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Investor-state dispute settlement: A government's dilemma

by
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Since investor-state dispute settlement (ISDS) was introduced in international investment agreements (IIAs) some 40 years ago, it has experienced five fundamental developments:

- *The number of investment disputes has risen significantly*

At the end of 2011, at least 450 treaty-based investor-state disputes were publicly known -- approximately 6.5 times more than the 67 known cases ten years earlier.

- *The nature of the disputes has changed*

Foreign investors increasingly challenge host countries' regulatory activities, such as environmental policies, energy policies, health policies, and policies related to economic crises.

- *Investment disputes are becoming more complex*

Arbitrators need to decide difficult legal issues related to, inter alia, indirect expropriations and the meaning and scope of fair and equitable treatment.

- *IIA provisions are interpreted expansively and sometimes incoherently*

Different arbitration tribunals have interpreted IIA provisions differently. There already exists a list of the most controversial or surprising investment awards.[1]

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[1] "OGEMID awards," *Transnational Dispute Management*, available at: http://www.transnational-dispute-management.com/ogemidawards/.

- *Developed countries have become defendants in ISDS*

In recent years, more developed countries have been drawn into investment disputes. As of end 2011, at least 18 developed countries had faced investment arbitration -- as compared to 55 developing countries and 16 economies in transition.

Governments face a dilemma. While many governments consider ISDS a key element of international investment protection, ISDS is becoming increasingly risky. For one, governments' risk of being sued by foreign investors is growing. Second, when a dispute arises, the defence requires enormous resources; if a case is lost, damages can be very high. Third, governments live with an unpredictable arbitration practice without having the legal safety net of an appellate body like in the WTO. Fourth, complex domestic legal issues reaching beyond international investment law are examined by international arbitrators. Fifth, as more disputes are directed against countries with highly developed domestic judicial systems, governments need to ask themselves how positive discrimination of foreign investors in respect of ISDS can be justified.

Most countries are following a "wait and see" approach, not (yet) considering it necessary significantly to change their traditional approach to ISDS. Some countries, in particular Canada and the US, have taken a more defensive approach in IIAs to preserve domestic regulatory space, mainly by clarifying treaty provisions, introducing exception clauses and limiting access to ISDS.[2] Others have taken more radical steps. For example, Bolivia, Ecuador and Venezuela denounced their ICSID memberships and have started to terminate their BITs. Australia intends no longer to include ISDS provisions in its IIAs, while Ecuador and South Africa are reviewing their BITs with the objective of renegotiation or termination.

Overall, the existing ISDS system is no longer recognized as an indispensable core part of IIAs. Discontent is not limited to a few developing countries, but has spread to G-20 countries, including some of the BRICs. Further momentum could jeopardize the ISDS system as a whole.

Reforming the ISDS system poses the difficulty that most countries are bound by a network of thousands of IIAs containing the traditional ISDS model. Successful renegotiation and the achievement of a "better" treaty are in no way guaranteed.

A careful evolution of the ISDS system requires a balanced approach that recognizes the legitimate interests of both host countries and foreign investors. Numerous reform suggestions have been made. The governments' dilemma described above could be addressed particularly through the following policy options:

Differentiate between treaty partners. Not every IIA may require ISDS provisions allowing access to international arbitration.[3] It is doubtful there is a case for international arbitration in IIAs when contracting parties share the view that all

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[2] See, e.g., 2012 US Model BIT, available at: http://www.ustr.gov/about-us/press-office/press-releases/2012/april/united-states-concludes-review-model-bilateral-inves.

[3] See, e.g., US-Australia Free Trade Agreement (2005).

countries involved have highly competent, neutral and efficient domestic judicial systems. More consideration should be given to improvements in individual countries.

Clarify the scope of individual treaty provisions. Countries may wish to reduce their exposure to ISDS by clarifying the content of specific IIA provisions, especially those that -- because of vague treaty language -- are prone to broad and inconsistent interpretation by tribunals, such as the provisions on indirect expropriation and fair and equitable treatment.

Consider an appeals mechanism. The establishment of an appeals mechanism in BITs beyond the existing annulment procedures in ICSID -- although institution-wise a challenging task -- would substantially contribute to ensuring coherent interpretations of IIA provisions, increasing legal predictability and stability and strengthening the legitimacy of ISDS.[4] In order not to lose a significant advantage of ISDS -- the relative rapidity of arbitration -- it would be important to establish time limits within which an award would have to be rendered.[5]

The growing number of ISDS cases highlights benefits and deficiencies of international investment arbitration. Governments' discontent with the functionality of the current system calls for careful reform, limiting the exposure of host countries while strengthening the rule of law and recognizing foreign investors' right to be protected.

For further information, including information regarding submitting to the *Perspectives*, please contact: Vale Columbia Center on Sustainable International Investment, Jennifer Reimer, jreimer01@gmail.com.

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[4] The US Model BIT 2012 (art. 28, para. 10) considers the setting-up of an appellate body in the future.
[5] This approach has been adopted in the WTO. See http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm.

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