposals would create an ISDS system that is wide open for abuse and fundamentally incompatible with Europe’s human rights system. Given ISDS’s inherent design flaws which threaten democracy and human rights and can only be solved by abolishing the system, there are imperative reasons for the EU to exclude ISDS from its trade and investment agreements. In doing so, the EU would give direction to the debate and create room to strengthen alternatives. As a next step states should withdraw from ISDS agreements, mutual withdrawal is preferable. As the birthplace of democracy Europe has to take its responsibility.

ISDS gives multinationals the right to sue states before special tribunals if changes in law may lead to lower profits than expected. Multinationals can challenge reform of copyright and patent law, challenge environmental and health policies. For an introduction see Stiglitz (2013) or Vrijschrift (2014).

This note is divided into three sections. The first section analyses the system’s design flaws. It argues that ISDS has four inherent design flaws which can only be solved by abolishing the system: ISDS gives companies equal standing to states, unequal standing creates pressure on human rights, ISDS

places specialised investment panels above general supreme courts, and the system lacks a legislative feedback loop.

Further, the section notes that the inherent design flaws are aggravated by non-inherent design flaws: the tribunals are not courts, the arbitrators are not judges, there is no tenure, there is a lack of openness and there is a strong perverse incentive. It concludes that the 2013 UNCTAD investment report shows that these flaws can be solved but that this would require a complete overhaul of the current regime through the coordinated action of a large number of states, an overhaul which is not foreseeable. The section also notes that ISDS is vulnerable to outside pressure. An argument for inclusion of ISDS in TTIP is that if ISDS is not in TTIP, China may object to having ISDS in its trade agreement with the EU. But the vulnerability to outside pressure defeats the sense of including it in trade agreements. The section raises the question whether China will be able to pressure arbitrators.

The second section discusses the EU commission's reform proposals, which it presents in its consultation. The commission reforms both substantive investment protection provisions and procedural (ISDS) rules. Regarding substantive investment protection provisions, it concludes that the commission's proposal contains a very broad definition of investment. Contrary to commission statements, the known Most Favoured Nation loophole still exists. Companies will not only be able to use the substantive investment protection provisions in TTIP, but they can cherry-pick from any other investment agreement the EU or EU member state signed. The text creates supreme investors rights which trump human rights. There is no general exception that safeguards the right to regulate. Specific limitations to safeguard the right to regulate are limited and do not solve the kind of uncertainty the EU is trying to avoid.

ISDS tribunals would apply these substantive investment protection provisions. The section concludes that the commission fails to identify the ISDS system's inherent design flaws, noted in the first section. Non-inherent design flaws could be solved but this would require a complete overhaul of the current regime through the coordinated action of a large number of states. The commission limits itself to some minor adjustments: better transparency, limitation to post establishment and avoidance of multiple parallel proceedings. The commission can not solve the inherent design flaws and additionally does not solve these issues: ISDS tribunals are not courts, the arbitrators are not judges, there is no tenure, the strong perverse incentive, frivolous claims, the growing number of ISDS claims, lack of independence and impartiality of arbitrators, arbitrary decisions and the vulnerability of the system to outside pressure. The section concludes that the commission's timid reform proposals would create a system that is wide open for abuse.

The third section argues that the commission's ISDS proposals are fundamentally incompatible with Europe's human rights system. It concludes that ISDS threatens our privacy and reform of copyright and patent law. It further argues that ISDS creates a higher chance on compromising the stability and integrity of the financial system. The filter mechanism proposed by the commission has a very limited scope, is dependent on other parties, doesn't help against the chilling effect of threats and even creates a perverse incentive. This section also argues there is a lack of necessity for ISDS.

## **1 Design flaws**

This section discusses the ISDS system's design flaws.

### **1.1 Inherent design flaws**

Inherent design flaws can only be solved by abolishing the system.

