

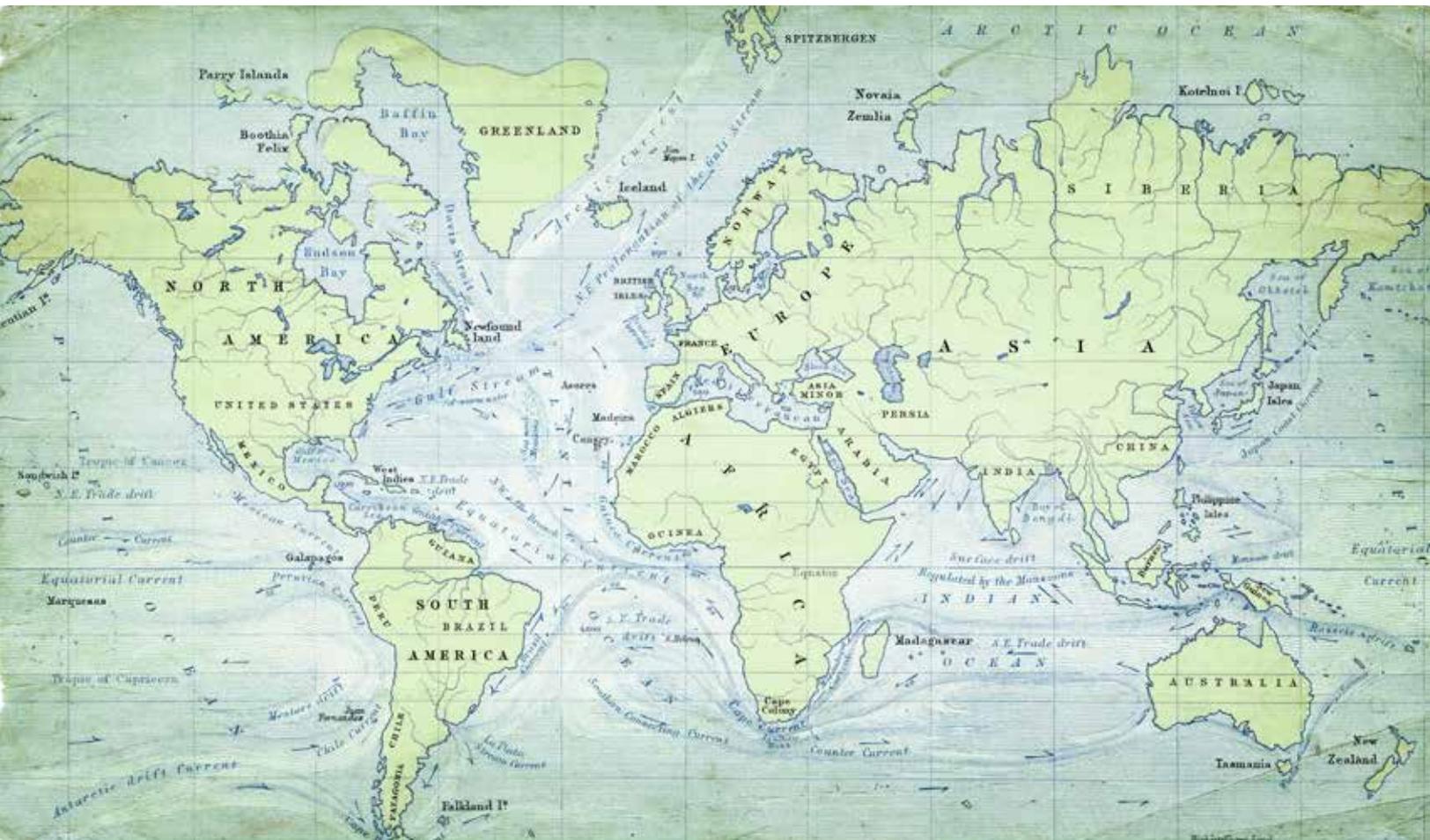


INVESTOR-STATE ARBITRATION SERIES

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LIMITING THE PARTICIPATION OF DEVELOPED STATES: IMPACTS ON INVESTOR-STATE ARBITRATION

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**LIMITING THE PARTICIPATION OF DEVELOPED STATES:
IMPACTS ON INVESTOR-STATE ARBITRATION**

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ABOUT THE INVESTOR-STATE ARBITRATION PROJECT

Launched in November 2014, this project is addressing a central policy issue of contemporary international investment protection law: is investor-state arbitration (ISA) suitable between developed liberal democratic countries?

