Ruthless exploitation in the raw materials sector: How corporations are using the investment court system to enforce their interests

OceanaGold and *Commerce Group Corp.* versus El Salvador

On 14 October 2016, the Australian–Canadian mining business OceanaGold lost a USD 250 million lawsuit for compensation against El Salvador. The company had been seeking *'redress'* for its past investments and lost profits. For several years, the Canadian concern Pacific Rim, which OceanaGold went on to acquire, had been involved in gold explorations in El Salvador. In 2008, the government of the Central American country refused to grant the company a mining license.

El Salvador's decision was well founded: Pacific Rim had not fulfilled its statutory environmental requirements, nor had it produced a final feasibility study or even provided proof that it actually owned the site it proposed to mine. El Salvador, in turn, had learned from the bad experiences it made in the past. As gold extraction requires large amounts of water and involves the use of toxic compounds such as cyanide, it poses a high level of risk to people and the environment. In fact, contaminated water from the shafts of a gold mine that was abandoned in the 1980s still leaks into San Sebastián River in the north-east of the country. Before, the river had been used for drinking water.

Despite El Salvador's protests, the case gained approval to go to court. The court ignored El Salvador's argument that, only because it had provided a company with an exploration permit, this did not necessarily mean that it had to grant the company a mining licence. The case lasted for seven years and cost El Salvador at least USD 12 million in legal fees. OceanaGold had initially demanded USD 77 million in compensation but later raised its claim to over USD 300 million. This is almost double the level of the international development funds that were provided to El Salvador in 2014. Against the background of threats of similar cases, it should hardly be surprising that the country has refrained from strengthening other environmental protection laws.

***OceanaGold* in the Philippines** photo: Michael Reckordt

After the trial, OceanaGold sought to persuade the El Salvadorian government and local communities to accept gold mining. This situation fuelled further conflict as local communities were divided about whether mining should or should not be permitted. Even though it lost the court case, the company refused to pay its share of El Salvador's legal costs (USD 8 million). As a response, El Salvador has frozen OceanaGold's bank accounts. Following its legal victory against the company, in spring 2017, El Salvador passed a law prohibiting the extraction of metallic raw materials.

Investment Protection Agreements and Investor–State Dispute Settlement (ISDS)

The case OceanaGold versus El Salvador was taken to the International Centre for Settlement of Investment Disputes (ICSID), an organisation that belongs to the World Bank in Washington DC. Other relevant institutions in which investor–state dispute settlement (ISDS) proceedings are held include the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce in Paris. However, the ICSID deals with most of the well-known cases. Investor–state arbitration enables companies that have made investments in a certain state to sue this same state if a newly enacted law – such as extensions to environmental protection legislation – affect their investment. However, ISDS law suits not only enable companies to claim compensation for investments that they have already made; they also permit them to sue for compensation for profits they had expected to make in the future but now '*lose*'. Such claims are based on the argument that new statutory measures will prevent a company from making profits that it would have otherwise made.

The ISDS mechanism – special rights for companies to bring cases against states before a tribunal – is regularly included in bilateral investment treaties (BITs). These agreements between two countries are designed to promote and protect investment. In addition, multilateral treaties between several countries or regional blocs are often accompanied by investment protection chapters and ISDS mechanisms. Currently, around 3,000 international treaties include an ISDS mechanism, 1,400 of which were signed by EU member states. Although advocates claim that these provisions increase foreign direct investment, this has never been proven.

If foreign investors intend to sue a state, they do not have to go through a country's domestic legal system. Instead, a special statutory provision – a right that domestic enterprises, states, civil society and even citizens have never been granted – allows companies to take a state to an international arbitrational tribunal. Moreover, the arbitrational courts that preside over these cases are not composed of permanent judges. Instead, three private arbitrators make the decisions in these cases. The procedures they entail often completely lack transparency and there is no legal right to be heard, which means that civil society organisations cannot become party to a case. The German Association of Judges argues that the Investment Court System (ICS), which has replaced the ISDS mechanism in more recent EU agreements (such as CETA), does not fulfil the '*international requirements stipulating the need for courts to be independent*'.

Worse still, arbitrators not only receive around USD 3,000 per day in fees; they are paid according to the number of cases they take on, and the length of time the cases last. As such, it is in their interests to ensure that court cases not only last as long as possible, but that judgements favour the investors; if they do not, it is unlikely that investors will use the courts in the future. Academic studies of investment law have also demonstrated a tendency towards investor-friendly judgements.