#### **1.1.1 ISDS gives companies equal standing to states**

Companies do not have to use the local court system, they can challenge states from the outside. ISDS gives companies equal standing to states. This fundamentally changes the power balance between companies and states, it weakens the power of democracies. From a constitutional point of view ISDS can be understood as a transfer of sovereignty to companies. (Kelsey and Wallach, 2012)

ISDS changes the dynamics of the interpretation of international agreements. International agreements are agreements between states (or union(s)). If the parties to an agreement disagree over the interpretation, they can use state-to-state dispute settlement. This is an arbitration procedure. The arbitrators may be trade specialists, not much interested in policy space, which may be problematic.

But limiting the other party's policy space limits the own policy space as well. Parties have an interest in not limiting policy space too much, and will be careful with dispute settlement. The dynamics of state-to-state dispute settlement leave a margin of appreciation, policy space.

ISDS gives companies equal standing to states. Companies have no interest in leaving policy space to states. Companies can demand and threaten to demand high damages. The dynamics of ISDS create pressure on policy space. There is a serious risk on erosion of policy space.

### **1.1.2 Unequal standing erodes human rights**

In Europe, citizens can test in court laws that harm their human rights. This includes testing the implementation of international agreements. But citizens can not test international agreements themselves. The interpretation of trade agreements happens at a level above the EU, outside the reach of citizens.

States have to ascertain that the substantive and procedural rules of state-to-state dispute settlement produce results that are compatible with human rights. This is of course true for all legal systems.

Like citizens, companies are not parties to international agreements. But ISDS gives companies equal standing to states, not to citizens. Companies are allowed at the supra national (supra EU) legal space. This creates unequal standing, creates pressure from one side for one issue, investor's rights. The dynamics of ISDS create pressure on human rights. There is a serious risk on erosion of human rights.

### **1.1.3 Specialists above supreme courts**

There is not one law system, there are various law systems, which may conflict. For instance the intellectual property rights system and the human rights system may conflict. To resolve conflicts oversight is needed. A general supreme court is needed at the top of legal systems.

Specialists may easily over-value the instrument they are specialised in. Two examples will clarify this. First, Henry and Turner (2005) find that the specialist US Court of Appeals for the Federal Circuit has been pro-patent with respect to validity of patents. On various occasions the Supreme Court corrected the specialist court. (EFF, 2012)

Second, over the years the European Patent Office (EPO) has weakened the exclusion of software as such from patentability. The EPO rendered the exclusion as good as worthless. In the Brimelow Referral G3/08 the EPO had a chance to normalise its interpretation, but it decided that doing that would be a too big step to take for the EPO, only the legislator could do that. (FFII, 2010) The EPO finds itself competent to cripple an exclusion, but not competent to come up with a more balanced interpretation of the exclusion. Courts can not correct the EPO.

The ISDS system does not have a general court on top. ISDS puts investment specialists on top. That is a wrong set-up, as a general supreme court is needed at the top of a legal system, not the other way around. There is a serious risk on one-sided decisions.

Arguably this is not an inherent design flaw, as a general world-wide supreme court is theoretically possible. But such a court is not foreseeable and would lack a legislative feedback loop.

#### **1.1.4 No legislative feedback loop**

In democracies the legislator makes the law and courts interpret it. If the end result (the case law) is not satisfying, the legislator can amend the law. Over time, societies can find a fair balance. Societies have a legislative feedback loop, although it may be called “crude, sluggish, and under-inclusive” (Rens, A, 2012). Legal reasoning may go awry. The legislative feedback loop is essential. Trade agreements do not have a legislative feedback loop.

In sum, ISDS fundamentally changes the power balance between companies and states, the dynamics of ISDS create pressure on policy space and human rights, there is a serious risk on one-sided decisions, and the lack of a legislative feedback loop leaves the system without legislative corrective input.

The system’s inherent design flaws, which threaten democracy and human rights, can only be solved by abolishing the system.

## **1.2 Non-inherent design flaws**

The inherent design flaws are aggravated by non-inherent design flaws. These are flaws that can be solved.

