

Reforming Investor-State Arbitration by Recourse to the Domestic Courts of Host States

Armand de Mestral and Lukas Vanhonnaeker

Key Points

- In response to concerns raised about investor-state arbitration (ISA), different proposals for reform of this means of dispute settlement have been proposed. One such proposal is to entrust domestic courts with the resolution of investment disputes.
- Although opting for the resolution of investment disputes before domestic courts has led to some discussion about the advantages and difficulties of this approach, very few studies have analyzed the specificities of domestic regimes in this regard. Many questions remain unanswered, including whether foreign investors have, in practice, access to domestic courts in the host state and whether the remedies available domestically are comparable to those available in ISA.
- In an attempt to answer some of these questions, a questionnaire was prepared and answered by respondents in 17 countries, in addition to Canada, from different regions of the world.

Fundamental Questions

There have been many proposals for the reform of ISA over the last two decades.¹ Among the many approaches suggested, none appears more plausible than the call to abandon recourse to ISA and to send all such disputes to the domestic courts of the host state of the investment. In particular, entrusting domestic courts with the resolution of investment disputes would answer the legitimacy deficit that, it is sometimes argued, affects investment arbitration. Allowing the domestic courts of the host state — which are arguably in a better position to decide on matters having to do with the host state's public policies — to adjudicate investment disputes would thus strengthen domestic democratic control.

Although such arguments are sometimes made in the debate surrounding the legitimacy of ISA, the available documents on domestic remedies for foreign investors rarely delve into the specificities of domestic regimes.² An important and as-yet-unanswered question, however,

1 Proposals include a reformed ISA mechanism with broader clauses on the transparency of proceedings or control over the adjudicators, the creation of a permanent investment court or deleting ISA from investment agreements altogether.

2 Some initiatives exist that provide information to foreign investors on the investment climate of diverse countries, including on the efficacy and functioning of domestic judicial systems. See e.g. the World Bank's Doing Business initiative: www.doingbusiness.org; the Organisation for Economic Co-operation and Development's domestic economic surveys: www.oecd.org; and the US Department of State's Investment Climate Statements: www.state.gov/e/eb/rls/othr/ics/investmentclimatestatements/index.htm#wrapper.

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is whether foreign investors have, in practice, access to domestic courts in the host state and, in the affirmative, whether the remedies available domestically are comparable to those available in ISA if host states were to disengage from ISA. These questions might have been of a more theoretical nature some years ago; today they are in need of answers, as countries around the globe are increasingly contemplating withdrawing from investment treaties and disengaging from ISA. One country, South Africa, has actually done this by denouncing its bilateral investment treaties (BITs) and by adopting a major new law governing the conduct of foreign investment.³ In a book published by the Centre for International Governance Innovation in 2017⁴ regarding the many concerns about ISA expressed in developed democracies, one chapter examined the question of how the many claims against Canada under the North American Free Trade Agreement (NAFTA) would have fared had they been pleaded before the courts of Canada.⁵ The chapter looked at 35 NAFTA Chapter 11 claims launched against Canada. Rather surprisingly, the conclusion of the chapter was that only a handful of these claims could have produced a result comparable to that which could be obtained under ISA.⁶ Many other claims could have been heard by the courts, but as administrative law claims, where damages are not awarded. Others would simply not have found a comparable remedy for substantive or procedural reasons. Recourse to the domestic courts of Canada might be a suitable policy choice, but would definitely not provide a remedy similar to those generally available under ISA.

The fact that only a few claims against Canada would produce results before domestic courts comparable to those available under ISA prompted the decision to look at this question in greater detail. It was decided to look at the legal systems of a representative number of countries in order to determine if there is any pattern that might assist in answering the question as to whether ISA should be dropped in favour of returning all

3 Act to provide for the protection of investors and their investments; to achieve a balance of rights and obligations that apply to all investors; and to provide for matters connected therewith [S Afr], No 22 of 2015.

4 Armand de Mestral, ed, *Second Thoughts: Investor-State Arbitration between Developed Democracies* (Waterloo, ON: CIGI, 2017).