The history of ISDS in short

After the former colonies gained political independence, the ISDS system was created as a means of protecting Western investments and enterprises from expropriation. In 1959, West Germany signed the first BIT with Pakistan. In 1964, a resolution was adopted at a World Bank meeting aimed at creating an ISDS mechanism and a corresponding arbitrational court (ICSID). The resolution was passed despite 21 countries from the Global South voting against it. Importantly, no comparable instrument exists that ensures human rights law is implemented or that enables citizens to gain redress in cases of human rights violations.

In 1969, the Netherlands and Indonesia signed the first BIT that included an ISDS mechanism. In the 1990s, the debt crisis pushed many countries in the Global South to implement '*structural adjustment*' measures drawn up by the International Monetary Fund (IMF) and the World Bank. Similarly, in the context of economic liberalisation, many new trade and investment agreements included an ISDS clause. It was during this period that the North American Free Trade Agreement (NAFTA) came into force.

ISDS had hardly been used until this point, and only a few conglomerates had ever taken a state to court. In fact, only twelve cases are known to have taken place before the mid-1990s. Nevertheless, the law firms associated with the '*arbitration industry*' had for a long time already understood the enormous potential offered by this powerful legal instrument. Over the last 15 years, the number of ISDS cases has risen rapidly, and the arbitration industry has experienced an immense boom: 817 ISDS cases have been heard of until July 2017.

A sharp disparity exists between the North and the South regarding the cases that go to court: a survey looking at 893 ISDS-cases revealed that 690 out of 893 cases, the complainant came from the US, Canada or the EU. Investors from the EU are particularly ready to sue: the number of cases filed by European investors even exceeds the number of lawsuits filed by investors from the US. The latter currently tops the list, however, with a total of 152 cases. This is followed by the Netherlands (96 cases), the UK (69) and Germany (57). Nevertheless, this does not necessarily mean that a company actually has to have its headquarters in one of these countries. Companies can channel their structure, including that of their subsidiaries, into branches that not only enable them to pay less tax but also provide them with access to countries that have signed a significant number of investment agreements. PacificRim, the Canadian company mentioned above, used a subsidiary based in the US to file its lawsuit against El Salvador.

In some cases, a company's turnover may even be higher than the annual budget of a defendant state; this was the case when the tobacco company Philip Morris sued Uruguay. The countries that have been taken to court the most are Argentina (60 times), followed by Venezuela (42 times), Spain (36), the Czech Republic (35 times) and Egypt (29 times). However, the number of complaints against countries located in the Global North is increasing: Canada has been sued at least 26 times.

Court cases in the raw materials sector

About a quarter of all ISDS cases that have been brought before the ICSID's courts are related to the oil, gas or mining industry. This is hardly surprising, with the raw materials sector – which has a particularly harsh reputation – dominating foreign investment in the Global South. Due to special tax treaties, countries in the Global South receive low levels of state income. At the same time, the raw materials industries create very few jobs for local people and technology transfer remains inadequate. Consequently, the hopes pinned on foreign direct investment are seldom met. Instead, it often results in human rights violations, environmental pollution and the displacement of the local population. Despite the fact that foreign investment is seldom beneficial to a country's economic development, it enjoys particularly strong protection through BITs.

It is therefore hardly surprising that the ISDS system is so popular with mining companies. The Canadian mining industry also broadly supports the CETA agreement between the EU and Canada. Mineweb, an industry-related portal, recognises '*the potential of investor protection to change political behaviour.*' It views the ISDS mechanism in CETA as the '*most significant development*' that the agreement offers for mining companies on both sides of the Atlantic. Mineweb points out that, as long as governments can be sued for damages for passing new legislation, they will '*think twice about doing so*'. Consequently, numerous regulations and laws will never be put in place, and this will have fatal consequences for people and the environment. An employee of a law firm is quoted as stating that ISDS '*can be described as a lobbying tool, in as much as all we have to say is "Okay, if you do that, we'll sue you for damages".*' This means that governments will no longer trigger legislation that '*protects national interests at the expense of foreign companies.*' '*National interests*', however, can refer to democratic or sovereign decisions that reflect the public interest in fields such as health, environment, labour and financing. In fact, even the mere threat of a lawsuit can limit a government's scope for political action – and companies know this. A former Canadian government official has pointed out that letters usually arrive from US law firms as soon as the Canadian government considers new environmental regulations. Most planned environmental legislation, he argues, is never adopted. This same effect, which was also observed in El Salvador, is referred to as '*regulatory chill*'. Simply threatening to take a country to court can block legal proposals, including better water regulations or permanent bans on the extraction of metallic raw materials.

