
Kluwer Arbitration Blog

Arbitration: An Effective Tool for Resolving Investor-State Disputes in the Extractive Industries?

Naomi Lisney (Herbert Smith Freehills LLP) · Tuesday, December 24th, 2013 · Herbert Smith Freehills

London-based think-tank Chatham House is predicting an increase in the number of arbitrations between governments and companies in the extractive industries. Commercial stakes being particularly high in this sector, companies generally seek to resolve disputes with a host state through negotiation, viewing arbitration as the method of last resort. Yet Chatham House believes that there are a number of key drivers which will force more and more disputes regarding natural resources off the negotiating table and into a formal arena. What are these drivers, and do they simply influence the likelihood of disputes in the extractive industries escalating to arbitration, or are there wider implications for investor-state dispute resolution more generally?

International arbitration clauses have become commonplace in investment contracts and the number of bilateral investment treaties (BITs) has increased dramatically (from fewer than 500 in 1990 to more than 2,500 today). However, the more widespread availability of the option to arbitrate against a host government in itself does not explain the sharp rise in international arbitration cases involving governments and companies in the extractive industries. Indeed, companies generally want to minimise the risk of being removed from projects in which they have made considerable investments, and will only resort to arbitration where there has been an irretrievable breakdown of the relationship, according to a recent Chatham House report (available [here](#)).

Chatham House identifies in this report sets of key drivers for host country-company disputes in the extractive industries, namely resource nationalism, tensions with local communities, environmental impacts, and liability and due diligence issues. “Resource nationalism” is a popular concept generally used to refer to moves by producer countries to gain greater control of their country’s resources. As further explained in the report, rather than necessarily being the source of a dispute, a resource-nationalist orientation can make existing tensions more difficult to resolve. Where resource nationalism becomes a driver for, or a public interest issue behind, a dispute, a negotiated outcome may be nigh on impossible.

Centerra Gold’s on-going dispute with Kyrgyzstan in respect of the Kumtor mine is a

case on point. A series of protests and riots over the last year have put pressure on the parties to renegotiate an investment deal struck 10 years ago, under the previous government. Both sides worked out a new deal in September, with the government agreeing to swap its 32.7% stake in the company for a 50% stake in a new joint venture. The Kyrgyz parliament, however, rejected this agreement and asked the government to continue negotiating with Centerra to increase the country's stake to 67%. The government was given until 23 December 2013 to report on its talks with Centerra, against a backdrop of calls from the opposition for nationalisation of the gold mine.

Environmental issues are also frequent sources of tension in the mining sector in particular, with companies facing protests not only from local communities, but also stakeholders at home. Canadian organizations including MiningWatch Canada, Common Frontiers, Sierra Club Canada, Comité pour les droits humains en Amérique latine (CDHAL), the Council of Canadians and the United Steelworkers (USW) have called on Infinito Gold to drop its ICSID arbitration against the government of Costa Rica for making illegal its open-pit mine in the northern region of Crucitas. In a letter dated 10 October 2013, they criticize what they call "secretive investment arbitration" ICSID proceedings and refer to Infinito Gold's arbitration claim as "an attempt to intimidate the people, court system and government of Costa Rica over their rightful decision not to approve the controversial Crucitas gold mine".

In circumstances where a negotiated resolution of a dispute has become politically impossible to achieve, companies in the extractive industries may seek to enforce their rights and recover their losses by bringing an arbitration claim against the host government, whether contractually or under a BIT. However, the drivers identified by Chatham House do not fall away once a formal dispute resolution process has begun.

Drivers such as public interest, human rights and the environment are also front and centre amongst the current key issues in investor-state dispute settlement, from the drafting of investor-state dispute resolution provisions right through to the arbitral process itself. Legislators drafting new BITs and negotiators involved in agreeing stabilisation clauses are increasingly seeking to protect a state's right to change local rules and regulations to "protect the public interest" in more explicit terms. Indeed, the Fact Sheet on Investment Protection and Investor-to-State Dispute Settlement in EU agreements recently published by the European Commission stresses that, when the state is protecting the public interest in a non-discriminatory way, the right of the state to regulate should prevail over the economic impact of those measures on the investor. This reflects Principle 9 of the UN Guiding Principles on Business and Human Rights, which refers to the need for states to maintain "adequate policy space" to meet their human rights obligations.

In respect of the arbitral process itself, the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (the transparency rules) will come into force on 1 April 2014. The transparency rules make documents available to the public, provide access to hearings and allow interested parties (such as environmental NGOs) to make submissions. Future treaties referring disputes to the UNCITRAL Arbitration Rules will be subject to these rules unless the parties agree otherwise, but the rules are also available for use in other investor-state arbitrations.

Nor is the drive for transparency limited to the procedural level. The perceived neutrality of arbitrators in investor-state arbitrations continues to loom large on the radar, highlighted once more by the recent decision (available [here](#)) by World Bank president Jim Yong Kim to sustain a challenge by Venezuela against Spanish arbitrator José Maria Alonso. Kim found that the facts indicated a “manifest lack” of one of the qualities required in an arbitrator, in circumstances where “a third party would find an evident or obvious appearance of lack of impartiality on a reasonable evaluation of the facts in this case”.

Companies involved in investment arbitration in the extractive industries (and indeed beyond) are likely to find that the drivers which have precipitated the arbitral process will remain drivers throughout the dispute settlement process itself. Heightened tensions with local communities bring with them accompanying reputational and commercial risk, while increasing the likelihood of NGO involvement in the arbitral process. Arbitrators may even feel entitled or required to consider these drivers in their deliberations as proceedings become ever more transparent.

The current social and political attitudes towards companies in the extractive industries, mirrored in trends in investor-state dispute settlement, present challenges for those in the sector. Yet, it would be wrong to see the drivers for environmental or human rights protection as purely one-way. Companies are not only concerned with enforcing their contractual rights. They also recognise the need to maintain their “social licence to operate” with local communities, and are coming under increasing pressure from their shareholders, other stakeholders and the international community more widely to protect human rights and the environment.

Many talk of the current “legitimacy crisis” for investor-state dispute settlement, in particular, the concern that the system can be abused to prevent countries from making legitimate policy choices. The current efforts to introduce greater transparency in the arbitral system and to rebalance investor protections and governments’ ability to address legitimate policy concerns are directly aimed at restoring that legitimacy.

Companies in the extractive industries will still prefer a negotiated outcome to a dispute. However, in circumstances where such an outcome will not always be possible, it is to be hoped that current efforts in the industry will, in time, lead to greater trust by the general public in investor-state arbitration as a fair and independent mechanism for the settlement of investor-state disputes. This may enable companies to continue to use the threat of arbitration as an effective bargaining tool in their negotiations with host countries and effectively protect their investments through arbitration where necessary.

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