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Annex 1: Reality check of the Commission's plans for 'reform' of "substantive" investor rights

When European Trade Commissioner Karel de Gucht launched the public consultation on the investor rights in the proposed EU-US trade deal (TTIP), he said: "I fully agree with the many critics who claim that investor-to-state-dispute settlement (ISDS) up until now has resulted in some very worrying examples of litigation against the state." The problem, according to de Gucht, lies in some problematic features of existing investment agreements – which the Commission claims to "re-do" to build a "legally water-tight system".

This Annex looks into the Commission plans to re-do the so called "substantive" investor rights (Annex 2 is on their proposals to reform the dispute settlement system). The Commission claims that it will introduce "clear and innovative provisions" with regards to some of the traditionally vaguely formulated investor rights so that they "cannot be interpreted by arbitral tribunals in a way that is detrimental to the right to regulate". Because, it argues, "in the end, the decisions of arbitral tribunals are only as good as the provisions that they have to interpret and apply," (question 5 in the Commission's consultation document).

PR-speak: **what the Commission claims in its consultation document**	**Reality check:** **what the Commission really does** **– and what it means in practice**
The EU wants to make sure that states' **right to regulate** is "confirmed as the basic underlying principle" of the EU-US agreement so that arbitrators "have to take this principle into account" when assessing an investor-state dispute. The Commission quotes a section of the preamble of the EU-Canada agreement (seen as a template for TTIP) that indeed recognises the parties' right "to take measures to achieve legitimate public policy objectives", (from question 5 in the consultation document).	It is impossible to check the claim with just an excerpt of the preamble. According to a Canadian summary of it, the 'right to regulate' is specified ("in a manner consistent with the Agreement"). According to this analysis from the International Institute for Sustainable Development (IISD, p.2), this detail puts the investor rights above the right to regulate – the exact opposite of what the Commission claims. During a public debate in March, a high-ranking Commission official admitted that the formulation on the right to regulate will "not make any difference" in investor-state disputes.
The EU sees no problem with the "intentionally broad" **definition of "investment"** in investment treaties covering "a wide range of assets, such as land, buildings, machinery, equipment, intellectual property rights, contracts, licenses, shares, bonds, and various financial instruments," (from question 1).	The definition of "investment" is key because it determines what is covered by the chapter. A broad – and open-ended – definition such as the Commission's not only covers actual enterprises in the host state, but a vast universe ranging from holiday homes to sovereign debt, exposing states to unpredictable legal risks.
The EU wants to avoid abuse by improving the **definition of "investor"** to eliminate so called "shell" or "mailbox" companies from the scope of the agreement: "to qualify as a legitimate investor of a Party, a juridical person must have substantial business activities in the territory of that Party," (from question 1).	The definition of "investor" is key because it determines who is covered by the agreement. The EU seems to have understood that a broad definition can lead to abuse of the treaty via "treaty shopping", allowing, for example, a US firm to sue the US via a Dutch mailbox company. But unfortunately, it fails to define the term "substantial business activity". Thousands of investors will be covered by the chapter.

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National treatment: Investors "should not be discriminated against" except in "rare cases" and "specific sectors" where discrimination "may need to be envisaged". The aim is to ensure "a level playing field between foreign investors and local investors," (from question 2).	The EU's investor rights do not create a "level playing field", but VIP treatment for foreign investors: they get greater private property rights than everyone else and access to a parallel legal system that is exclusively available to them – not local businesses or ordinary people.
Most-favoured nation treatment (MFN): A provision to ensure "a level playing field" between different foreign investors. EU member states and the US would have to treat investors from the other party "no less favourably" than investors from any other state. But the Commission "seeks to clarify" that investors will not be able to "import" more favourable rights from other agreements signed by the US or EU member states, (from question 2).	In reality the provision has indeed been interpreted like a "magic wand" that allows investors to 'import' rights from other treaties signed by the host state (as a lawyer defending states against investors has recenty put it). Under the EU's current MFN wording, this cherry-picking would be possible, self-cancelling all of the supposed 'clarifications' of investor rights and multiplying the risks of successful investor-state attacks against public policy. In meetings with NGOs, the Commission admitted that it only recently became aware of the problem.
Fair and equitable treatment (FET): Investors shall be treated in a "fair and equitable" manner. The EU wants to clarify the standard so that it only covers "breaches of a limited set of basic rights" (denial of justice; disregard of fundamental principles of due process; manifest arbitrariness; targeted discrimination; abusive treatment), (from question 3).	The standard has become the catch-all guarantee most relied on by investors when suing states. In 74% of the cases won by US investors, tribunals found an FET violation. And investors frame their claims precisely around the same "basic rights" listed by the Commission. Philip Morris, for example, argues that Australia's anti-tobacco law was arbitrary because the claimed health benefits are "contradicted by facts" and other policies to reduce smoking without a negative effect on Philip Morris were available. Canadian mining firm Lone Pine also argues that the revocation of its "right to mine for oil and gas" in Quebec was "arbitrary" and without "due process". It seems the EU's 'clarifications' do not offer much protection.
Protecting investors' legitimate expectations: The Commission explicitly states that tribunals which apply the fair and equitable treatment standard may take into account whether a state made a "specific representation" to an investor that "created a legitimate expectation" upon which the investor relied when making or maintaining an investment, (from question 3).	The protection of an investor's "legitimate expectation" has been interpreted by tribunals as a right to a stable regulatory environment – binding governments to not change regulation. In the Quebec case where strong community resistance halted a fracking project, Lone Pine, for example, argues that the "revocation" of its gas exploration permits violated its "legitimate expectation of a stable business and legal environment". The EU does not define the type of "specific representation" by a state which could create such legitimate expectations. Would a prime minister's twinkling of an eye be enough?
Expropriations (direct and indirect ones) of investors are permitted only if they are for a public purpose, non-discriminatory, follow due process and are compensated. The EU wants to clarify the provision to "avoid claims against legitimate public policy measures". It wants to make clear that "non-discriminatory measures taken for legitimate public purposes, such as to protect health or the environment, cannot be considered equivalent to an expropriation, unless they are	From a certain, investor-friendly view, almost any law or regulatory measure can be considered an 'indirect expropriation' when it has the effect of lowering profits. Several tribunals have interpreted legitimate public policies that way and have ordered states to pay compensation. Would the EU's 'carve-out' for public welfare measures prevent this? Not necessarily. The state would have to prove that a measure "was designed and applied to protect public welfare objectives" (and as in the Philip Morris case, investors would challenge this). In