Examples of legal action that has been taken in the raw materials sector

Newmont Mining versus Indonesia

In 2009, the Indonesian government adopted a new mining law: from 2014, unprocessed raw materials were no longer to be exported; instead, they were to be processed in Indonesian factories, smelting works and refineries. Thus, a larger part of the value chain would remain in the country – essentially, a promotion of the Indonesian economy. State investment in mining companies was also to be increased to 51 % within ten years. The corporations were given five years to adjust to the new system.

In 2014, however, the US company Newmont Mining filed a claim for compensation via its Dutch subsidiary PT Newmont Nusa Tenggara. It used a BIT between the Netherlands and Indonesia that the Indonesian government had no longer wanted to extend. In order to ensure that Newmont withdrew its lawsuit, the Indonesian government settled with an out-of-court exemption. As is often the case, the exact details of the agreement are unknown. However, Newmont is said to have negotiated a reduction in export taxes (they were to be set at between 10 % and 30 %, whereas the company will now be paying around 7.5 %).

The ISDS lawsuit enabled Newmont Mining to undermine national legislation and to gain an exception for itself. Furthermore, although Indonesia now intends to cancel the over 60 BITs that it has signed, '*zombie clauses*' mean that corporations will still be able to file law suits against the country for a further 15 to 20 years.

Piero Foresti et al. versus South Africa

In 2004, the South African government attempted to address unfair distribution and ownership structures within the mining sector with a new law: the Mineral and Petroleum Resources

Development Act. In line with the Black Economic Empowerment Act, the new law was focused on anti-discrimination measures. Black South Africans were to own up to 26 % of companies in these sectors. In addition, the South African government intended to terminate all of its existing treaties and to renegotiate company licenses. In 2006, a group of investors from Italy and Luxembourg, which jointly controlled the bulk of the South African granite industry, sued the South African state for USD 350 million. They claimed that the new law would *'unfairly'* affect them and that it amounted to *'illegal expropriation'*.

Four years later the investors dropped their case and the tribunal ordered investors to pay EUR 400,000 of South Africa's legal costs (which amounted to EUR 5 million). However, due to the pressure caused by the case, the South African government decided to accept a special agreement: instead of the planned 26 %, only 5 % of the company's shares were to be transferred to black South Africans.

Xavier Carim, who currently represents South Africa at the World Trade Organization (WTO) in Geneva, commented on the case: *'International arbitration – three individual judges – has enabled democratically implemented laws to be challenged in South Africa.'* The two BITs that the companies invoked were negotiated in the late 1990s, shortly after the end of apartheid, a time during which many of the staff in the relevant ministries had only just taken up their work. After the lawsuit, the South African government decided to terminate most of its investment agreements. Carim now advises other African states to review their existing BITs and not to sign any more at the current time. As a result of structural adjustment measures, the countries in sub-Saharan Africa are among the most liberalised in the world. A South African government study concluded that none of its BITs had led to increased foreign investment from signatory states. As such, Carim stresses that *'These agreements are not even particularly useful; at best they pose a risk.'*

The future

ISDS can restrain governments from passing laws that are in the public's interest in two ways: directly, when a company sues a state; and indirectly, when a country refrains from implementing a new law for fear of a lawsuit. As such, ISDS works in a similar manner to a risk insurance scheme for investors – albeit one that it is financed by state budgets. If investors need protection against risk, they could take private and public precautionary measures, and companies could negotiate investment contracts with relevant governments. Similarly, countries could terminate or let existing contracts expire, adapt domestic laws and ensure that all domestic legal routes have to be exhausted before cases can be heard in investor courts.

The ISDS mechanism prioritises private ownership over democratic laws that reflect the public interest. Due to the huge level of disparity in terms of the cases that are brought to court – the vast majority involve the North suing countries in the South – it is understandable that states in the Global South have repeatedly resisted the ISDS mechanism and that they continue to do so. Consequently, the EU clearly needs to abandon ISDS and ensure that ICS clauses are no longer included in its future agreements.

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