### **1.2.1 UNCTAD investment report**

The UNCTAD World Investment Report 2013, Global value chains: investment and trade for development notes that the functioning of ISDS has revealed systemic deficiencies. Concerns relate to legitimacy, transparency, lack of consistency and erroneous decisions, the system for arbitrator appointment, arbitrators independence and impartiality and financial stakes. As a response, UNCTAD has identified five broad paths for reform: promoting alternative dispute resolution, modifying the existing ISDS system through individual international investment agreements, limiting investors access to ISDS, introducing an appeals facility and creating a standing international investment court. The last option rests on the theory that a private model of adjudication (i.e. arbitration) is inappropriate for matters that deal with public law. (UNCTAD, 2013)

The last option proposed by the UNCTAD report solves many non-inherent design flaws. The report notes: “However, this solution would also be the most difficult to implement as it would require a complete overhaul of the current regime through the coordinated action of a large number of States.”

It is possible to solve the ISDS system’s non-inherent design flaws. However, this would require a complete overhaul of the current regime through the coordinated action of a large number of States. Such a complete overhaul is not foreseeable. Moreover, the system’s inherent design flaws, which threaten democracy and human rights, can not be solved.

### **1.2.2 Captive in-crowd**

The current system led to the emergence of a captive in-crowd: a group of people sharing beliefs and interests. (Vrijschrift, 2014) The system contains a strong perverse incentive. Unlike judges, arbitrators are paid by the hour or by the day, and they are very well paid. They have an incentive to let cases drag on. And they have an incentive to make the system more appealing by taking multinational friendly decisions, as only multinationals can start ISDS cases. The current ISDS system is riddled with conflicts of interest and attracts speculation. (CEO and TNI, 2012)

### **1.2.3 Will China be able to pressure arbitrators?**

The current ISDS system is vulnerable for outside pressure. Kleinheisterkamp (2014) recalls that in the Loewen ISDS case one of the tribunal members publicly conceded having met with officials of the US Department of Justice (DoJ) prior to accepting his appointment. The DoJ put pressure on him. The incident highlights how vulnerable the ISDS system is for outside pressure. Kleinheisterkamp notes, “[a]s it happens, the US is not known to have so far lost in any investment arbitration.” The incident raises the question how much influence outside pressure can have on the outcome of ISDS cases.

During the 17 April meeting at the Ministry of Foreign Affairs it was said that local courts may be vulnerable to outside pressure too. But if the US government would have put pressure on the US Supreme Court, it would have been a first class scandal, a violation of the separation of powers. The Loewen case did not cause a scandal. The US won the Loewen case on a technicality.

An argument for inclusion of ISDS in TTIP is that if ISDS is not in TTIP, China may object to having ISDS in its trade agreement with the EU. But the vulnerability to outside pressure defeats the sense of including it in

trade agreements. China too may be able to pressure arbitrators. Over time, China will need and develop a better local court system, while ISDS will deteriorate, because of its inherent and non-inherent design flaws.

During the meeting at the ministry someone noted that ISDS has an influence on legal doctrine. This was seen as positive. But as the system has both inherent and non-inherent system flaws, and the system is vulnerable for outside pressure, there is a serious risk that the influence on legal doctrine is a corrupting influence.

If other parties would use outside pressure on arbitrators, the EU may be tempted to do this too. The vulnerability to outside pressure has an overall corrupting effect.

## **2 Commission reform proposals**

This section discusses the EU commission's reform proposals, which it presents in its consultation. The commission reforms both substantive investment protection provisions and procedural (ISDS) rules. (Commission, 2014b, all commission references in this section to this document)

The commission's proposals do have some positive elements: better transparency, limitation to post establishment and avoidance of multiple parallel proceedings.

The commission could (logically) not solve the inherent design flaws. It also did not solve many non-inherent design flaws.

### **2.1 Substantive investment protection provisions**

In the negotiation mandate the commission was tasked to provide the highest possible investment protection.

#### **2.1.1 Investment**

Table 1 commission reference text defines the protected investments. It is an open list, containing for instance "intellectual property rights" and "the expectation of gain or profit".

The International Institute for Sustainable Development (IISD) scrutinized earlier reform proposals. Regarding an open list the IISD (2014, page 12) noted: "The open-ended list is problematic because it allows for the most expansive interpretation by tribunals of what that definition encompasses,

since the list that follows is merely indicative. This definition is therefore the least predictable for host states. This increases the risks of being sued.” The IISD notes that Canada and the EU seem to have taken note of the problems of expansive interpretation to some extent, but deems it is much more likely that the formulation used will have limited impact on the initial expansive language of “any asset.”

