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Speech on Efficacy of Investment Treaty Arbitration

The concept of bilateral investment treaties became popular in the 1960s, as capital exporting countries started entering into investment treaties with individual capital-importing states. These treaties were aimed at the promotion and protection of foreign investment and the interests of foreign investors in host states, while also aiding development.

In 1965, the ICSID Convention on the Settlement of Investment Disputes between States and Nationals of Other States, came into existence. It put in place for the first time, a general system of compulsory arbitration for matters relating to international investments – at the instance of private actors in international economic relations.

The most innovative aspect of a bilateral investment treaty is the opportunity it provides to investors of capital exporting states to directly enforce claims in respect of investments, against the host-state in which the investments are made. Investors are also provided with a forum for dispute resolution by way of arbitration, thereby excluding the national courts of the country where the investment is made. The intention of the investor-state dispute settlement system (ISDS) is to provide a legal mechanism that encourages foreign investments, with the expectation that the investing party is protected from discriminatory practices such as expropriation by the host government. It is for this reason that the ICSID Convention has been successful – 154 nation states are parties to the Convention.

Although arbitration has become the predominant means of dispute resolution in investment treaties, the ISDS framework has become extremely controversial today, and threatens to jeopardise several trade agreements. It would be worth analysing the efficacy of investment treaty arbitration in this context.

For India, a kind of wake-up call came in 2012, in the form of an UNCITRAL award in the case of *White Industries Australia Ltd. v. India.* The claimant had won an ICC award; its efforts at enforcing it through the Indian legal system met with delay on account of jurisdictional objections. Treating the award as a debt, White Industries successfully claimed against the Indian government under the Australia-India BIT, invoking principles of international law and contending that the means of asserting claims or enforcing rights (guaranteed under the Australia-India BIT), in order to be effective could not be subjected to indefinite or undue delays. This claim was upheld in the arbitral award dated 30th November, 2011, despite a provision in the India-Australia BIT that subjected legal proceedings to the laws of the host-state, i.e., India.

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Following the 2011 Fukushima disaster in Japan, Germany decided to shut down its nuclear power industry. In response, a Swedish company with two operational nuclear plants in Germany sought compensation of approximately USD 4.7 billion under the ISDS clause in an energy treaty between Sweden and Germany, for the change in governmental policy.

Another instance of trade agreements strained by the ISDS clause is that of Ecuador, which decided to exit the ICSID in 2009, when Occidental Petroleum, an oil company was awarded USD 2.3 billion by an ICSID governed arbitral tribunal, due to the Ecuadorian government's decision to terminate an oil-concession contract. Ecuador terminated 13 of its BITs in 2013. Bolivia and Venezuela have also denounced the ICSID Convention. The Australian Government (prior to the 2014 elections) had announced the discontinuance of investor state dispute settlement with developing countries. South Africa has also given notice of termination of its BITs with Germany, the Netherlands, Spain and Switzerland.

In 2015 and 2016, the negotiation of the Trans Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TIPP) attracted severe opposition from legal scholars as well as public stakeholders like healthcare providers and environmental activists, to the inclusion of the investor-state dispute settlement (ISDS) clause.[1] The ISDS clause was viewed as a threat to the rule of law and national sovereignty, as it grants foreign corporations the right to initiate proceedings against a government for violation of loosely defined investor rights, and allows them to seek damages for lost profits. The ISDS is a mechanism that can therefore be used to challenge government policies, actions or decisions that corporations allege, reduce the value of their investments.

National legal systems are designed to allow corporations to sue the government for harm caused to their business interests, with checks and balances. These include rules on court procedures and evidence, which aid in ensuring the fairness, legitimacy and reliability of proceedings; rules on who may bring lawsuits and under what circumstances, which aid in balancing the right to sue with the need to ensure that government regulation in the public interest is not made impossible due to unlimited litigation; rules on the power of courts, appropriate remedies, punishment, and compensation; and rules on the independence and accountability of judges who decide cases against the government.

[1]https://www.citizen.org/wp-content/uploads/isds-law-economics-professors-letter-sept-2016.pdf; https://isds.bilaterals.org/?open-letter-on-the-energy-charter;

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Through BITS, foreign investors have the ability to bypass robust democratic institutions that safeguard public interests. They are able to frame questions of domestic law as treaty claims, and have these ascertained by a panel of private arbitrators, circumventing the national judicial process. Corporations can further raise arbitral claims in cases they have already lost in domestic courts. BITs lack, at times, basic safeguards provided by the judicial system. There are no mechanisms for domestic citizens or entities affected by arbitral claims, to intervene in or meaningfully participate in the disputes; there is no appeals mechanism to address errors of law or fact made in arbitral decisions; and there is no oversight or accountability of the private lawyers who serve as arbitrators, several of whom may rotate between being arbitrators and bringing cases for corporations against governments.

