Developing Country Opposition to an Investment Court: Could State-State Dispute Settlement be an Alternative?

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The Comprehensive Economic and Trade Agreement (CETA) made waves in a post-Trump era of hostility towards free trade. But not all press is good press and CETA's investor–state dispute settlement (ISDS) mechanism has come under fire.

While all chapters of the CETA entered into force at midnight on September 21, 2017, one didn't: the controversial Investment Court System (ICS). After concluding CETA, Canada and the EU vowed to "work expeditiously" to create a permanent investment court, and certain issues arose during the exploratory discussions hosted in December 2016. This would mean a leap from the current regime of *ad hoc* investor–state arbitration included in around 3200 investment treaties in force today towards a WTO-like multilateral system. Such a radical shift signifies turbulent times for developing economies.

Multilateral Investment Court and the EU ICS Proposal
Traditional ISDS mechanisms have faced much criticism. They are alleged to increase the power of large corporations at the expense of national sovereignty, and allow corporations to bypass national judicial systems. Further, "regulatory chill" is the fear that ISDS could discourage governments from adopting regulations for public welfare in health, environment, labour and other areas. Investor claims also have a strong impact on the public exchequer, as the average cost of defending an investor claim is estimated at US$4.5 million. In addition to this, there is no guarantee of recovering costs even if the respondent state is successful. There is also a perception of conflict of interest on the part of arbitrators, many of whom are also practitioners. Lack of procedural transparency is another issue.

Based on the above concerns and the backlash against ISDS, the European Commission has moved away from traditional ISDS towards a different ISDS mechanism. This can be seen as a compromise that addresses many of the criticisms while preventing states from abandoning ISDS entirely. The EU proposal includes in the first place, an appellate mechanism, as part of a two-tier system; a roster of 15 members who may be chosen to form the first-instance tribunal, who are prohibited from acting as counsel, party-appointed expert, or witness in an investment dispute during their terms; and full transparency, with proceedings and key documents publicly available.

Developing Country Opposition—to ISDS, the EU ICS and the Multilateral Investment Court

In recent years, countries including Brazil, India and South Africa have significantly rethought their approach to investment protection, leading to many policy innovations. Brazil follows a model of signing "Cooperation and Facilitation Investment Agreements" which have no mention of "protection of investments" or an ISDS system. Similarly, India's new model Bilateral Investment Treaty (BIT) excludes the Fair and Equitable treatment (FET) and Most-Favoured-Nation (MFN) treatment clauses. Before turning to investor–state arbitration, investors must exhaust local remedies for five years. Since the model BIT has been publicised, most of India's BITs have lapsed, with many partner-nations unwilling to renegotiate with the new model BIT as its basis. South Africa has also developed a domestic bill that fully excludes recourse to international arbitration and relies on mediation instead.

Other states that are attempting to disengage from the bonds of traditional BITs and the ISDS regime are are Bolivia, Ecuador, Venezuela, South Africa and Indonesia. The reason for this is that many countries concluded BITs without fully understanding their implications. When Pakistan was first sued in 2001, based on a 1995 BIT with Switzerland, no one in the government could find the text and had to ask Switzerland for a copy. It is unlikely that developing countries would make this mistake again.

Argentina, Brazil, India, Japan and some other countries have reportedly rejected the initiative to establish a multilateral investment court. This suggests that some of the strongest opposition to the ICS is likely to come from developing countries based on the following factors:

1. Costs
If Japan, the world's third largest economy, rejected ICS citing the heavy costs involved in international arbitration, this consideration is even more relevant for developing countries. In one case, Libya was ordered to pay US$935 million to a company which had only invested US$5 million. Legal costs average roughly US$4.5 million for each side per case, but can be much higher. In the case against Russia, Yukos' lawyers alone billed US$74 million and fees of the three arbitrators amounted to US$7.4 million. As legal costs are not always awarded to the winning party, states can end up footing the bill even if they do not lose.

2. Sovereignty
The idea that a panel of three individuals can sit in judgment over a sovereign state in a dispute initiated by a private individual or corporation may still be hard for many countries to digest. Galling examples are the cases of Philip Morris' claims against Australia and Uruguay over plain tobacco packaging laws intended to reduce the rate of smoking and Vattenfall's pending €4.6 billion claim against Germany arising out of the phase-out of nuclear power in the wake of the Fukushima nuclear disaster in Japan. These issues invite the question: what gives a corporation the right to challenge a sovereign state's legislative actions meant to protect its citizens' health and safety?

3. Regulatory chill
In Guatemala, citizens protested against a controversial gold mine owned by Canadian mining giant Goldcorp, and the Inter-American Commission on Human Rights recommended closing it down. Even so, as revealed by internal government documents obtained through the country's Freedom of Information Act, the risk of an investor–state dispute weighed heavily on the state's decision, and the mine was ultimately allowed to stay open. The risk or threat that ISDS may discourage States from regulating in the public interest concerns all states. However, the stakes are higher for developing and least developed countries, many of which are in greater need for legislation and may be more susceptible to cave when intimidated by foreign investors threatening to pull out their investment.

State–State Dispute Settlement as an Alternative?
States have a number of alternatives to granting excessive procedural rights for corporations. Not to grant them in the first place is one. For example, neither the Australia–United States Free Trade Agreement (FTA) nor the Australia–Japan Economic Partnership Agreement allow for ISDS: in case of a dispute, foreign investors must resort to domestic courts. Investors going abroad can insure their

investment against political risks by purchasing private insurance, rather than relying on ISDS.

Another alternative would be working out a multilateral system for state–state dispute settlement instead of the ICS. Just as States provide diplomatic protection, if a private investor believed a host state was in breach of its investment obligations, it could ask its home state to bring a case on its behalf, and the home state could then decide whether it believed the case merited initiating a formal claim. States would have the power to prevent controversial claims from going forward. This would place checks on the power of corporations to initiate claims and assuage the fear of developing countries of expensive lawsuits, since home states would be expected to have considerations other than the profits of its corporations.

Recourse to state–state dispute settlement would not be unprecedented. The Australia–United States FTA allows for state–state dispute settlement when domestic remedies are unsuccessful. Since 2014, Brazil has negotiated investment agreements based on a model that prominently features state–state dispute settlement in place of ISDS. The Southern African Development Community (SADC) amended its Finance and Investment Protocol in 2016 to exclude the ISDS clause, leaving state–state dispute settlement as the only option. The recently negotiated Australia–China FTA, while not fully excluding ISDS, provides for a state–state filter: if both states agree a potential ISDS claim is about a non-discriminatory regulatory issue, the claim may not proceed.

Consider India, which has never indicated any particular inclination towards the state-state dispute settlement model. However, as India prepares to resume FTA negotiations with many EU nations this year, ten months after its unilateral termination of BITs, it is likely that the state–state dispute settlement mechanism would find the greatest favour with India and the EU. Given India's stand on the ISDS, as reflected in the 2016 model BIT, India would find this outcome favourable.

Conclusion

All of this leads us to the importance of addressing the concerns of developing nations in the arena of investment arbitration. Since it is almost-universally agreed that the ISDS, system as existing, is unsustainable for developing nations, a multilateral state–state dispute settlement mechanism, coupled with other mechanisms to guarantee participation and access to justice to all stakeholders affected by foreign investment, could help rebalance public and private interests in the investment regime, ensuring states, rather than corporate interests or the legal community of arbitrators, maintained control.

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