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## INVESTMENT TREATY ARBITRATION AND ITS FUTURE – IF ANY

By  
Kaj Hobér

### 1. Introduction

Stated in general terms, the property of foreigners have, since at least the early twentieth century enjoyed protection under international law from unacceptable measures of the host State. While the scope and contents of the rules and principles of international law in this respect were unclear, these rules and principles were collectively referred to as the “international minimum standard.”

Today, the debate and development of international investment law is, to a very large extent, based on investment protection treaties, in particular on so-called “bilateral investment protection treaties” (BITs). The first BIT was entered into in 1959 between Germany and Pakistan. Today there are approximately 3000 BITs. The vast majority of them have clauses providing for so-called “investor-state arbitration,” also referred to as investment treaty arbitration. This means that BITs entitle investors to commence arbitration against the host state, even though the investor is not a party to the BIT. The BIT is entered into between the two States in question. By operation of the BIT, the investor obtains a derivative right to initiate arbitration. In this way BITs create an international forum for investors, not available under customary international law.

In addition to the BITs, there are a number of multilateral investment protection treaties, for example: the Energy Charter Treaty (ECT) and the North American Free Trade Agreement (NAFTA). They also have arbitration clauses providing for investor state arbitration.

During the last 15-20 years we have witnessed a virtual explosion of investment treaty arbitration, with somewhere between 500-600 decided and pending cases as of today. The most frequently used arbitration regime is the International Center for Settlement of Investment Disputes (ICSID) Convention and the ICSID Arbitration Rules, based on the 1965 Washington Convention on the Settlement of Investment Disputes between States and Nationals of other States. Other frequently used arbitration rules include the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules and the Arbitration Rules of the Stockholm Chamber of Commerce.

The heart and soul of every investment protection treaty is protection against expropriation, which represents the most severe form of governmental interference with the property and property rights of foreign investors. Under international law it is now generally accepted that States have the right to expropriate foreign property, but only under certain conditions. One of these conditions is that the investor be paid compensation for the expropriated property. In many, if not most, investment treaty arbitrations, the amount of compensation for an alleged expropriation is one of the disputed issues.

In addition to protection against expropriation, most investment protection treaties provide for other standards of protection, such as: fair and equitable treatment, national treatment, and most favoured nation treatment.

Today, fair and equitable treatment is the most frequently relied upon standard of protection. While protection against expropriation is at the center of all investment protection treaties, the

fair and equitable treatment standard is, from a practical point of view, the more relevant standard. The majority of successful claims in investment treaty arbitrations are based on the fair and equitable standard.

While many investment protection treaties cover more or less the same issues and have similar clauses, it is important to keep in mind that the clauses are seldom identical. When there is a dispute, relevant clauses must be interpreted. This is done on the basis of the Vienna Convention on the Law of Treaties. The basic rule of interpretation is that a treaty must be interpreted in good faith which means it must be interpreted in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of the object and purpose of the treaty. Investment protection treaties are thus interpreted like any other treaty, with due account taken of the object and purpose of such treaties.

Another important aspect of investment-treaty arbitration, is the extent to which the host State is responsible for the acts and omissions of its organs. As a rule of thumb, the State is responsible for all its organs, including territorial units, provinces, and municipalities. A threshold question is often to ascertain whether certain conduct is attributable to the State. Such issues are addressed by the so-called rules of attribution in customary international law. These rules have been codified in the Articles of State Responsibility prepared by the International Law Commission.

## **2. Investment Treaty Arbitration**

As mentioned above, the majority of investment protection treaties have arbitration clauses providing for investor-state arbitration. Such arbitrations may take place under the auspices of a variety of arbitration institutions and rules. As also mentioned above, the most frequently used rules are the ICSID Arbitration Rules.

Recognition and enforcement of ICSID awards are handled within the framework of the self-contained system based on the ICSID Convention. Other investment treaty awards are recognized and enforced pursuant to the provisions of the 1958 New York Convention, or other similar arrangements.

It should be noted that neither the ICSID Convention nor the New York Convention deal with questions of State immunity. In fact, there is no generally applicable international convention in force which deals comprehensively with state immunity. Issues concerning state immunity arising at the enforcement and execution stages are therefore dealt with on the basis of municipal law and customary international law.

By and large, the system of investment treaty arbitration has been a success. At any given point in time, there are literally hundreds of investment arbitrations pending - albeit in different stages of progress - at the leading arbitration centres of the world, including ICSID, Stockholm, Paris, London and The Hague, under the ICSID Arbitration Rules, the UNCITRAL Arbitration Rules, or the SCC Rules. Investment treaty arbitration is now an everyday occurrence; whereas, in the past it was regarded as an extraordinary measure.