In recent years, corporations have challenged a wide range of environmental, health, and safety regulations, fiscal policies, bans on toxic substances, denials of permits including for toxic waste dumps, moratoria on extraction of natural resources, measures taken in response to financial crises, court decisions on issues ranging from the scope of intellectual property rights to the resolution of bankruptcy claims, policy decisions on privatizations of prisons and healthcare, and efforts to combat tax evasion, among others.

The UNCTAD's World Investment Reports for 2013 and 2014 also reiterate the deficiencies in the dispute settlement mechanism in investment treaties. In response to these challenges, the UNCTAD has recommended the introduction of an appeals mechanism, and the creation of a standing International Investment Court. It also recommended that it should be made compulsory for investors to 'exhaust local remedies' before resorting to international arbitration, and for arbitral tribunals to follow precedent and adhere to timelines for dispute resolution.

Since the first bilateral investment treaty in 1959 between Germany and Pakistan, BITs have proliferated, and will likely continue to do so in the near future as capital deficient nation states seek to attract foreign investment. However, it would be wise to remind ourselves that treaties are a mechanism designed to be negotiated, and to take into account the interests of all parties entering into the treaty. Reflecting on the practise of treaties over time, Goerg Nolte, Rapporteur of the International Law Commission, noted that:

> *"The general question of 'treaties over time' reflects the tension between the requirements of stability and change in the law of treaties. On the one hand, it is generally the purpose of the law of treaties to provide stability in the face of evolving circumstances. On the other hand, legal systems must also leave room for the*

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consideration of subsequent developments in order to ensure meaningful respect for the agreement of the parties and identification of its limits.[2]"

Accordingly, clauses in BITs must be seriously negotiated by the contracting states, in a balanced manner. The practise of negotiating and interpreting BIT clauses should take into account the absence of a level playing field between developed capital exporting nations with stupendous legal resources at hand, and developing capital importing states that might not have such access to legal resources. Channels for influencing treaty interpretation can include: careful crafting of treaties, documenting the intent of treaty parties prior to adopting treaties, using various tools (e.g. authoritative interpretations) for influencing interpretations after the investment treaty has been adopted, and, in cases where more substantial adjustments appear necessary, amendment or replacement of the treaty.

Developing countries can avoid burdensome claims by foreign investors by negotiating and drafting treaties clearly, providing evidence of state practice (such as model treaties), actively taking part in setting up frameworks for dispute settlement, and issuing joint or unilateral instruments clarifying the intent of the contracting parties. For example, some treaties – especially more recent treaties concluded by Canada, Colombia, the United States and Peru – contain mechanisms that reserve state-parties the power to make joint determinations on individual tax and prudential measures. The joint determination in the area of tax typically provides that, where the tax authorities agree that this is not the case, the investor is barred from bringing a case to dispute settlement. Some treaties establish a similar procedure for the question whether a measure is a taxation measure in the first place, and the decision of the states shall bind any tribunal. Such declarations can be a useful tool to preclude onerous arbitral claims resulting from uncertainty in the treaty.

Another significant problem with investment treaty arbitration is precedential instability. Arbitral tribunals should follow precedent while interpreting commonly used phrases in BITs, such as 'fair and equitable treatment', 'full protection and security', 'national treatment', etc.[3]

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[2] Georg Nolte, Rapporteur of the International Law Commission, 2008 Recommendation: See Annex A, 'Treaties over Time, in Particular: Subsequent Agreement and Practice'; A/63/10 International Law Commission; Page 365.

[3] For examples of awards containing inconsistent interpretations of standard clauses in BITs see – (i) Lauder vs. Czech Republic – UNCITRAL London Award 2001); CME vs. Czech Republic – Stockholm Award (2001); (ii) SGS vs. Islamic Republic of Pakistan (ICSID Case No.2003); SGS vs. Republic of Philippines (ICSID 2004); (iii) S.D. Myers Inc vs. Canada (UNCITRAL 2000): Metalclad Corporation vs. United Mexican States (ICSID 2000); (iv) Pope and Talbot Inv. Vs. Canada (UNCITRAL 2000); Suez Inter Aguas v. Argentina (ICSID 2006); (v) Suez-Vivendi v. Argentina (2006): Vladimir Berchader v. Russian Federation (2006).

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The treaty practise in this regard has been inconsistent, and the repeated arbitration of concepts that should have settled meanings, puts a strain on economic resources and the time taken for dispute resolution.

BIT claims can also have a chilling effect on vital national policy areas such as regulations concerning national debt restructuring, tailoring public health policies using legitimate flexibilities in TRIPS (such as issuance of compulsory licenses, patentability standards, disclosure norms for clinical trials, etc.). These threats are not imaginary, but stem from instances such as *Philip Morris v. Australia, Eli Lily v. Canada*, etc.