The project will seek to establish how many agreements exist or are planned between economically developed liberal democracies. It will review legal and policy reactions to investor-state arbitrations taking place within these countries and summarize the substantive grounds upon which claims are being made and their impact on public policy making by governments.

The project will review, critically assess and critique arguments made in favour and against the growing use of ISA between developed democracies — paying particular attention to Canada, the European Union, Japan, Korea, the United States and Australia, where civil society groups and academic critics have come out against ISA. The project will examine the arguments that investor-state disputes are best left to the national courts in the subject jurisdiction. It will also examine whether domestic law in the countries examined gives the foreign investor rights of action before the domestic courts against the government, equivalent to those provided by contemporary investment protection agreements.

CIGI Senior Fellow Armand de Mestral is the lead researcher on the ISA project. Contributors to the project are Marc Bungenberg, Charles-Emmanuel Côté, David Gantz, Shotaro Hamamoto, Younsik Kim, Céline Lévesque, Csongor István Nagy, Luke Nottage, Ucheora Onwuamaegbu, Carmen Otero, Hugo Perezcano, August Reinisch and David Schneiderman. A conference was held in Ottawa on September 25, 2015. The papers presented at that conference are in the process of being issued as CIGI Papers and will ultimately appear as a collective book.

ABOUT THE AUTHOR



Ucheora Onwuamaegbu is a CIGI senior fellow and a lawyer with 28 years of experience. He provides consultancy services on various aspects of international law, with a strong focus on international investment law and arbitration. For close to a decade, he was senior counsel at the World Bank's International Centre for Settlement of Investment Disputes (ICSID) in Washington, DC, administering disputes under treaties, national laws and contracts. Prior to his time at ICSID, he worked for more than six years with the United Nations Compensation Commission, a unique post-conflict claims program based in Geneva, Switzerland.

A solicitor of the Supreme Court of England and Wales, and a barrister and solicitor of the Supreme Court of Nigeria, Ucheora has been involved in private practice in both jurisdictions. He was a senior visiting fellow on international investment disputes at the Vale Columbia Center on Sustainable International Investment at Columbia University, New York, and has written and spoken extensively on disputes between governments and foreign investors and related administration infrastructure.

Ucheora currently provides consultancy services to the State of Kuwait's multibillion-dollar post-award environment remediation program, and to the Government of Nigeria on its program for oil exploration related hydrocarbon pollution remediation. He has also acted as arbitrator in disputes before the International Chamber of Commerce, Dubai International Arbitration Centre and the Court of Arbitration for Sport.

ACRONYMS

BITs	bilateral investment treaties
CETA	Comprehensive Economic and Trade Agreement
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
ISA	investor-state arbitration
ISDR	investor-state dispute resolution
ISDS	investor-state dispute settlement
MFN	most-favoured nation
NAFTA	North American Free Trade Agreement
PCA	Permanent Court of Arbitration
SADC	Southern African Development Community
SCC	Stockholm Chamber of Commerce
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
UNCITRAL	United Nations Conference on International Trade Law

EXECUTIVE SUMMARY

Although the present system for resolving investment disputes between states and foreign investors has been around for about five decades, the most significant changes to it have occurred in just the past two. Important changes were forced upon the system when developed countries first were faced with actual prospects of appearing as respondents in investor-state arbitration (ISA).¹

While prospects always existed for developed economies to be respondents, based on the consent they provided in their bilateral investment treaties (BITs), such prospects were, at best, academic. The expectation and reality was that the system would be invoked by developed-country investors to enforce their rights against developing-country governments. With the exception of a handful of cases that were brought by developing-country governments against investors on the basis of contracts, the system worked primarily to provide a neutral international forum where developing-country governments could be held to account for their obligations to foreign investors.

However, starting with the North American Free Trade Agreement (NAFTA),² steps began to be taken to incorporate more detailed provisions in investment treaties, some of which have served to make the system more acceptable to governments. NAFTA was the first instrument in which developed countries (Canada and the United States) provided advance consent to arbitration with investors of other such countries. Beyond NAFTA, under which proceedings started to be brought against Canada and the United States, further provisions have been introduced in later, new-generation, treaties based on lessons learned and reactions from the respective constituencies.³

Chief among the new provisions are those introducing increased transparency to the process as well as those designed to ensure more procedural fairness and efficiency, and to reduce costs. Some of these relate to the qualification, appointment and disqualification of arbitrators; consolidation of proceedings; and summary proceedings mechanisms. Others are more substantive than procedural, such as those that redefine the scope of the system. Yet others, currently under discussion, can be considered structural — insofar as they aim to introduce new elements such as standing arbitral and appellate systems.