The success of investment treaty arbitration is to a large degree explained by the fact that this form of arbitration is very attractive for the foreign investor, certainly if compared to the alternative of going to local courts in the host State. Investment treaty arbitration is also in the

interest of host States, since the possibility to go to arbitration against the host State tends to encourage businessmen to make foreign investments. Most host States are typically interested in attracting foreign investment. Another important aspect of investment treaty arbitration is that this form of dispute settlement tends to de-politicize investment disputes, at least compared to the previously existing alternative of diplomatic protection, which required the involvement of the governments of the investor's home State and the host State, respectively.

Despite the success of investment treaty arbitration, critical voices have been raised. They have mostly come from some host States and NGOs. These critical voices have led some commentators to question the future of investment treaty arbitration. To answer the question whether investment arbitration has a future, it is necessary to take a closer look at the criticisms raised. Broadly speaking, they fall into two categories: (i) criticism relating to the system, as such, *i.e.* is it necessary and/or appropriate, or desirable at all, to provide for investment treaty arbitration?; (ii) criticism with respect to specific aspects of the existing system of investment treaty arbitration, *e.g.* transparency. I will look at these two categories in turn.

### **3. Criticisms of the system**

#### **3.1 Developments within the European Union**

Investment treaty arbitration has recently been questioned within the European Union. When the Lisbon Treaty entered into force in December 2009, the power to conclude BITs was transferred from EU member States to the EU itself, at least with respect to foreign direct investment. In draft regulations prepared by the European Commission, it was proposed that the Commission be given the authority during a five year period to force the termination, or renegotiation, of existing BITs, provided that the BITs, in the view of the Commission, were incompatible, or overlapped, with EU law, agreements, and policy. The Commission has asked EU member States to explain if they would agree to the termination of intra-EU BITs. In the view of the Commission, such BITs are unnecessary given the availability of EU remedies to solve investment disputes. The majority of EU member States seem to be of the view that intra-EU BITs are still necessary. It is interesting to note that in May 2010, the European Union Parliament voted to limit the proposed authority of the Commission to amend, review, and terminate existing EU member States' BITs both with each other and with non-EU parties. Only those BITs which constitute a serious obstacle to future EU-wide treaties can be reviewed by the Commission.

The origin of the problem is most likely to be found in the fact that when the Berlin Wall came down, many Central and East European States concluded a large number of BITs, including with members of the EU. Subsequently, these countries applied for membership in the EU. Apparently, however, during the accession negotiations the legal and practical consequences of these BITs were not dealt with. This has resulted in a complex legal situation raising many issues, including the approach of the EU, its institutions, and the EU legal order to public international law.

The approach taken by the Commission, so far, with respect intra-EU BITs can be summarized as follows: BITs between member States concern legal issues which are also covered by EU law. Some of the BITs may be incompatible with EU law, in particular since they could result in discrimination among EU investors. In addition, they provide for binding investor-state arbitration which is not subject to review by the European Court of Justice on

issues concerning the interpretation of EU law. That is why member states have been requested to terminate intra-EU BITs.

As far as extra-EU investment protection treaties are concerned, the Commission is now negotiating such treaties on behalf of member States, including the controversial TTIP (Transatlantic Trade and Investment Partnership), between the US and the EU, with respect to which investor-state arbitration has become a political football.

If the approach suggested by the Commission were to prevail, this would bring about radical changes to the system of investment treaty arbitration as far as EU member States are concerned. If and when that happens, the map of investment arbitration will undoubtedly be redrawn, but investment treaty arbitrations will not, it is submitted, disappear. In this context, it is noteworthy that the EU, as an entity, has ratified the ECT and is thus bound by its provisions, including the arbitration clauses providing, inter alia, for investor-state arbitration.

### 3.2 A skewed system

Another criticism raised is that the system of investment protection and investment treaty arbitration works only in favour of investors, without taking due account of the interests of the host State. The fact of the matter, however, is that the number of BITs has been growing for the last decade, and continues to grow. Presumably, therefore, host States take the view that some benefits follow from investment protection treaties, be they bilateral or multilateral. From a legal point of view, BITs do provide a clear and reliable framework for protecting foreign investments. Among economists, views are divided as to the extent to which BITs actually have any effect at all on the volume of foreign investments. Several commentators have questioned whether there is any empirical data supporting the assumption - and the hope - that investment protection treaties do indeed increase the volume of foreign investment. For the purposes of this contribution, it is really irrelevant if that is the case or not. Most States apparently take the view that they benefit from BITs; that is why they continue to negotiate and sign them.

It has also been suggested that host States usually are on the losing side in investment disputes. Some States, particularly in Latin America, but also other States, have been unhappy with their roles as respondents in arbitrations. They have, therefore, taken measures to distance themselves from investment treaty arbitrations, or at least limit their exposure to investment treaty arbitration. This has led some States to denunciate the ICSID Convention pursuant to Article 71 and/or to terminate BITs. The number of States having taken such measures is small. In addition, both the ICSID Convention and most BITs provide for transitional periods, or have so-called sunset provisions, meaning that the treaty will continue in force for a specified number of years following termination.