The commission’s proposal contains a very broad definition of investment.

### **2.1.2 A known major loophole**

The IISD noted a loophole in the text regarding the Most Favoured Nation (MFN) clause. Companies will not only be able to use the substantive investment protection provisions in TTIP, but they can cherry-pick from any other investment agreement the EU member state signed. The IISD (2014, page 15) concluded: “The benefits to the states of the more careful drafting are thus, quite simply, lost.” This referred to all substantive investment protection provisions.

Regarding this loophole the commission notes: “On the ‘importation of standards’ issue, the EU seeks to clarify that MFN does not allow procedural or substantive provisions to be imported from other agreements.”

This is correct regarding the procedural provisions, but not regarding the substantive provisions. Table 2, article X.2.4: “4. For greater certainty, the “treatment” referred to in Paragraph 1: a. does not include investor-to-state dispute settlement procedures provided for in other international investment treaties and other trade agreements, including compensation granted through such procedures, and b. shall only apply with respect to treatment accorded by a Party through the adoption, maintenance or application of measures.”

Only investor-to-state dispute settlement procedures including compensation are excluded, not substantive investment protection provisions.

Contrary to commission statements, the known Most Favoured Nation loophole still exists. Companies will not only be able to use the substantive investment protection provisions in TTIP, but they can cherry-pick from any other investment agreement the EU or EU member state signed.

### **2.1.3 Investor rights trump human rights**

The commission proposals does not protect human rights. States can interfere with human rights only by law, if necessary in a democratic society, and only in so far as necessary. States have to respect, protect and fulfil



human rights, and human rights have an extraterritorial working. But the substantive investment protection provisions do not protect human rights. The commission's reference text does mention privacy and health, but does not refer to them as human rights, but only as an exception to investment and trade rules, limited by investment and trade rules. This limits these human rights and reverses the burden of proof. The text creates supreme investors rights which trump human rights. Other human rights are not even mentioned.

The commission may state that the Preamble will contain a reference to human rights, but preambles are not binding. The commission trades away human rights.

#### **2.1.4 No general right to regulate**

The commission's proposal contains a very broad definition of investment. The right to regulate is formulated as exceptions to investment protection. There is no general exception that safeguards the right to regulate. The various protection clauses have their own limited exceptions.

There is no general right to regulate. The Preamble does not create such a right. Commission reference text Table 5, Preamble: "RECOGNISING the right of the Parties to take measures to achieve legitimate public policy objectives on the basis of the level of protection that they deem appropriate,"

A preamble is not binding. Furthermore, the right to take measures is limited to "legitimate" objectives. What are legitimate objectives? Preambles end with something like: "HAVE AGREED as follows:". The answer what is legitimate can be found in the agreement itself. The arbitrators can disregard the preamble.

#### **2.1.5 Reservations and exceptions with unknown scope**

Various protection clauses have their own limited exceptions. The scope of article X: Reservations and Exceptions (first mention) in Table 5 is unknown as it contains "...". Currently the scope is limited to National Treatment and Most-Favoured-Nation Treatment. Thus, these reservations and exceptions currently do not apply to fair and equitable treatment (FET) and expropriation.

These reservations and exceptions are limited to continuation, procurement, subsidies, and audiovisual services (read: the exception culturelle). This leaves open the possibility to challenge continuation, procurement, subsidies

and the exception culturelle on fair and equitable treatment and expropriation grounds.

In addition, paragraph 4 contains a limited exception for intellectual property rights: “4. In respect of intellectual property rights, a Party may derogate from Article X.3 (National Treatment), Article X.4 (Most-Favoured-Nation Treatment) where permitted by the TRIPS Agreement, including any amendments to the TRIPS Agreement in force for both Parties, and waivers to the TRIPS Agreement adopted pursuant to Article IX of the WTO Agreement.”

First, this exclusion only regards discrimination, not fair and equitable treatment, and expropriation. Second, there are systemic implications, should ISDS function as a new venue to litigate compliance with international intellectual property rights treaties? (Grosse Ruse - Khan, Henning, 2013)

Regarding the prudential carve-out, see below.

