

INSIDE ARBITRATION: INVESTOR-STATE DISPUTE RESOLUTION SERIES PART I - A CLOSE LOOK AT THE CONCERNS ARISING OUT OF INVESTOR-STATE DISPUTE SETTLEMENT

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Investor-state dispute settlement (**ISDS**) has historically been seen as a way of promoting foreign investment flows, depoliticizing disputes between investors and states, fostering the rule of law, and providing compensation for harm or damage suffered by investors.¹ However, the past two decades have witnessed stakeholders raising concerns about the legitimacy of the system as a whole and the decision-making process.

These concerns about ISDS have led to numerous parallel initiatives being instigated by the United Nations Commission on International Trade Law (**UNCITRAL**), the International Centre for Settlement of Investment Disputes (**ICSID**) and other arbitration groups in order to address some of the issues that have caused the so-called legitimacy crisis. These initiatives have their own scope, path, and time.

As debates continue regarding the pressing issues ISDS is facing and how the system should be reformed, investor-state tribunals have been as busy as ever. Recent data by the United Nations Conference on Trade and Development (**UNCTAD**) in its September 2021 report (**UNCTAD Report**) reveals that, consistent with the general trend for the past two decades, there was an increase in the number of investor-state cases initiated in 2020 compared with the previous year.²

In this two-part series, we examine what has caused the legitimacy crisis – recapping the concerns and challenges that the ISDS mechanism has triggered, including the path followed at ICSID. In the next issue, we will analyse what has been (or likely to be) the responses to the legitimacy crisis including possible reforms.

ISDS TRENDS: CASES ARE ON THE UP

Before delving into the alleged legitimacy crisis and its causes, it is important to make sense of where things stand with ISDS and where we are going.

The UNCTAD Report shows that 68 known ISDS cases were initiated in 2020, in line with a general growth trend since 1994.³ Of the total of new cases in 2020, 58 were registered under ICSID.⁴ However, it is important to bear in mind that the UNCTAD Report does not provide information about investor-state disputes arising from contracts or domestic investment legislation. In addition, some ISDS cases are conducted out of the public domain and may not have been picked up in the numbers recorded. As a result, the total figure reported is likely to be an underestimate.

The 68 new cases initiated in 2020 brought the total number of known ISDS cases to 1,104,⁵ which is a remarkable amount considering that the first known ISDS case was only initiated in 1987. The 2020 ISDS cases were initiated against 43 countries, with Peru and Croatia being the most frequent respondent states. This is confirmed by ICSID, in which thirty-two percent of newly registered cases involved States in South America, followed by 20% in Eastern Europe and Central Asia.⁶ While in 2020 four countries faced their first ISDS cases (Denmark, Norway, Papua New Guinea and Switzerland), the majority of new cases (approximately 75%) were brought against developing countries and transition economies. Similarly, in 2020 about 70% of investors from developed countries brought most of the cases (particularly investors from the United States, the Netherlands, and the United Kingdom).⁷ However, the UNCTAD Report identifies 124 countries and the EU as respondents to one or more ISDS claims in the past 35 years.

The ICSID statistics report a similar trend for the year 2021. In line with the UNCTAD Report, the latest ICSID Annual Report reveals that 30% of newly registered cases at ICSID involved states in Eastern Europe & Central Asia, followed by 14% in South America and Sub-Saharan Africa respectively.⁸ Comparable to previous years, from July 1, 2020, to June 30, 2021, the majority of new ICSID cases were brought under bilateral investment treaties (63%). 7% were brought under investment contracts between an investor and a host state, and 3% were commenced under the investment law of the host state. Cases brought under the Energy Charter Treaty (**ECT**) remain significant, making up 8% of ICSID's 2020 caseload.⁹

Lastly, in 2020, four known ICSID annulment proceedings were decided. With respect to these, applications for annulment were rejected in three instances, whereas only in one case the award was annulled in its entirety.¹⁰

Anyone who might expect the force of the detractors of the ISDS to have an impact on the number of ISDS cases, would be mistaken. At the same time, it could be argued that precisely because there is increased recourse to ISDS, this has stoked the flames of discontent.

WHAT HAS TRIGGERED THE SO-CALLED “LEGITIMACY CRISIS” OF ISDS?