As far as decided cases are concerned, the fact is that there is no evidence of any bias in favour of investors. On the contrary, host States have, in general, done well, in the sense that they have probably won as many cases as they have lost. Investors sometimes fail to meet the jurisdictional requirements of BITs. In addition, they often fail to convince arbitral tribunals that the investment has been expropriated, or that it has been subject to unfair and inequitable treatment.

For investors it is clearly of critical importance to have access to the dispute settlement mechanisms provided in BITs and multilateral treaties. This is perhaps the most important

aspect of BITs, i.e. that they provide a neutral forum for the resolution of disputes, mostly in the form of international arbitration. As mentioned above, foreign investments have always enjoyed protection under customary international law. Prior to the BIT era, however, the foreign investor did not have access to a neutral forum. The traditional method then was to use diplomatic channels, typically by asking the home State to exercise diplomatic protection, its *ius protectionis*. It is probably fair to assume that most host States also welcome the arbitration mechanism in most BITs. This way they can escape the economic and political pressures often exercised by powerful home States of foreign investors within the framework of diplomatic protection. On balance, it would seem therefore that the system of investment treaty arbitration has well served the interests of host States, as well as of investors.

### 3.3. Sovereignty undermined

A third aspect, with respect to which critical voices have been raised, is that of sovereignty. The argument is that BITs impose restrictions on, and indeed undermine, the sovereignty of the host State by preventing it from implementing its policies in various areas, such as, health and environment. It is, of course, correct that a BIT constitutes a limitation on the sovereignty of the host State, in the sense that it is bound by the undertakings in the BIT, as it is by the undertakings in any other treaty. That is indeed the whole purpose of the BIT and, in fact, of most treaties. This consequence is not unique to investment-protection treaties. One of the hallmarks of sovereignty is that a State must be sovereign enough to agree to certain limitations of its sovereignty. One of the cornerstones of international law is that a state cannot rely on its internal, national law to avoid its obligations under international law. This follows, inter alia, from Article 27 of the Vienna Convention and Article 32 of the ILC Articles on State Responsibility. This could mean, for example, that a democratically elected parliament may not have unfettered freedom with respect to its legislative activities, since the international obligations of the State in question may result in certain restrictions.

The advocates of this argument fear that arbitral tribunals will interfere with the formulation and implementation of government policies. As the saying goes, however, “the proof of the pudding is in the eating.” Even though environmental and health regulations have been tried by several arbitral tribunals in investment treaty arbitrations, it is submitted that there are few examples of where they have unduly interfered with governmental measures. On the whole, it would seem that arbitral tribunals have taken a balanced approach to such questions.

## 4. Criticism of specific aspects of investment arbitration

### 4.1. Transparency

One aspect which has been identified as a problem with investment treaty arbitration is the lack of transparency. Confidentiality and secrecy are traditional hallmarks of international commercial arbitration. Parties often chose arbitration because of its confidential character. When States are involved, however, the situation is different. The issues involved are almost always of a public nature, as well as of a public interest. As a consequence, public funds, *i.e.* taxpayers' money, are also involved. Against this background, it is not surprising that there have been demands from politicians, public interest groups, and NGOs for greater openness and transparency in investment treaty arbitration. Approximately ten years ago an article in the New York Times described investment arbitration in the following way:

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

It is clear that ten years ago lack of transparency was perceived as a problem in investment arbitration. Complaints were raised primarily in three respects, *viz.*: (i) the confidentiality prevented the public from obtaining both information about the arbitration and access to documentation in the arbitration; (ii) impossibility for third parties to attend and/or become involved in the arbitration; and, (iii) publication of arbitral awards.

During the last decade, developments have taken place in all three respects, especially as regards ICSID arbitrations. In the new ICSID Arbitration Rules it is clear that transparency is beginning to outweigh privacy and confidentiality. For example, the parties are encouraged to allow the award to be published. Even if the parties do not consent to publication, ICSID will publish excerpts of the legal reasoning in the award. The new ICSID rules also authorise the tribunal to allow non-disputing parties to file written submissions. In NAFTA arbitrations submissions, orders, and awards are available on the internet.

