"Super-protections" for corporations

How investment treaties and investor-to-state dispute settlement grant foreign investors greater rights than Dutch and EU law

Fact Sheet | March 2021

On 2 February 2021, the German energy company RWE commenced arbitration proceedings against the Netherlands at the International Centre for Settlement of Disputes, invoking the protections of the Energy Charter Treaty (ECT).[1] The company seeks €1.4 billion in compensation for damages resulting from a new law, adopted in December 2019, that prohibits the use of coal for the production of energy as of 2030.[2] According to RWE, the law constitutes a de facto expropriation of its investments in a coal-fired power plant that went into operation in 2015 and breaches certain economic expectations the company had when deciding to construct the plant more than a decade ago.

The arbitration request is the first investment treaty-based claim against the Netherlands. Furthermore, it is one of the first cases that directly targets legislation aimed to phase out coal in the fight against climate change. This raises the question of why RWE decided to resort to international arbitration, rather than first challenging the law before a Dutch court. During a hearing in the Dutch Parliament in February 2021, an RWE representative said that "the arguments that you can put forward in arbitration are not the same as in a Dutch court".[3]

To what extent do foreign investors have greater rights and a better chance of success to obtain compensation under investment treaties such as the ECT than under Dutch or EU law?

Investment treaties and greater rights for foreign investors

In the Netherlands, concerns over potential investor-to-state dispute settlement (ISDS) claims arose in the Dutch Parliament during the contentious debates on the ratification of the EU-Canada Comprehensive Economic and Trade Agreement (CETA) during the first half of 2020. Sigrid Kaag, the Dutch Minister of Foreign Trade, sought to reassure Dutch parliamentarians by stating that CETA provides the same level of protection for investors as Dutch law and that signing on to CETA would not increase the risk for damages claims against the Dutch government.[4] She also suggested that the ECT upholds a similar standard of investment protection as Dutch law, implying that concerns over investment treaties are misguided.[5]

However, in practice, the way ISDS tribunals have interpreted and applied the substantive provisions of investment treaties has resulted in the development of "super-protections" for foreign investors that go beyond those found in many domestic judicial systems.[6] This has also led to situations where foreign investors have been awarded compensation in cases where damages would not be granted under domestic law.[7] Not surprisingly, foreign investors increasingly resort to ISDS in disputes with states, including those that have well-developed legal systems and a strong rule of law.[8]

Investment protection under investment treaties, Dutch law and EU law: a comparative analysis

To better understand the ways in which ISDS provides a more favourable legal avenue than domestic courts, SOMO commissioned the Amsterdam European Law Clinic of the University of Amsterdam to compare the procedural and substantive elements of investment protection under the ECT and CETA with Dutch civil and administrative law and the EU's non-contractual liability regime. The study identified four main areas in which foreign investors enjoy greater rights under the ECT and CETA.[9]

- The structure of arbitration proceedings under the ECT and CETA benefit foreign investors. Under both agreements, arbitrators have financial incentives to rule in favour of foreign investors, while the lack of transparency safeguards under the ECT prevent the general public and civil society from critically evaluating arbitration cases;
- Foreign investors do not have to challenge a measure in an administrative court first, but can directly gain monetary compensation for having to comply with that measure;
- The open-ended wording and expansive interpretations of substantive investment protections constrain the regulatory space of governments in a way Dutch and EU law do not. This could result in the "chilling" or watering down of measures designed to protect public interests. Although CETA aims to clarify certain substantive standards, it still creates more legal uncertainty and restricts the regulatory space more than Dutch or EU law.
- Foreign investors can obtain higher amounts of compensation under the ECT and presumably under CETA as well.

The matrix below summarizes the main findings. Further elaboration and substantiation of the arguments and evidence can be found in the study itself.