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manifestly excessive," (from question 4).	"rare circumstances" it could then still be considered an expropriation. Academics (p. 28) have argued that amidst "significant debate and uncertainty" about the meaning of such clauses, there is "the possibility that an arbitral tribunal might interpret [...] an EU-US investment chapter expansively [i.e. in a pro-investor way] despite the addition [...] of cautionary footnotes and annexed clarifications". Also, the current text on MFN (see above) would allow investors to refer to expropriation clauses in other treaties without public policy exceptions, rendering the EU's carve-out pretty meaningless.
When greater clarity is needed to protect the right to regulate, the EU and the US will be able to "adopt **interpretations** of the investment protection provisions which will be **binding** on arbitral tribunals." This will allow them to monitor how the law that they created is interpreted and influence the interpretation, (from questions 5 & 11).	Following a wave of investor claims under the North American Free Trade Agreement NAFTA, the US, Canada and Mexico have already issued such joint clarifications of vaguely formulated investor rights. In practice, however, arbitrators have proven that they are willing to ignore these 'binding' interpretations (see here for examples relating to fair and equitable treatment).
The EU will ensure that "all the necessary **safeguards and exceptions** are in place" to protect the right to regulate – for example, with regards to environmental and consumer protection, health and the stabilisation of financial markets. EU agreements also contain "general exceptions applying in situations of crisis". This suggests that certain types of regulatory measures might be exempt from the obligations in the treaty, (from question 5).	A closer look at the relevant provisions shows that this provides false comfort. Measures to ensure financial stability, for example, "shall not be *more burdensome than necessary* to achieve their aim". "Safeguard measures that are *strictly necessary*" may be taken "in *exceptional* circumstances of *serious* difficulties for the operation of monetary and exchange rate policy". For policies to tackle "*serious* balance-of-payments or external financial difficulties", the EU even states that they should "avoid *unnecessary* damage to the *commercial*, *economic* and *financial* interests of the other Party". It will be up to a tribunal of unaccountable for-profit lawyers to determine which policy was "strictly necessary" and which caused "unnecessary" costs for the other party. An easy hurdle to pass for investors.
Umbrella clause: The EU also wants to protect investors when the host country avoids "contractual obligations" towards them, (from question 3). While there is no exemplary treaty text in the consultation on this issue, there is a similar clause in the leaked EU-Canada investment chapter from November 2013 (Article X on page 14).	This would bring all obligations a state assumed with regards to an investment under the TTIP 'umbrella' (like a contract with one investor), multiplying the risk of costly lawsuits. In a 2011 resolution, the European Parliament had asked the Commission for a study on the impacts of the inclusion of an umbrella-clause in future European investment agreements. There is no such study yet.
'Survival' (or better: 'zombie') clause: An issue that is not mentioned in the Commission's document, but that deserves some attention.	The EU discretely forgot to mention that the EU-US trade deal would allow investors to sue states for decades – even if they cancelled the treaty in the future. The leaked EU-Canada agreement (article X.18) says that, for investments already made, the treaty "shall continue to be effective for a further period of 20 years" from the moment it is terminated. The corporate super rights would live on like a zombie – even if the agreement was dead.

All in all, the Commission's plans to "re-do" the "substantive" investor rights do not do the job of building a "legally water-tight system" that "cannot be interpreted by arbitral tribunals in a way that is detrimental to the right to regulate". On the contrary, many of the proposed provisions seem to have the exact opposite effect (which was also the conclusion of analyses of previously leaked negotiation texts from the Commission by the International Institute for Sustainable Development (IISD) and the Seattle to Brussels Network).

Under the EU's reforms, the investor rights will remain what a lawyer defending states in investor-state lawsuits recently called: "weapons of legal destruction".