Good, Oil, and Cigarettes: How an Obscure Trade Provision Protects the World's Biggest Companies

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March 11, 2015

Import duties, intellectual property, labor protections, NAFTA superhighways, strategic inroads to Asia — this is the stuff of your typical inflamed debate over trade. Only rarely does one of the least-understood quirks of the global trade system come up in these debates: something called the investor-state dispute settlement.

Tucked into most investment treaties and trade agreements, investor-state provisions give companies ("investors") the power to sue sovereign states where they do business, in bodies like the World Bank's International Centre for the Settlement of Investment Disputes. They can bring claims for essentially anything that they argue cuts into their profits or even future potential earnings.

For decades, investor-state provisions avoided the spotlight. Outside of stalwart trade reformers like the consumer advocates at Public Citizen, skeptical wonks at the Cato Institute, or the financial press, investor-state provisions rarely got much attention. Plus, companies rarely even filed investor-state claims. When they did, the claims were largely to limit or penalize state seizure of their assets.

But in the last decade, the number of investor-state cases has sharply increased, arguably as a tool for companies based in developed, wealthy countries to browbeat developing nations. Critics of investor-state provisions argue that they grant corporations access to private courts that circumvent sovereign legal systems. In turn, that hands power to exclusive, shadowy tribunals manned by corporate lawyers.

With the United States currently negotiating two monster trade deals — the Trans-Pacific Partnership and the Transatlantic Trade and Investment Partnership — activists, on both the left and the libertarian right, have mobilized to keep investor-state provisions out of the agreements. The texts of these measures are closely held secrets, and it is unclear whether investor-state

provisions will be included in the final versions. On the other side of the debate, the U.S. Chamber of Commerce has likened opposition to investor-state provisions to a child's irrational fear of monsters lurking in the closet.

Investor-state provisions began to appear in trade agreements in 1959 as a way of discouraging countries from nationalizing private assets, a big problem at a time when many colonies in Africa and Latin America were gaining independence and laying claim to their own natural resource assets. Still, even in its heyday (and long after), the system never exactly came under much strain. Between 1959 and 2002, fewer than 100 known investor-state claims were made, according to U.N. figures. But the mere existence of such a system at least guaranteed that private corporations had some way of addressing grievances against states that, they argued, were screwing them out of profits.

Then something changed. From 2003 to 2012, the cumulative number of cases jumped to 514, with claimants — companies — bringing some 58 cases forward in 2012 alone. It's worth noting that investors don't win every time. Nor do the damages they're awarded always equal the losses they claim. According to data compiled by Susan Franck, a law professor at Washington and Lee University, tribunals in investor-state cases have ruled in favor of investors and awarded them damages in 38.5 percent of cases. Governments won and paid nothing in 57.7 percent. Only 3.85 percent of cases were settled.

The problem, though, isn't the win-loss record of investors, writes Simon Lester, a trade expert at the libertarian Cato Institute. Rather, the problem lies in a powerful system built on vague legal provisions. "The existence of any legal victories under these provisions helps demonstrate that investors can and have used the rules to influence how governments regulate," he argues.

Consider, for example, the legal battle playing out between the government of El Salvador and the Australian mining company OceanaGold. In 2013, OceanaGold bought Pacific Rim Mining and with the purchase acquired that company's El Dorado mining interest. In 2002, the Salvadoran government at the time allowed Pacific Rim to explore for gold, but the venture fell apart amid concern that mining in the area would pollute the water supply.

Now, OceanaGold is suing the Salvadoran government to the tune of $300 million, which is how much the company claims it would have made at the mine. In other words, the claim is for how much the company expected it would make on the project, not how much it has already sunk into it and lost. The case is being considered at the International Centre for the Settlement of Investment Disputes, where final arguments began in September 2014.

Extractive industries are a frequent topic before that board. In October, the board ordered the government of Venezuela to pay Exxon Mobil $1.6 billion in damages that the company incurred in 2007 when Venezuela seized oil projects belonging to the American energy giant. But that award was a mere fraction of the $14.7 billion sought by Exxon.

There are now signs that governments have grown weary of this arbitration process, and this may endanger the inclusion of a state-investor provision in the Transatlantic Trade and Investment Partnership (TTIP), the free trade agreement currently being negotiated between the European Union and the United States.

A series of aggressive arbitration lawsuits has given the distinct impression that international corporations are using investor-state clauses of trade agreements simply to skirt environmental and consumer protections. In 2010, Germany agreed to withdraw environmental restrictions on the construction of a coal plant on the Elbe River by the Swedish utility Vattenfall after it threatened to sue under arbitration rules. Then, in 2012, Vattenfall demanded $6 billion in compensation after Germany decided to phase out nuclear power following Japan's Fukushima disaster.

Another ugly such lawsuit involved cigarette giant Philip Morris, when it sued Australia in 2011 over graphic cigarette packaging warning about smoking's ill health effects. The measure, the company argued, would dilute the company's profits. (A scathing, hilarious 20-minute skit by HBO's John Oliver ripped into Philip Morris for its efforts on this front.)

On Jan. 21, France and Germany together requested that the European Commission "examine all the options for modifying" the investor-state provision of the EU-Canada free trade deal. That move came on the heels an "online consultation" carried out by the commission to assess European sentiment about investor-state tribunals in the proposed EU-U.S. TTIP trade deal. The commission received some 150,000 responses, an unprecedented figure for a trade-related matter, the Financial Times reported. Many of the respondents worried that the treaty would undermine national sovereignty.

Cecilia Malmström, the EU trade commissioner, has announced that she will be looking to reform the investor-state provision in the still-under-negotiation TTIP. "We need to see if there is a possibility to reform [investor-state] in a modern way. So there is only a limited possibility for targeted cases for investors to have their investments protected," Malmström told the Guardian last month.

The same day, U.S. Rep. Mark Pocan (D-Wisc.) and 12 fellow progressives in the House introduced legislation that would bar the president from entering the United States into a free trade agreement or investment treaty that included investor-state dispute settlement provisions. Odds are that Pocan's two-page bill dies on the vine.

On this issue, the White House finds itself caught between its base and its attempt to build a legacy for President Barack Obama as the man who decisively led the United States out of recession. Free trade deals such as TTIP and Trans-Pacific Partnership (TPP) represent key initiatives of his final years in office and may spur economic growth. But labor and environmental groups are deeply skeptical toward such deals in general, and investor-state

provisions have emerged as a flash point in the White House's tussle with the left-wing of the Democratic Party.

Writing in the Washington Post last month, Sen. Elizabeth Warren (D-Mass.) railed against such a provision in the TPP. "Replacing the U.S. legal system with a complex and unnecessary alternative — on the assumption that nothing could possibly go wrong — seems like a really bad idea."

In a White House blog post, Jeffrey Zients, the director of the National Economic Council, fired back that the investor-state provision being written will improve transparency and prevent the kind of abuses that have marked previous litigation under such measures.

In short, on both sides of the Atlantic, economic officials are not so subtly hinting that investor-state provisions are here to stay.