These changes, while essential for the countries introducing them to remain in the system, have impacted the system as a whole and contributed to its evolution. For instance, developing country governments that end up as respondents under the new-generation treaties have been operating under transparency rules originally designed to address the interests of the US and Canadian governments, respectively.⁴

If these developments have occurred — and continue to occur — as reactions to developed countries facing the possibility of being respondents before the system, it follows that removing that prospect would ultimately have a chilling effect on the continued dynamic development of the system. In that scenario, the system's evolution would be left mostly in the hands of institutions, which are usually constrained by their delicate position of neutrality from acting nimbly enough (if at all) to meet the ever-changing demands of their users. If developed states decided to forgo ISA in disputes arising from their treaties, this would also invariably herald similar moves by developing states, who usually take their cue from the developed ones.

1 The terms *developed* and *developing* are used loosely here in describing countries. The discussion and controversy about the specifics of such classifications are beyond the scope of this paper and, in any event, of little import to its focus. The World Bank's classification of countries, which is revised yearly on July 1, is a useful guide, especially given the position of the International Centre for Settlement of Investment Disputes (ICSID) as a member organization of the World Bank Group.

2 *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can TS 1994 No 2 (entered into force 1 January 1994) [NAFTA], online: <www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/text-texte/toc-tdm.aspx?lang=eng>.

3 The system has continued to evolve and the latest manifestations of that are evident in the investment protection provisions of the draft texts of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA); of the European Union's September 2015 internal document on the Transatlantic Trade and Investment Partnership (TTIP); and of the Trans-Pacific Partnership (TPP) between the United States and some countries in the Asia-Pacific region.

4 Examples include the different cases that have been brought against Mexico under NAFTA, and those brought against the Dominican Republic, El Salvador, and Guatemala, respectively, under the Dominican Republic-Central America Free Trade Agreement.

In the end, the system — or whatever is left of it — would be worse off for such a move by developed countries, as would investors whose options for bringing proceedings against their host states would be limited to a staid system or domestic fora. Therefore, if it is agreed that the system ought to be kept in place, at least for the benefit of investors around the world, then the full participation of both developed and developing countries is essential.

As the issue of the continuing development of the system remains relevant to all countries, there is need for a mechanism that ensures its balanced evolution for the benefit of all its users, which would not be dependent on the reactionary steps of only segments of the user community at any given time.

INTRODUCTION

In the context of discussions around recent and ongoing major investment treaty negotiations — especially TTIP⁵ (between the United States and the European Union); CETA⁶ (between the European Union and Canada); the TPP⁷ (between the United States and some Asia-Pacific nations); and others⁸ — calls for the abandonment of ISA between developed countries have been increasing.⁹ The general premise behind the argument is that ISA is not necessary or suitable for disputes arising under investment treaties between developed economies. Without getting into a discussion about the merits or otherwise of that argument, this paper looks at the impact on the ISA system if its use is ultimately abandoned in disputes between developed countries and investors from other developed countries. My conclusion is that such a move would be harmful to the continued dynamic evolution of the system. It would threaten the system's existence in the long term, and it would not serve the interests of investors from either developed or developing countries.

The ISA system, an aspect of investor-state dispute resolution (ISDR),¹⁰ refers to the entire mechanism that exists for the resolution of disputes between foreign investors and governments, by arbitration, under any of the different rules that currently exist. The most commonly used such rules are those of the ICSID¹¹ and of the United Nations Conference on International Trade Law (UNCITRAL), for institutional and ad hoc arbitrations, respectively. Others include the rules of the International Chamber of Commerce (ICC), the Permanent Court of Arbitration (PCA), the Stockholm Chamber of Commerce (SCC), and a host of regional arbitration centres under whose rules ISA proceedings may be conducted from time to time.