5 Armand de Mestral & Robin Morgan, "Does Canadian Law Provide Remedies Equivalent to NAFTA Chapter 11 Arbitration?" in de Mestral, *ibid* at 155.

6 *Ibid* at 177-78.

foreign investors' claims to the domestic courts of host states. In the first instance, 17 countries⁷ were chosen in addition to Canada. These countries were chosen as representative of major legal systems and different regions of the world. One constraint was the availability of suitable scholars to undertake the work.⁸ Ideally, the number of countries studied should be double those covered in this study.

The method of analysis chosen was a questionnaire designed to gain insight into the working of different legal systems and inquiring into the availability of legal remedies comparable to those under ISA. The questions asked were as follows:

Question 1. International Investment Agreements (IIAs) concluded by your country.

Question 1.2. International Trade Agreements with an Investment Chapter.

Question 2. Please review the clauses generally included in BITs signed by your government, such as:

- Most-Favoured Nation clause;
- National Treatment clause;
- no expropriation without compensation;
- fair and equitable treatment and full protection and security; and
- no performance requirements.

Question 3. Is it possible for private persons and companies to sue your government before domestic courts in your country to obtain damages for economic harm done by the government or government officials or agencies?

Question 4. Is it possible for foreign investors to sue your government before domestic courts in your country to obtain damages for economic harm done by the government or government officials or agencies?

Question 5. If so, before what courts, using what procedure and on the basis of what legal rules?

Question 5.1. Does the *procedural* law allow such actions in damages by foreign investors?

Question 5.2. Does the *substantive* law grant a remedy in damages equivalent to that obtained by the private claimants in BITs arbitrations against your government?

Question 6. Please list the cases taken under IIAs against your country.

Question 6.1. Could the same acts have been litigated before the courts of your country?

Question 7. Is it possible to sue the government on the basis of a treaty such as a BIT or a trade agreement using the treaty right as the basis of a civil claim? Please give examples if this has been done.

The fundamental purpose of these questions was to determine whether a remedy in damages similar to that provided under ISA was available in domestic courts to foreign investors when their economic interests were compromised by the host government or other public authorities. The procedural law applicable, the types of court before which the remedy could be pursued and the method of proceeding were all highly relevant to the general question of the availability of a remedy before the domestic courts of the host state.

Summary of Responses

Availability of Domestic Courts and Procedures for Foreign Investors

One of the most striking findings that emerges from the answers to the questionnaires is that foreign investors, whether individuals or companies, generally do have access to domestic courts to sue the government and challenge a measure as illegal or unconstitutional. This is often provided explicitly in domestic laws or constitutions⁹ and applies both to domestic and foreign individuals

⁷ Belgium, Brazil, Burkina Faso, China, Colombia, Ecuador, England and Wales, Germany, Greece, India, Italy, Mexico, Nigeria, Peru, the Russian Federation, South Africa and Turkey.

⁸ The respondents for the surveyed countries were selected on the basis of their knowledge of the domestic legal regime of the country for which they were asked to answer the questionnaire.

⁹ See e.g. Constitution of the Federative Republic of Brazil, art 37(6); Constitution of Colombia, art 90; Constitution of Ecuador, arts 78(2)m, 11(9); Administrative Act (Ecuador), art 15; Judicial Code (Ecuador), art 326; Crown Proceedings Act (UK), 1947, ss 1, 2; Constitution of Italy, art 113; Constitution of Peru, arts 63, 200; Constitution of the Russian Federation, arts 46(2), 52; Civil Code of the Russian Federation, arts 2(1), 16(1), 1069.

or companies,¹⁰ as long as the conditions to bring a lawsuit are met.¹¹ Nigeria is an exception, as it favours other means of dispute settlement for disputes involving foreign investors.¹²

In addition to the broad availability of courts, foreign investors challenging the lawfulness or constitutionality of governmental measures generally have access to the same courts as domestic individuals or corporations and the same procedural rules and judicial structures apply in this regard, with certain restrictions, such as the standing of foreign corporations in Germany. When administrative courts exist, they are normally responsible for assessing the legality of administrative acts. Foreign investors must identify the nature of the act that caused an alleged harm in order to determine the competent tribunal.