Investment treaties necessarily influence policy decisions and have a social and economic impact. A case in point is the "Cochabamba Water Wars," in which the privatization of water and sewer services in Bolivia led to social unrest, protests, deaths, and the imposition of martial law! While dispute settlement is a private mechanism, the issues being arbitrated are public in their nature. Investment treaty arbitration tribunals should consider making effective use of *amicus curiae* submissions in order to include neglected perspectives of the issues raised in arbitration, which may bridge this public/private gap.

Further, arbitral tribunals themselves must be composed more equitably to include arbitrators from developing and third world countries, as well as persons with experience in domestic legal systems. This would help increase confidence in the dispute settlement mechanism and also ensure that arbitrators are cognizant of the constraints upon governments to take policy decisions in public interest. Arbitrators from third world countries would also be more realistic in imposing damages on developing host-states that already face a severe resource crunch. Such a dynamic balancing of interests is vital to keep the investment treaty regime attractive.

In understanding the efficacy of BITs, it would be useful to note that studies on determinants of foreign direct investment (FDI) confirm that there are several factors that are far more important to investors than investment treaties, in making the decision to invest. These include market size and growth, the availability of natural resources, and the quality of hard and soft infrastructure. This helps explain why, for example, investment flows between the United States and China are high despite the absence of an investment treaty, and why Brazil has continued to be a major destination for foreign investment despite not being party to investment treaties. Similarly, it helps explain why countries that have stepped away from investment treaties do not appear to have suffered losses of FDI: South Africa announced

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several years ago that it would be terminating its BITs, and has since terminated almost all of its agreements with capital exporting states; yet it has continued to be the top African destination for FDI projects through 2016;. Indonesia announced in 2014 that it would terminate its BITs and has since terminated 27 of 53 BITs previously in force; nevertheless, in 2016, 'FDI into Indonesia by capital investment increased by 130% to $38.5 billion as a result of multiple metals, chemicals and coal, oil and natural gas projects'. India, which released a new model BIT in 2015 that was notably narrower in its protections than its previous agreements, became the leading destination for FDI in Asia. That spot was previously held by China, a country which, in contrast to India, has been expanding its BIT network and increasing the breadth and strength of its commitments in those agreements. While these examples are anecdotal, empirical evidence that BITs lead to increased foreign investment is inconclusive.

To the extent that political risk is a limiting factor that hinders foreign investment, other means are available to investors to protect themselves against some of the risks associated with investing abroad. Many risk insurers, for example, provide coverage that supports outward investment by reducing exposure to political risks. Broadly, however, it is not clear or certain that investment treaties (which effectively act as free political risk insurance and provide compensation when certain kinds of political risks materialize) address many of the conditions and limiting factors that hinder investment.

The World Economic Forum's Global Competitiveness Index, for example, considers factors such as corruption, crime, theft, tax rates and other issues that hinder investment; those factors are not specifically addressed by investment treaties. Importantly, even if there was a link between investment treaties and FDI flows, investment agreements and their protections can potentially undermine investment and its intended benefits. For one, there is evidence that the mere initiation of an ISDS claim against a country can result in a drop in FDI into that country; and, if the country loses that ISDS case, that the drop is even more significant. Thus, even if ISDS were to spur additional FDI, those positive effects might later be negated by an ISDS claim – which is easy for an investor to file – or loss of an ISDS dispute.

Another consideration is that while investment treaties may be seen as favourable by some investors, they may also reduce the host country's ability to secure ample revenues desirable for other investors and stakeholders. Wellhausen, for example, highlights that many investors use investment treaties to challenge measures that were taken by the government in order to

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raise revenues or reduce costs such as decisions to impose new taxes or terminate incentives or subsidies. 'Because sovereign bondholders ultimately care most about debt serviceability', they may be 'indifferent to – or even rewarding of' such revenue-raising or cost-reducing measures. Nevertheless, those are precisely the types of measures that have come under repeated attack through ISDS claims. BITs rules, which can reduce governments' willingness or ability to adopt new revenue raising or cost-saving policies, may ultimately make it more difficult for governments to raise funds by issuing sovereign bonds.

Overall, the available evidence is inconclusive that BITs result in higher investment flows than in the counterfactual case. Furthermore, while an investor may naturally want the strong substantive and procedural protections that an investment treaty can provide, and may therefore structure its investment so as to ensure that it is covered by a favourable investment treaty (e.g., by establishing an affiliate in a nominal "home" country, and routing its investment through that affiliate), that does not mean that the investor would not have made its investment in a particular host state, in the absence of an investment treaty or with an investment treaty that offers weaker protections. Thus, even if investment treaties and ISDS were found to influence FDI flows originating in or flowing through a particular "home" country, that does not mean that those treaties actually affect investors' decisions on whether or how much to invest in a particular host country.