> Minister Kaag stated that the regime of investment protection under CETA does not differ from what is applied under Dutch law

Time to scrap investment treaties

The findings of the study show that investment treaties largely shift the risks and costs associated with regulatory changes from investors to states and taxpayers.
The exposure to ISDS claims, together with the uncertain and unpredictable outcomes of ISDS cases and the staggering amounts involved, affects the regulatory space of governments in ways that would be inconceivable under domestic legal systems. The current climate crisis is one example for which this creates an undesirable situation. The broadened scope of potential liability puts greater pressure on governments to refrain from taking climate action. Foreign investors could also be less inclined to anticipate possible future climate measures and to divest from fossil fuels, and instead try to recover the losses through compensations under ISDS.

Investment treaties with excessive corporate rights form major obstacles to the transition towards low-carbon societies and need to be scrapped or withdrawn from. Our domestic legal systems offer a proper avenue for resolving and addressing investment disputes; they establish a fair and proper balance between private and wider public interests, while respecting the regulatory space of governments in ways that are needed to confront the climate crisis.

Four areas in which foreign investors enjoy greater rights under the ECT and CETA than under Dutch and EU law

1 Structure of arbitration proceedings

ECT and CETA

Under the ECT, arbitrators are appointed by the disputing parties, but they are paid per case under both agreements. The fact that only foreign investors can initiate claims, combined with the payment per case, creates financial incentives for arbitrators to be appointed in more cases and not to discourage foreign investors from doing so. Such incentives contribute to expansive, investor-friendly rulings by arbitrators. In the case of the ECT, a general lack of transparency in the proceedings may result in less public scrutiny, which can protect investors" reputations and images.

Dutch civil and administrative law

Investors have no influence on which judge will rule in their case. Dutch judges are employed on a full-time basis and receive a fixed annual salary that is not dependent upon the number of cases they handle. Judges are appointed for life and usually selected randomly for a particular case. These conditions help to create a fair judicial system based on impartiality and independence. The overwhelming majority of hearings are publicly accessible and rulings have to be published immediately.

EU non-contractual liability regime

Similar to Dutch law, judges at the Court of Justice of the European Union receive a fixed salary independent of the number of cases brought. Investors have no influence on the composition of the judiciary. Every three years, a replacement of one half of the judges is due. Rulings, including the parties" arguments and judicial reasoning, are made publicly available, and proceedings usually include public hearings.

2 "Endure and cash in"

ECT and CETA

Both the ECT and CETA foster an "endure and cash in" attitude as foreign investors do not have to challenge a disputed measure in court first, but can directly gain monetary compensation for "enduring" that measure. Instead of first having to request the measure be repealed, it is profitable for investors to directly obtain compensation with the measure still in place, because in that case, expected lost profits can be compensated. This means that no actual commercial production or risk-taking is needed to obtain future profits, and that investors can cash in directly.

Dutch civil and administrative law

Under Dutch law, foreign investors first have to challenge the legality of the measure enacted by a governing body in administrative court. If the measure is found to be illegal and therefore repealed by an administrative court, investors are put back in the same position as they were before the measure was enacted. Any future profits will then have to be earned by actual production and/or risk-taking. If the measure is found to be legal and not repealed by an administrative court, investors can claim compensation for all damages already suffered and lost future profits.

EU non-contractual liability regime

Under EU law, investors can "endure" a measure and directly claim damages in a non-contractual liability suit. However, chances of obtaining compensation are extremely low, so it can hardly be said that investors can "cash in". The European Court of Justice has consistently applied a strict approach towards non-contractual liability of EU institutions. Up to 2020, only 23 out of 530 filed damages claims succeeded, meaning that in 95.7% of all claims, no damages at all were awarded.

3 Regulatory space for administrators and legislators

ECT and CETA

Vaguely formulated and broadly applied substantive protections constrain the regulatory space of administrators and legislators in a way that Dutch and EU law do not. Both the ECT and CETA leave considerable space for arbitrators to determine what "indirect expropriation" and "fair and equitable treatment" means. This may lead to legal uncertainty, potentially spurring "regulatory chill", and could lead to damages awards for investors in instances that would not give rise to compensation under Dutch or EU law.

Dutch civil and administrative law

Dutch law provides for greater legal certainty as Dutch legal standards are interpreted uniformly. The notion of "indirect expropriation" is interpreted restrictively and compensation is allowed only if the damage falls outside the scope of "normal company risk" and if the measure was not foreseeable. Likewise, Dutch law protects against "arbitrary and unreasonable conduct" and breaches of "legitimate expectations", but in an extremely restrictive manner, leaving a wide margin of appreciation for administrators and legislators.