#### **2.1.6 Non discrimination**

The commission proposal protects foreign investors against discrimination. This non discrimination provision contains a limited exception. Table 2, “Article Y: General exceptions” incorporates exceptions from GATT and GATS and extends them to environmental measures necessary to protect human, animal or plant life or health.

GATT and GATS exceptions are limited. GATS article XIV: “Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member of measures:”

This leads to the question whether ISDS tribunals will interpret GATT and GATS. GATS Article XIV (c) (ii) provides an exception to protect privacy, but not as a human right, but as an exception to investment and trade rules, limited by investment and trade rules. This limits this human right and reverses the burden of proof. This note will further discuss privacy below.

#### **2.1.7 Expropriation**

The commission proposal protects foreign investors against expropriation, this protection includes the problematic indirect expropriation, a change of rules which has the effect of making profits lower.

The proposal makes an exception for compulsory licenses. Table 4, article X: Expropriation, paragraph 5: “This Article does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, to the extent that such issuance is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights in Annex 1C to the WTO Agreements (‘TRIPS Agreement’).

First, this exclusion only regards expropriation, not fair and equitable treatment and discrimination. Second, this leads to the question whether ISDS tribunals will interpret the consistency of compulsory licenses with the TRIPS agreement, will decide on the matter of preventable suffering and death. Third, note that the EU and US use a more limited interpretation of the Doha Declaration on TRIPS and Public health than the WTO. (KEI, 2011) This has negative consequences for public health. The EU and US can not be expected to properly defend against ISDS claims regarding this. A weak defense will lead to case law with negative consequences for public health, this creates a negative incentive.

Table 4, Annex (3): “For greater certainty, except in the rare circumstance where the impact of the measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.”

The exception is limited to measures to protect legitimate public welfare objectives. ISDS arbitrators will decide on what is legitimate. The arbitrators will also decide whether measures are manifestly excessive. This note discusses the implications for privacy, copyright and patent law below.

### **2.1.8 Fair and equitable treatment**

The commission proposal protects foreign investors against treatment that is not fair and equitable. FET will be limited to a closed list of basic rights for investors (Table 3). This may be a step forward. On the other hand, an expert interviewed by Inside US Trade argued “that many of the definitions listed in the EU’s closed list are also not legally well-defined and could invite arbitrators to bring their own value judgements to cases without being tethered to norms accepted by governments. The closed-list structure of the definition is irrelevant if the items within the list are open-ended, he said, adding that this could introduce exactly the kind of uncertainty the EU is trying to avoid.” (IUST, 2014)

Regarding legitimate expectations (Table 3 XX.4) as part of the fair and equitable treatment standard, the IISD (2014, page 7) noted: “The intro-

duction of a broad basis for reviewing the legitimate expectations of an investor adds increased uncertainty and subjectivity.”

The commission’s proposal regarding fair and equitable treatment does not solve the kind of uncertainty the EU is trying to avoid.

In sum, the commission’s proposal contains a very broad definition of investment. Contrary to commission statements, the known Most Favoured Nation loophole still exists. Companies will not only be able to use the substantive investment protection provisions in TTIP, but they can cherry-pick from any other investment agreement the EU or EU member state signed. The text creates supreme investors rights which trump human rights. There is no general exception that safeguards the right to regulate. Specific limitations to safeguard the right to regulate are limited and do not solve the kind of uncertainty the EU is trying to avoid.

## **2.2 Procedural rules: ISDS**

ISDS tribunals would apply the substantive investment protection provisions discussed above. The commission limits itself to some minor adjustments: better transparency, limitation to post establishment and avoidance of multiple parallel proceedings. Problems noted earlier by the IISD still exist in the new text.

Regarding frivolous claims the IISD (2014, page 17) noted: “Consequently, this feature, while it may be useful, will only find its utility in reducing the costs of arbitration, not the scope of any decisions that would otherwise be made on jurisdiction or the merits.”

Regarding domestic courts, the IISD (2014, page 20) noted: “We do not see that anything in the text ‘encourages the use of domestic courts’ as the European Commission claims it does.”