By contrast, a legislative act will have to be contested before the ordinary courts or the constitutional courts. This distinction is important because, depending on the nature of the act, some courts might decline jurisdiction. In addition, the remedies that are awarded by administrative courts and the ordinary courts may differ considerably. For instance, China has both an Administrative Procedural Law and a State Compensation Law, which regulate different types of measures. Article 2 of the Administrative Procedural Law of the People's Republic of China provides that administrative courts have the authority to rule on claims by citizens or other legal persons. By contrast, article 2 of the State Compensation Law of the People's Republic of China provides for a special tribunal to resolve claims for damages against the state.

In Germany, some restrictions with respect to access to domestic courts apply, depending on the nationality of the foreign investors. Indeed, while access to general courts is unrestricted,

foreign juridical persons do not enjoy fundamental rights under German law, pursuant to article 19(3) of the *Grundgesetz*. Therefore, they have no access to the German Constitutional Court to lodge a constitutional complaint against direct legislative interference with their rights. Since the protection of legal interests provided by administrative courts can usually not be directed against statutory acts, foreign investors suffer from a significant lack of legal protection against legislative interference, unless they are incorporated under German law. However, juridical persons having their seat within the European Union, and operating within the scope of application of EU non-discrimination principles, are not affected. Due to the primacy of application of EU law, they hold rights under EU law, contrary to the wording of article 19(3) of the *Grundgesetz*.

In Mexico and Peru, a constitutional remedy is available. In Mexico, government measures may be ultimately challenged through the constitutional remedy known as *juicio de amparo* (or simply *amparo*). If the challenge is successful, the measure must be terminated and things restored to the state they were in prior to the adoption of the measure. Exceptionally, where compliance with an *amparo* decision would result in greater harm to society than the corresponding benefit to the plaintiff, or where restoring things to the earlier state is no longer possible or would be disproportionately onerous, damages may be paid to the plaintiff in lieu of compliance. In Peru, investors have the opportunity of suing the government before domestic constitutional courts. In this case, there is a specific constitutional process to protect fundamental rights, also called *amparo* (article 200 of the Constitution of Peru, 1993). In this type of process, the investor may argue that the government breached one or more of the investor's fundamental constitutional rights, such as its property right(s), entrepreneurial freedom, due process and so forth. The aim of the *amparo* process is to restore or return to the situation prior to the violation of the right or, if this is not possible, to compensate or repair the victims for the violation of the fundamental right.

In Burkina Faso, it is the administrative courts that are entrusted with the resolution of investment disputes, as provided in article 30 of Burkina Faso's Investment Code. In several countries that provide for an investment code, the possibility for foreign investors to have recourse to non-

10 See e.g. Constitution of the Federative Republic of Brazil, art 5; Constitution of Burkina Faso, art 4; Code of Civil Procedure (Burkina Faso), art 2; Investment Code (Burkina Faso), arts 5, 30 (the administrative tribunal is competent for disputes taking place under the Code; disputes in the mining sector are excluded and regulated by article 220 of the Mining Code of Burkina Faso); Persons and Family Code (Burkina Faso), art 5; Greek Civil Code, arts 4, 7, 9; Civil Code of the Russian Federation, art 2(1).

11 In Belgium, the basic conditions that must be met to initiate any legal proceeding before domestic courts are provided in articles 17 and 18 of the Belgian Judicial Code.

12 *Nigeria Investment Promotion Commission Act*, Decree No 16 of 1995, s 27.

adversarial alternative means of dispute resolution and arbitration is often mentioned alongside the possibility to have recourse to domestic courts.¹³ Some countries, such as Burkina Faso¹⁴ and Brazil, have provided in their domestic law for the creation of specific procedures to resolve disputes involving foreign investors, even if generally not of a judicial nature. Brazil's model Cooperation and Facilitation Investment Agreement (CFIA) provides for the creation of focal points, or "ombudsmen." The CFIA further provides, in article 18(4), that among the responsibilities of such a "National Focal Point" is the resolution of conflicts between the host state and its foreign investors, as a preliminary step before other procedures can be pursued. The National Focal Point reflects a strong bias to promote the non-judicial approach to the resolution of disputes with foreign investors, both in its domestic procedures and under its recent international agreements.

