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## **When Foreign Investors Sue the State**

**By Martin Khor**

**The investor-state dispute system, whereby foreign investors can sue the government in an international tribunal, is one of the issues being negotiated in the Trans-Pacific Partnership Agreement and other free trade agreements.**

In the recent public debate surrounding the Trans Pacific Partnership Agreement (TPPA), an issue that seems to stand out is the investor-state dispute settlement system (ISDS).

It enables foreign investors of TPPA countries to directly sue the host government in an international tribunal.

In most US free trade agreements, the tribunal most mentioned is ICSID, an arbitration court hosted by the World Bank in Washington.

The ISDS is a powerful system for enforcing the TPPA's rules. Any foreign investor from TPPA countries can take up a case claiming that the government has not met its relevant TPPA obligations.

If the claim succeeds, the tribunal could award the investor financial compensation for the claimed losses. If the payment is not made, the award can potentially be enforced through the seizure of assets of the government that has been sued, or through tariffs raised on the country's exports.

The ISDS is related to relevant parts of the TPPA's investment chapter. One of the provisions is a broad definition of "investment" which includes credit; contracts; intellectual property rights (IPRs); and expectations of future gains and profits. Investors can make claims on losses to these assets.

Under the national treatment provision, foreign investors can claim to be discriminated against if the local is given preference or other advantage.

Under the clause on fair and equitable treatment, investors have sued on the ground of non-renewal or change in terms of license or contract; and changes in policies or regulations that the investor claims will reduce its future profits.

Finally, investors can sue on the ground of "indirect expropriation". Tribunals have ruled in favour of investors that claimed losses due to government policies or regulations, such as tighter health and environmental regulations.

The arbitration system has come under heavy criticism, including that the tribunal decisions are arbitrary and can contradict decisions of other tribunals in similar cases.

There is often a conflict of interest situation. A few lawyers monopolise the international investment arbitration business; they act as lawyers in one case and as arbitrators in other cases. In a few cases, an arbitrator was on the Board of Directors of the parent company of the investor that took up the case.

There is a pro-investor bias in many cases, with decisions or arguments that are quite clearly unfair to the governments being sued. However there is no appeal possible.

Another issue is the high awards and the strong enforcement, including seizure of assets.

The claims have tended to be very high in recent years, running to billions of US dollars. Awards are usually lower, but recent ones can also be very high, for example the US\$2.3 billion award granted to an American oil company against Ecuador.

The ability to enforce these awards through seizure of assets owned and located abroad by the government makes the ISDS a very powerful instrument.

Among recent cases was an award by ICSID to a US oil company against Ecuador for US\$2.3 billion; a case taken against South Africa by a European mining company claiming losses from the government's black empowerment programme and a US\$2 billion claim against Indonesia by a UK-based oil company, after its contract was cancelled because it was not in line with the law.

Australia has also been sued for billions of dollars by the tobacco company Philip Morris because of its regulation that the cigarette boxes cannot promote the logo and brand names.

An American company Renco sued Peru for \$800 million because its contract was not extended after the company's operations caused massive environmental and health damage.

There are several implications of the ISDS. Not conforming to TPPA rules can carry a heavy penalty, since government can be sued in an international court, and thus government will be constrained when formulating future policies or implementing existing ones.

It is difficult for government to make new policies, as it cannot predict whether certain policies it wishes to introduce or change is allowable, since it is uncertain or unpredictable how a tribunal will view this, i.e. the view of a particular tribunal can differ from that of another tribunal.

The country's judicial sovereignty will be affected. Investors will choose to take up cases in the international tribunal where their chances of success and the pay-out are higher than in local courts.

The country will become vulnerable to multi million-dollar and billion-dollar legal suits taken by foreign investors. Potentially this may cost government a lot of financial resources.

The TPPA negotiations are still going on, and thus the ISDS component can still be negotiated. However, there is probably limited room for negotiation on the key aspects, since the USA is unlikely to deviate from the main points in its FTAs.

If the ISDS is deemed to contain too many problems, one option is to ask for an exception, i.e. that it does not apply to the country, similar to what Australia has requested. It is doubtful however whether such a request will be granted by other TPPA countries.

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**Author: Martin Khor is the Executive Director of the South Centre. Contact: [director@southcentre.int](mailto:director@southcentre.int).**

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**For more information, please contact Vicente Paolo Yu of the South Centre: Email [yu@southcentre.int](mailto:yu@southcentre.int), or telephone +41 22 791 80 50.**