Furthermore, when companies have to choose between local courts and ISDS, they may choose for ISDS, the number of ISDS cases may rise even more.

Regarding the lack of independence and impartiality of arbitrators, the IISD (2014, page 22) noted: “As a consequence, all the problems resulting from party appointments, such as arbitrators focusing more on pleasing the nominating parties and being re-appointed in future cases, are not resolved through the roster system proposed in the CETA draft.”

Regarding a code of conduct for arbitrators, the IISD (2014, page 24) noted: “Given the uncertainty as to whether this Code will ever be finalized and the uncertainty regarding its content, we cannot, at this point in time, agree with the European Commission that steps have been take to address the issue of

arbitrator impartiality and independence. Any assessment of impact of the Code would be mere speculation.”

Regarding binding interpretation, the IISD (2014, page 25) noted: “The inclusion of a process for binding joint interpretation in the CETA is useful, as it can effectively preclude unintended interpretations through arbitration panels from being binding on the parties over the longer term.”

Furthermore, this is not comparable with the legislative feedback loop in a democratic society. It depends on the cooperation of the other party, and is executed by the executive, not the legislator.

The commission states: “The EU aims to establish an appellate mechanism in TTIP so as to allow for review of ISDS rulings. It will help ensure consistency in the interpretation of TTIP and provide both the government and the investor with the opportunity to appeal against awards and to correct errors. This legal review is an additional check on the work of the arbitrators who have examined the case in the first place.”

However, not much is known at this moment about the appellate mechanism. The competence seems limited to awards and correcting errors.

The commission doesn’t mention the survival clause. The survival clause would allow companies to sue the EU for decades after the EU withdraws from an ISDS agreement.

This note discusses the filter mechanism below.

In sum, the commission fails to identify the ISDS system’s inherent design flaws, noted in the first section. Non-inherent design flaws could be solved but, as noted above, this would require a complete overhaul of the current regime through the coordinated action of a large number of states. The commission limits itself to some minor adjustments: better transparency, limitation to post establishment and avoidance of multiple parallel proceedings. The commission can not solve the inherent design flaws and additionally does not solve these issues: ISDS tribunals are not courts, the arbitrators are not judges, there is no tenure, the strong perverse incentive, frivolous claims, the growing number of ISDS claims, lack of independence and impartiality of arbitrators, arbitrary decisions and the vulnerability of the system to outside pressure. The commission’s timid reform proposals would create a system that is wide open for abuse.

## **3 Four issues**

### **3.1 Human rights, privacy**

We saw above that the dynamics of ISDS create pressure on human rights. We also saw that the commission's proposals do not protect human rights and would create a system wide open to abuse.

Europe has an excellent human rights system, local courts with appeal to a human rights court, in addition the EU has a Charter of fundamental rights. Human rights are deeply integrated in the European legal system.

The commission proposal would create a parallel legal system without human rights. It is incomprehensible that the commission, the guardian of the treaties, proposes this. The commission's ISDS proposals are fundamentally incompatible with Europe's human rights system.

#### **3.1.1 Privacy**

The ideas about privacy differ widely between the US and the EU. The EU regards the protection of personal data in the US as insufficient. Presently cross border flows of data to the US are allowed under a safe harbour agreement, which many in the EU regard as dysfunctional. In a resolution the European Parliament calls for suspension of the safe harbour agreement, the parliament regards such a measure as GATS article XIV compliant (EP, 2014).

The US Trade Representative (USTR) takes the opposite view. The 2014 Section 1377 Review On Compliance with Telecommunications Trade Agreements mentions critical voices in the EU (but not the parliament's resolution). It describes the safe harbour agreement as a "practical mechanism for both U.S companies and their business partners in Europe to export data to the United States, while adhering to EU privacy requirements". The USTR states: "The United States and the EU share common interests in protecting their citizens privacy, but the draconian approach proposed by DTAG and others appears to be a means of providing protectionist advantage to EU-based ICT suppliers." (USTR, 2014)

If the EU would take strong measures to protect our privacy, for instance through suspension of data flows to the US, could companies use ISDS?