Criticisms against the ISDS system began at least at the turn of the century, when external commentators started critiquing the lack of transparency of ISDS – in light of the confidential nature of the proceedings and decisions. In a 2001 article in the New York Times, arbitral tribunals constituted under the North American Free Trade Agreement (NAFTA) were described as follows:

“ [t]heir meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a small number of international tribunals handles disputes between investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations challenged.”¹¹

The concern with the lack of transparency and decisions taken “behind closed doors” was picked up by NGOs and academics in the subsequent years. By 2005, academics were already referring to the “Legitimacy Crisis in Investment Treaty Arbitration”.¹² But in addition to transparency concerns, the issues now being raised included inconsistent decisions that could not be “appealed” except on very limited grounds.¹³ According to commentators, the inconsistency of decisions was particularly problematic given that many ISDS decisions were deciding and interpreting substantive investment rights, such as fair and equitable treatment (FET), for the first time.¹⁴

Amidst the concerns raised on the ISDS system, governments such as Venezuela, Bolivia and Ecuador—who were on the receiving end of awards—sought to partially abandon the system. In 2007, Bolivia denounced the ICSID Convention, thus becoming the first country in history to withdraw from the ICSID Convention. After Bolivia’s denunciation, Ecuador and Venezuela followed suit and denounced the ICSID Convention in 2009 and 2012 respectively (although Ecuador has recently re-joined the ICSID Convention). At the time, the leaders of these countries heavily criticised the system, pointing not only to its secrecy, but also describing the system as protecting multinationals at the expense of foreign states. In effect, when Bolivia denounced ICSID, the Bolivian President Evo Morales called upon Latin American countries to also withdraw from ICSID,¹⁵ and was quoted by the Washington Post stating: “(we) emphatically reject the legal, media and diplomatic pressure of some multinationals that ... resist the sovereign rulings of countries, making threats and initiating suits in international arbitration”.¹⁶ Venezuela took a similar stance when it denounced ICSID in 2012, and the Venezuelan Foreign Ministry’s 2012 press release erroneously claimed that ICSID tribunals had “ruled 232 times in favour of transnational interests out of the 234 cases filed throughout its history.”¹⁷

Another, albeit different, “legitimacy crisis” developed in Europe in around the same time. On 7 December 2012, the arbitral tribunal in the case *Achmea B.V. v. The Slovak Republic* issued its final award finding that the Slovak Republic had violated the Netherlands-Slovakia BIT¹⁸ and ordered Slovakia to pay 22 million Euros in damages.¹⁹ The claim was based on the reversal of the liberalization of Slovakia’s health insurance sector, which Achmea claimed had constituted an unlawful indirect expropriation of its investment. Slovakia challenged both the merits of the claim and the jurisdiction of the arbitral tribunal, claiming that Slovakia’s accession to the EU in May 2004 had terminated the Netherlands-Slovakia BIT, or in any event, rendered its arbitration clause inapplicable.²⁰ After the tribunal’s rejection of Slovakia’s arguments, Slovakia challenged the award before the German courts (the courts of the seat of the arbitration). While the Higher Regional Court of Frankfurt rejected Slovakia’s arguments,²¹ the German Federal Court of Justice on appeal referred the question of the compatibility with the EU to the Court of Justice of the European Union (**CJEU**).²²

In March 2018, the CJEU ruled that the arbitration clause contained in the Netherlands-Slovakia BIT had an adverse effect on the autonomy of EU law, and was therefore incompatible with EU law.²³

The CJEU’s ruling was a landmark decision, not least because it established the first precedent with respect to the incompatibility between EU law and protections contained in intra-EU BITs. The issue of the compatibility between EU law and investor protections were not only relevant to the Achmea case but also applied to a number of other ISDS cases, including *Micula v Romania*²⁴ (relating to the incompatibility of EU law with certain economic incentives introduced by Romania before acceding to the EU), as well as several cases brought against Spain and Italy. As a result of the CJEU judgment, in January 2019, several EU Member States declared their commitment to terminate their intra-EU BITs.²⁵ On 5 May 2020, 23 EU Member States signed the Agreement for Termination of all Intra-EU Bilateral Investment Treaties.²⁶

The events in Europe and Latin America, coupled with the growing discontent of the ISDS among its stakeholders, raised further concerns: (i) perceived limited mechanisms (annulment and enforcement proceedings) against awards; (ii) third-party funding, which has come a long way in ISDS, raising questions of transparency given the potential for conflicts of interest arising from relationships between arbitrators and funders if not opportunely disclosed; (iii) the potential lack of independence and impartiality of arbitrators as “issue conflict” became a sub-topic in the realm of whether it was fair that an arbitrator candidate might have a certain predisposition to investor or state arguments; (iv) the lack of diversity in the appointment of arbitrators; (v) interference with the state’s right to regulate issues related to human rights, environment, national security issues, etc. – with some tribunals going so far as to decide that a state’s right to regulate is limited by investor-state treaties; and (vi) the perceived expansion of the scope of the interpretation by tribunals of the standard of Fair and Equitable Treatment, among others.