Remedies Available to Foreign Investors

Despite courts (whether administrative or judicial) being broadly available in the surveyed countries, the efficacy of domestic systems for foreign investors must also be assessed in terms of remedies that can be granted by the competent courts. In this regard, it is noteworthy that several country reports emphasize that the remedies available domestically are not equivalent to the remedies foreign investors can seek before ISA.

In this regard, two questions must be distinguished: the measure of damages to be awarded and the standard of compensation attached to specific standards of protection. With respect to the latter, it is part of the substantive protections provided in IIAs, on the one hand, and in domestic regimes, on the other hand. Accordingly, depending on how the standards of protections are drafted in domestic laws, it can lead to different remedies.

Although a detailed comparison of all the standards of protection (and remedies in case of their breach) between domestic regimes and IIAs falls beyond the scope of the questionnaire, a striking example was nevertheless mentioned in some of the questionnaires: remedies in

case of indirect expropriation. In the context of international investment law, the international standard of "fair market value" is applied to calculate remedies in case of expropriation. By contrast, in China, for instance, article 28 of the State Compensation Law of the People's Republic of China only provides for "appropriate compensation" or "direct loss," but not "adequate, prompt and effective compensation" as seen in unlawful expropriation provisions in investment treaties. In Mexico, the Federal Expropriation Law and some state laws on that issue use the "commercial value" criterion to calculate remedies in case of expropriation, but many use the cadastral or fiscal value (for purposes of property taxes), which would not necessarily meet the international standard of fair market value.

With respect to remedies that are not standard of protection-specific, some reports highlighted that damages awarded domestically are generally lower than those awarded in ISA. In Colombia, for instance, articles 1613 and 1614 of the Civil Code cover moral and material damages, but do not cover lost profits. Accordingly, Colombian legislation does not provide remedies equivalent to ISA.¹⁵ German substantive law also allows remedies against the government that are structurally different from remedies that can be claimed and awarded in ISA. In particular, regarding property protection and state tort liability, compliance with primary obligations generally takes precedence over the state's liability for damages. Damages can generally only be obtained for unlawful infringements and only if the consequences of the unlawful infringements could not have been avoided by primary legal remedies, or if they cannot be restituted in kind. Furthermore, lawful infringements of property rights do not trigger compensation claims with the exception of atypical circumstances (*enteignender Eingriff*). Compensation for legislative acts can generally not be obtained. If legislative expropriations and limitations of property rights do not provide for the required compensation according to article 14 of the *Grundgesetz*, they have to be challenged before the German Constitutional Court.

In Italy, remedies are available for foreign investors and consist of the annulment of the disputed act or regulatory measure and/or damages. However,

¹³ See *Protection of Investment Act (S Afr)*, No 22 of 2015, s 13; see also *Constitution of Peru*, 1993, art 63.

¹⁴ *Mining Code (Burkina Faso)*, art 220(2).

¹⁵ The same conclusion was reached in the domestic reports for England and Wales, and Nigeria.

article 7(1) of Legislative Decree No 104/2010 of the Code of Administrative Justice states: “Administrative courts shall hear all claims dealing with legitimate interests and, when so provided by the law, subjective rights, pertaining to the exercise of regulatory powers, concerning any measure or act — even indirect ones — enacted by any public entity or institution (*Pubblica amministrazione*). *The laws and statutes passed by the Government in the exercise of its functions are excluded from administrative review*” (emphasis added).

Pursuant to this provision, whenever legislation is passed by the central government, administrative courts cannot be seized. In these circumstances, the only avenue is to bring an action before the Italian Constitutional Court. However, according to article 23(2) of Law No 87/1953, the latter court can only be seized indirectly, whenever a party raises a constitutional issue material to the outcome of a case before an ordinary or administrative court, and the court before which the dispute was brought agrees to refer the matter to the Constitutional Court. Moreover, article 29 of the same law states that the Constitutional Court per se can only declare legislation unconstitutional without the possibility of granting consequential damages. All further remedies may be granted only by the lower court (the one that previously agreed to refer the matter to the Constitutional Court).