In the summer of 2010, the question of transparency in treaty-based investment arbitrations was put on the agenda of UNCITRAL. Working Group II (Arbitration and Conciliation) was entrusted with the task of preparing a legal standard concerning transparency. The ultimate purpose of such rules was said to be to ensure transparency with a view to enhancing the legitimacy of and fostering the public interest inherent in investment treaty arbitration, while at the same time taking account of the parties' interest in a fair and efficient resolution of their dispute. This work was completed in December 2013 with the adoption of the UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration. The rules address different aspects of transparency, including: information about the commencement of an arbitration, publication of documents, filing of briefs by third parties, open hearings and publication of awards. The rules are applicable to arbitrations based on a treaty concluded on or after 1 April 2014, unless the parties to the treaty have agreed otherwise. In addition to the Rules, UNCITRAL also prepared a convention on transparency: The United Nations Convention on Transparency in Treaty-Based Investor State Arbitration. It was adopted on 10 December 2014 by the General Assembly, and enters into force when three States have ratified it, or otherwise accepted, approved, or acceded to it. The Convention is intended to apply to treaties concluded prior to 1 April 2014, and thus, in this way supplements the Rules.

As the work of UNCITRAL shows, it is clear that transparency issues are being addressed, and dealt with, in such a way that these issues are no longer viewed as a significant problem in investment treaty arbitration. In fact, if the provisions in the UNCITRAL Rules and the UN Convention are observed, investment treaty arbitration is more transparent than court proceedings in many countries.

#### 4.2 Inconsistency of awards

One issue which remains a problem, however, is the perceived unpredictability and inconsistency of investment awards. In fact, this should not come as a surprise. Arbitral awards based on treaties are rendered within the framework of public international law, which is a decentralised and non-hierarchic system of law. There is no principle of binding

precedent, *stare decisis*, in public international law, nor, for that matter in international arbitration in general. The traditional ball-and-chain with respect to international commercial arbitration has been - and to a large extent continues to be - that arbitral awards are kept confidential, and thus not published. Not so with respect to investment awards. Such awards are today, to a large extent, published or to be more precise, sooner or later they reach the public domain, with or without the consent of the parties. It is therefore possible to observe that there are in fact discrepancies and inconsistencies in the practice of investment tribunals. Some decisions seem to deviate from rules and principles which are perceived as established. While the awards seem to be getting longer and longer, they are not necessarily getting clearer and clearer. Lack of coherence and consistency sooner or later results in unpredictability and uncertainty. For many years now this has been a matter of concern. Various solutions have been discussed.

One suggestion has been to establish some form of appeals procedure based on the investment protection treaty in question, be it a BIT or a multilateral treaty. In fact, at one point, ICSID prepared a draft proposal envisaging the establishment of an appeals facility at ICSID. Nothing ever came of this proposal, one reason being that it would have required amendments to the ICSID Convention. An appeals procedure would of course run counter to one of the fundamental principles of arbitration, *i.e.* that arbitral awards cannot be retried on the merits. Also, in addition to the many practical, as well as legal and technical, problems that would need to be resolved, it is doubtful that an appeals mechanism would solve the problems of inconsistency and unpredictability given the decentralized and non-hierarchical nature of public international law. Simply put: what do you do if the appeals tribunal gets it wrong?

Another idea that has been discussed is the introduction of a system of preliminary rulings to be issued by a separate body, or organisation, established for this purpose. This idea has been inspired by the system of preliminary rulings applied in European Community Law where the European Court of Justice has the authority to issue such rulings at the request of domestic courts with a view to ensuring the uniform application of European law. Such a system would avoid the problem of reviewing arbitral awards on the merits, since the preliminary ruling would be issued prior to the rendering of the award. A system of preliminary rulings would require suspension of the arbitration proceedings awaiting the preliminary ruling. Such a system would also require agreement on the establishment and the composition of the separate body authorised to issue the preliminary rulings.

A third possible solution to the problem of inconsistent awards is the creation of a permanent investment arbitration court. For such a system to work it would, in practice, be necessary to create a multilateral treaty establishing the permanent investment court and defining its competence.

All these possible solutions have their *pros* and *cons*. The overarching problem, however, is that they all require amendments to, and changes of, existing investment protection treaties, as well as the creation of the new treaties. For this reason alone it is submitted that these suggestions are, from a practical point of view, unrealistic, at least for the foreseeable future.

Against this background, and given the fact that there is no principle of binding precedent in public international law, it is submitted that the way ahead is through the gradual development of arbitral case law. This process will take time but could be assisted and facilitated by relevant and responsible scholarly analysis of rendered awards.



## **5. Concluding remarks**

It is submitted that the answer to the question in the title is clearly 'yes.' Investment treaty arbitration does have a future. Despite the shortcomings that have been mentioned above, investment treaty arbitration has, on the whole, been a success. No system is perfect. There is room for refinement and improvement also of investment treaty arbitration. During the last decade a number of the shortcomings have indeed been addressed and remedied. It is reasonable to assume that this has been done - at least partially - based on the realisation that investment treaty arbitration is the most efficient and reliable dispute settlement mechanism for disputes between foreign investors and host States. There is simply no better, realistic alternative.