Yes, we saw above that the commission overlooked a known loophole. Companies will not only be able to use the substantive investment protection provisions in TTIP, but they can use the rules from any investment agree-

ment the EU signed. This creates major opportunities for companies to use ISDS against EU privacy measures.

Closing the loophole will not be enough. The US already called measures contemplated in the EU draconian and protectionist. US companies will have various possibilities to challenge measures the EU takes to protect privacy.

They may claim the EU discriminates them, the privacy protection in GATS Article XIV (c) (ii) mentioned above does not help against this claim.

US companies may claim the treatment is not fair and equitable, may call measures manifestly arbitrary or abusive - grounds in the commission's FET proposals.

US companies may claim the EU expropriates them, may claim that the impact of the privacy measure is so severe in light of its purpose that it appears manifestly excessive.

Additionally, in the TTIP negotiations the US tabled a proposal that would prohibit to require local data storage. If included in TTIP, US companies may claim that suspension of data flows amounts to mandatory local data storage.

Privacy is a human right in the EU. Strong measures are needed to protect this right. As we saw above, the commission proposals do not protect privacy as a human right. Companies will have various ways to challenge privacy measures, while the ISDS system suffers from inherent and non-inherent system flaws. There is a serious risk that measures to protect our personal data will be seen by arbitration tribunals as not compliant with investment rules. This would spell the end of privacy protection measures.

The eCommerce market is huge, cloud markets are huge. If the EU would decide to suspend the safe harbour agreement, ISDS claims could be enormous. The threat alone of such claims would have a strong chilling effect. Would the EU dare to protect our privacy, or just give in? ISDS is a very serious risk for privacy.

In the 17 April meeting at the Ministry of Foreign Affairs it was said that the US could use WTO arbitration, so what would ISDS change? First, if trade rules endanger our privacy, these trade rules have to change, or have to be interpreted in a way that is conform human rights obligations. As states have to respect, protect and fulfil human rights, WTO panels, where states meet, have to do this too. Second, after the Snowden revelations the US would probably not be well advised to start a WTO case on privacy. Third, ISDS adds investment rules to trade rules, adds treaty texts, adds companies as parties, adds the possibility of ISDS threats and adds a forum

plagued by inherent and non-inherent design flaws. ISDS changes the game, creates an extra threat to our privacy.

### **3.2 Reform of copyright and patent law**

Copyright does not work well in the digital world. The patent system is inefficient. (Stiglitz, 2008) Many in our societies believe that a major overhaul of copyright and patent law is needed. The commission's ISDS proposals do not protect such reforms. Much like in the case of privacy above, companies can challenge reforms using the known loophole, may claim the treatment is not fair and equitable (manifestly arbitrary or abusive), may claim the EU expropriates them (manifestly excessive, the measure does not serve legitimate public welfare objectives) or possibly that the EU discriminates them (see also "Reservations and exceptions with unknown scope").

An example will clarify this. Canada made a minor adjustment to its patent law, to ascertain better access to medicine. In reaction, United States pharmaceutical company Eli Lilly now claims 500 million dollar in ISDS arbitration. Lilly contends the Canadian measures produced "absurd results" and accused Canada of expropriation. (Wall Street Journal, 2014) Lilly lambasts the Canadian patent policy framework as "discriminatory, arbitrary, unpredictable and remarkably subjective".

A minor adjustment already leads to this. Lilly's claims may be without merit, bigger reforms will lead to stronger reactions, strong threats, a high chilling effect, and as the reforms will go deeper, with bigger effects, possibly more chance on success in ISDS arbitration. ISDS would seriously endanger a major overhaul of copyright and patent law.

Arguably substantive investment protection provisions are not politically neutral. They favour vested interests, as they protect projected profits.

The FFII has argued that EU copyright and patent law has to be made compatible with the UN International Covenant on Economic, Social and Cultural Rights (ICESCR). (FFII, 2013 and FFII, 2014) We already saw the commission proposals do not make an exception for human rights. Also note the US did not ratify the ICESCR.

For compulsory licenses, see above.