At a macro-economic level, there has also been a curious convergence of concerns between capital importing countries and capital exporting countries. Previously, the latter would prefer to support ISDS as a means of supporting their national investors facing legal challenges abroad. However, as capital exporting countries themselves became the targets of multiple claims, often for changes those countries felt were normal regulatory advances, they too joined the calls for change.

Against this background, the stakeholders did not sit idly by. On the contrary, initiatives were generated to discuss these challenges and possible reforms to the system – which we will focus on in Part II of this series.

ICSID - OWN CHALLENGES, OWN PATH

The legitimacy crisis can best be described as split in two halves. One is substantive – how international law should be interpreted, in order to hold sovereign states accountable for their conduct before ad hoc tribunals. The other is procedural – how should any such disputes be resolved, bearing in mind the adage that justice must not only be done but be seen to be done.

When Bolivia, Venezuela and Ecuador denounced the ICSID Convention, the criticism was that they were shooting the messenger. The expressed purpose of the ICSID system has been, just like ISDS, to encourage, maintain, and expand private sector investment abroad by offering a procedure to resolve disputes that could arise in the course of the investment, contributing to the “confidence” between the home States and foreign investors.²⁷ This is not an investor-only purpose, and was originally designed to offer legitimacy and depoliticize disputes for the benefit of sovereign states.

However, in recent years, this rationale has arguably been “obscured” due to the ongoing general debate on ISDS.²⁸ ICSID has not been a stranger to the discussions over concerns about ISDS. Nevertheless, while there are areas of overlap between the issues that are being addressed more globally and ICSID, they are distinct conversations with their own objectives and timeframes.”²⁹ In effect, discussions about the challenges posed by ICSID are not new: over the years, debates and consultations over their application have led to amendments to the ICSID Regulations and Rules and the Additional Facility Rules since 1970.³⁰ This responds to the ICSID’s willingness, as mentioned by its Secretary-General, “*to make sure that it remains fit for purpose*”.³¹

The most comprehensive debate over concerns and challenges presented by the ICSID rules has been taking place since 2016. The formal discussions were triggered in October 2016 during the 50th Annual Meeting of the Administrative Council of ICSID. ICSID Member States were advised of ICSID's intention to launch consultations in 2017 on potential amendments to its sets of rules and regulations.³² For such purpose, ICSID invited States and the public to suggest topics to be considered as part of a potential rule amendment process – and similar invitations were sent in the following years. Therefore, not only States have had the opportunity to express their views as to the challenges that the ICSID rules were posing, but also international organizations, academics, law firms, sole practitioners, among others. This turned out to be a very transparent process, with feedback encouraged from all interested stakeholders.³³

The ICSID Secretariat received several detailed comments pointing out different topics of concern: the question of whether to disclose third-party funding; the perceived lack of transparency, especially considering that ICSID disputes touch upon issues that are relevant to the general public; the alleged lack of compliance with ICSID awards by states; the concern over the duration of the proceedings, including the procedural delays in rendering awards, among others.

After discussions with Member States and stakeholders, ICSID is very close to approving a reform – which we will analyse in the next edition of Inside Arbitration.

CONCERNS AND CHALLENGES - AND WHAT'S NEXT?

In the next edition of Inside Arbitration we will look at what is being done to address these various concerns – and in particular, what is being proposed both at a substantive and procedural level by the various stakeholders.

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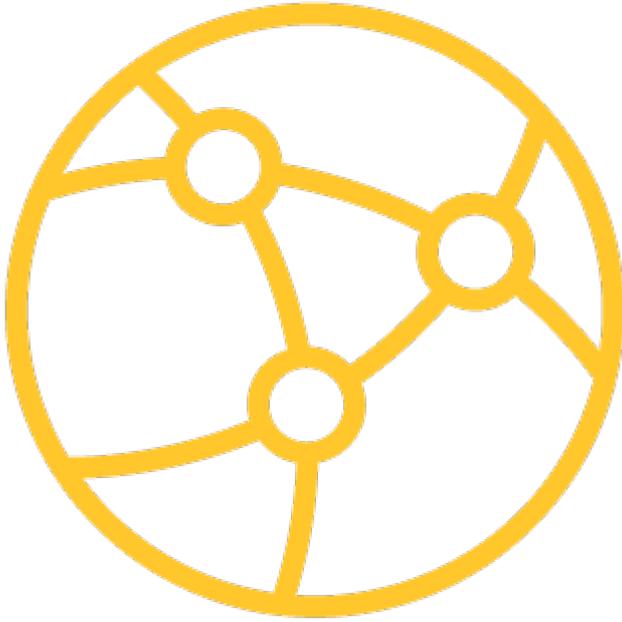
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