A number of respondents to the questionnaire attempted to answer how the claims brought against their governments under ISA might have proceeded before their domestic courts. In particular, several domestic reports emphasized that some cases were litigated before the competent domestic courts prior to being brought before an ISA tribunal. In Italy, for example, a significant amount of litigation took place before the domestic courts prior to ISA proceedings being initiated in a series of claims involving the construction and operation of solar plants.¹⁶ The Greek and Indian

legal regimes also allow foreign investors to litigate before the competent domestic courts claims that could otherwise be brought before an ISA tribunal. In Germany, the well-known *Vattenfall* cases were also litigated before the competent German courts prior to being submitted to tribunals of the International Centre for Settlement of Investment Disputes (ICSID). Similarly, in China, the *Ekran v China* case, which involved a joint venture established by Ekran and a Chinese company, was first litigated before the Chinese domestic courts. After the domestic proceedings the investor, Ekran, initiated ISA proceedings against China under the China-Malaysia BIT.

Conclusion

The questionnaires reveal a central paradox: while many of the countries studied do allow foreign investors broad standing before their domestic courts, this principle does not guarantee the existence of a remedy similar to ISA. Foreign investors are generally permitted to sue before domestic courts and in many cases there appears to be no bar to taking action against the host government. It is true that a few governments, such as Nigeria, require recourse to arbitration for disputes that are not amicably settled. Germany limits the standing of foreign corporations, but most countries do not. But once one begins to examine the conditions governing the courts in which such actions must be taken, and the nature of the actions available in such cases, it becomes clear that many qualifications are required.

As revealed by the case of Canada and other common law countries, many actions against governments must be taken before administrative tribunals, which are not empowered to award damages. Some administrative tribunals in civil law countries are empowered to award damages, but are not able to pass judgment on legislation. Such judgment is the prerogative of constitutional courts, which, as in Italy, may not award damages. A further complication arises with respect to the remedies available to enforce the various rights listed in typical BITs. For instance, the means of claiming damages for expropriation may vary considerably from jurisdiction to jurisdiction, both with respect to the governing tribunal and the extent of the remedy. The *amparo* procedure

¹⁶ The effects of reforms in Italy concerning the construction and operation of solar plants (Law No 129/2010 [*Salva Alcoa Law*] and the Legislative Decree 28/2011 [*Renewables Decree*]) in 2010 and 2011 were to lower the feed-in tariffs applied on solar plants after May 2011. Administrative proceedings were brought against these new regulatory measures, and some of the claims were partially upheld (see Regional Administrative Court of Lazio, 4 February 2013, No 9361). *Blusun SA, Jean-Pierre Lecorcier and Michael Stein v Italian Republic* (ICSID Case No ARB/14/3) is a striking example, as a great deal of litigation preceding the arbitration was brought before several administrative courts (see the factual background described in the final award rendered on 27 December 2016 at 15ff).

of Mexico and other Latin American civil law countries is a powerful means available to the courts to judge legislative and administrative actions. But many countries do not have a constitutional bar on discrimination between foreigners and citizens, or requirements of Most-Favoured Nation treatment of foreigners, or a bar on imposing performance requirements. The standards governing administrative procedures or the conduct of police vary considerably from one country to another, and it is difficult to imagine a uniform approach to the interpretation of such concepts as fair and equitable treatment. Nor is it easy to imagine that the domestic courts of each country will approach administrative decision making in the same manner. Some countries restrict decisions on legislative acts to constitutional courts where the procedures may be complex and lengthy and not at all comparable to ISA.

The issues raised in this study reveal as many unanswered questions as answers. In retrospect, the questionnaire should have required much more information on the enforcement of each of the major rights typically listed in BITs and should have required the responses to be more detailed on how the various ISA claims taken against their governments might have been resolved. Further work, and possibly a more detailed set of questions, may be required. The sample of countries, while constituting a reasonable beginning, should be expanded to at least 40.

In the final analysis, this study constitutes only a first step. The questions being asked are very broad and the evidence that must be considered is consequently very wide. But they are fundamental issues when the legitimacy of ISA is called into question, and warrant much further consideration and analysis.

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