### **3.3 Prudential carve-out and filter**

The substantive investment protection provisions contain a limited carve-out, see Table 5, Article X (second mention). The prudential carve-out for ensuring the integrity and stability of a Party's financial system is limited



in paragraph 2: “These measures shall not be more burdensome than necessary to achieve their aim.” Measures for ensuring the integrity and stability of a financial system may be burdensome. They may be taken over a weekend under a lot of stress. Did the crisis solvers find the least burdensome solution? There is often a possibility to argue other measures would have been less burdensome. ISDS adds complexity, this heightens the risk on not finding a solution to ensure the integrity and stability of a financial system. High claims are possible, threats are even more possible.

Regarding restrictions consultations shall be held promptly in the Trade Committee, adding complexity during a crisis.

Under the proposed EU rules on who pays the damages, the one who took the decision will have to pay. In a crisis situation, member state, commission, council, IMF may come together. Who did then take the decision? Uncertainty over who may face an ISDS claim adds complexity during a crisis. The Eurozone has a euro with design flaws, ISDS would add tribunals with inherent and non-inherent design flaws.

The prudential carve-out is accompanied by a procedural (ISDS) measure. The EU wants to include a filter mechanism whereby the Parties to the agreement may intervene in ISDS cases where an investor seeks to challenge measures adopted pursuant to prudential rules for financial stability. In such cases the Parties may decide jointly that a claim should not proceed any further.

The word to highlight is jointly. The party in crisis is dependent on the other party. Being dependent on other parties during a crisis will make solving a crisis more complex. A filter also doesn't help against the chilling effect of threats as the decision on whether the claim can proceed or not comes later. Furthermore, the EU intends to conclude many trade and investment agreements. A country may position itself as a party that does not stop claims. Vulture capitalists will choose that country to invest from. The filter mechanism creates a perverse incentive. There is a higher chance on compromising the stability and integrity of the financial system.

One of the questions in the Dutch study is: “The study should also include policy recommendations regarding whether or not to include an investment chapter with ISDS rules in TTIP, and if so, how any perceived risks could be mitigated for example through the use of filter mechanisms.”

The filter mechanism proposed by the commission has a very limited scope (only financial issues), is dependent on other parties, doesn't help against the chilling effect of threats and even creates a perverse incentive. The filter will not work.

### 3.4 Lack of necessity

There is a lack of necessity. The commission states: “Despite the general solidity of developed court systems such as the US and the EU, it is possible that investors will not be given effective access to justice, e.g. if they are denied access to appeal or due process, leaving them without any effective legal remedy. ISDS is therefore necessary to allow legitimate claims to be pursued. In such cases, the investors would have to prove that the measures have breached the investment protection provisions and that it caused them damage.” (Commission, 2014b)

The commission used this argument before. Members of EU parliament Franziska Keller (Greens/EFA) and David Martin (S&D) asked the commission for examples of cases where foreign investors have been denied access to local courts, expropriated, and not paid compensation in the USA. (Keller, F. and Martin, D., 2013) In its answer the commission gave examples. (Gucht, De, K., 2014) Kleinheisterkamp (2014) scrutinized the answer and notes that a closer look suggests that the cases actually undermine the strength of the commissions argument rather than supporting it. Despite being refuted, the commission uses the argument in its introduction to the consultation.

We saw above that the system is vulnerable for outside pressure, which defeats the sense of including it in trade agreements.

ISDS is not needed, companies can use local courts and insurance (Stiglitz, 2013), states can use state-to-state arbitration. The US – Australia trade agreement does not contain ISDS.

## 4 Conclusion

The commission’s timid reform proposals would create a system that is wide open for abuse and fundamentally incompatible with Europe’s human rights system.

It is possible to solve the ISDS system’s non-inherent design flaws. However, this would require a complete overhaul of the current regime through the coordinated action of a large number of States. Such a complete overhaul is not foreseeable.

Moreover, the system’s inherent design flaws, which threaten democracy and human rights, can only be solved by abolishing the system. The EU has imperative reasons to exclude ISDS from its trade and investment agreements. This step would give direction to the debate and create room to strengthen alternatives.

As a next step states should withdraw from ISDS agreements, mutual withdrawal is preferable. As the birthplace of democracy Europe has to take its responsibility.

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