EU non-contractual liability regime

Substantive protections are more restricted than those offered by the ECT and CETA. All legal measures are categorically excluded as a ground for compensation, the standard of "sufficiently serious" breach is higher, and compensation is allowed only for damages outside "normal economic risks", while "foreseeability" is also a factor in determining whether the investor can claim compensation. The European Court of Justice takes a strict approach in order to explicitly prevent hindrance of the EU's legislative function.

4 Amounts of compensation

ECT and CETA

The ECT and CETA have not laid down principles governing the quantification of damages for breaches of substantive standards of protection other than expropriation. Regarding expropriation, both the ECT and CETA require full compensation equal to the investment's "fair market value". Arbitrators frequently use the "discounted cash flow' valuation technique, which looks at the complete lifespan of an investment, including predicted future profits, and thus involves a degree of speculation. Arbitral tribunals have granted higher amounts of compensation more regularly, with awards often running into the billions.

Dutch civil and administrative law

Dutch courts apply a closed system of categories for costs eligible for compensation. Financial loss ("vermogensschade") consists of actual losses and lost expected profits, but there are several mitigating factors, such as whether the measure was legal or illegal, in the calculation of the amount of compensation. Compensation amounts are calculated according to objective and independent data that allow for less speculative accounts of what profits the investor could have made. Compensation is only available for losses exceeding "normal company risk" and can be excluded or reduced if a measure could have reasonably been foreseen.

EU non-contractual liability regime

EU institutions have only been found liable for small amounts of compensation. There is no specific standard used to calculate the amount of compensation. Full compensation of damages that have occurred due to the action or omission of the EU institution is the rule, but recent examples show that the amounts paid in successful non-contractual liability claims are considerably lower than the amounts paid out under the ECT and other investment treaties.

1 RWE AG and RWE Eemshaven Holding II BV v. Kingdom of the Netherlands (ICSID Case No. ARB/21/4). Available at: https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/21/4.

2 Law banning coal for electricity production, 11 December 2019, Official Journal of the Kingdom of the Netherlands, 2019, 493. Available at: https://www.eerstekamer.nl/behandeling/20191219/publicatie_wet/document3/f=/vl4je6b07ez1.pdf.

3 Hearing on the Summoning of the State by RWE in relation to the closure of coal-fired power plants, 11 February 2021. Available at: https://www.tweedekamer.nl/debat_en_vergadering/commissievergaderingen/details?id=2021A00976.

4 Kamerstukken I, 2020/21, 35154, p. 35; pp. 58-60. Available at: https://www.eerstekamer.nl/behandeling/20200918/nadere_memorie_van_antwoord/document3/f=/vlc6mytw27ye_opgemaakt.pdf.

5 Aanhangsel Handelingen II, 2019-2020 1769, p. 5-6. Available at: https://www.tweedekamer.nl/downloads/document?id=5160f38b-d125-4315-8c35-4f5be99f4059&title=Antwoord%20op%20vragen%20van%20het%20lid%20Ouwehand%20over%20de%20gevolgen%20van%20CETA%20voor%20onze%20rechtsstaat%2C%20onze%20soevereiniteit%20en%20de%20landbouw%20.pdf.

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7 Gaukrodger, D. and K. Gordon (2012), "Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community", OECD Working Papers on International Investment, 2012/03, OECD Publishing. http://dx.doi.org/10.1787/5k46b1r85j6f-en, pp. 79-87; A. De Mestral and R. Morgan (2016)," Does Canadian Law Provide Remedies Equivalent to NAFTA Chapter 11 Arbitration?", CIGI Investor-State Arbitration Series Paper No. 4, May 2016. Available at: https://www.cigionline.org/sites/default/files/isa_paper_no.4.pdf.

8 UNCTAD Investment Dispute Navigator, available at: https://investmentpolicy.unctad.org/investment-dispute-settlement.

9 http://www.somo.nl/super-protections-for-corporations

Colophon

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