The ISA system extends beyond disputes under investment treaties to include disputes under instruments regulating the investment relationship between governments and foreign investors, such as laws and contracts.¹² The fact that the system extends beyond the world of investment treaties to that of contracts and laws is another reason that its continued evolution remains important, in spite of the outcome of the current discussions on its continued application (or not) to investment treaty disputes between parties from developed countries.

In the past two decades, significant changes have occurred in the way ISA is conducted. This coincides with a period in the history of ISDR that stands out for the active participation of all its users, especially states, in its development.

5 European Commission, *Transatlantic Trade and Investment Partnership* (2016) [TTIP], online: <<http://ec.europa.eu/trade/policy/in-focus/ttip/>>.

6 European Commission, *Comprehensive Economic and Trade Agreement between Canada, of the one part, and the European Union [and its Member States...]. Final CETA Text* (29 February 2016) [CETA], online: <http://trade.ec.europa.eu/doclib/docs/2016/february/tradoc_154329.pdf>.

7 Global Affairs Canada, *Trans-Pacific Partnership* (4 February 2016) [TPP], online: <<http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/index.aspx?lang=eng>>.

8 The initial TPP members involved in the negotiations of the treaty were Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam.

9 This is not an entirely novel idea. The Australia-US FTA of 2005 does not contain ISA provisions.

10 Also sometimes referred to as investor-state dispute settlement (ISDS).

11 For present purposes, where applicable, ICSID arbitration includes arbitration under the ICSID Additional Facility Rules, which apply when one of the disputing parties is not a member of ICSID or is not a national of such a state; or the dispute does not directly arise from an investment. For the rules see the World Bank website, online: <https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/AFR_English-final.pdf>.

12 According to statistics published by ICSID, as at the end of FY2015, 17.7 percent of all cases registered by the Centre were brought on the basis of consent in contracts, while 9.5 percent were brought under national laws. See the World Bank website, online: <[https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/ICSID%20Web%20Stats%202015-2%20\(English\).pdf](https://icsid.worldbank.org/apps/ICSIDWEB/resources/Documents/ICSID%20Web%20Stats%202015-2%20(English).pdf)>.

THE ISA SYSTEM RESTS ON RULES ON WHICH ARBITRATIONS ARE CONDUCTED

The cornerstone of the ISA system — indeed, its foundation — is the body of procedural rules and regulations (collectively referred to herein as *rules*) under which proceedings are conducted by agreement of the parties. The parties' choice of rules would typically be expressed in their instrument of consent to arbitration; namely, in the contract, law or treaty under consideration.

Fundamental to the system, generally, is the concept of party autonomy, which recognizes the ability of the disputing parties to fashion the proceedings to suit their needs. In ISA, most often, parties agree to conduct their proceedings in accordance with preset rules (such as those of ICSID, UNCITRAL, ICC, PCA or SCC) that they adopt by agreement, and then adapt as necessary.

Party Autonomy Allows Parties (Almost) Total Control of the System

With the exception of a few rules that are considered mandatory, both the ICSID and UNCITRAL rules of arbitration permit the disputing parties to modify or vary the set rules to suit their purpose. Pursuant to article 44 of the ICSID Convention,¹³ arbitration proceedings are to be conducted in accordance with the arbitration rules in effect on the date on which the parties consented to arbitration “except as the parties otherwise agree.” Similarly, article 1 of the UNCITRAL rules provides for their application “subject to such modifications as the parties may agree [to].”¹⁴ These provisions, which recognize party autonomy in arbitration, allow parties to customize the rules to fit their purpose.¹⁵

While variations to the rules can be introduced by consent in the course of the proceedings, increasingly, many variations are expressed in the instrument of consent to arbitration — especially in investment-related treaties, well in advance of any disputes. This is a practice that has been more common with investment contracts than with treaties.

ISA Has Survived and Evolved through the Changes Introduced in the Exercise of Party Autonomy by States

The practice of introducing variations to arbitration rules within the instrument of consent has not only served the interest of the parties in disputes under the instrument in question, but has also served the wider purpose of the ISA system generally. In particular, introducing variations to the rules stated within treaties has been a means of introducing changes into the system. This has made it possible for the states in question to remain engaged and, in turn, has helped the system to survive. Some of the variations, like the ones introducing increased transparency, address the states' particular legal requirements.¹⁶ Without those changes, it is hard to imagine how states could remain engaged in the system, and participating as respondents, with the associated exposure to significant financial payouts.

Such changes have enabled the system to evolve without the need for frequent amendments to the different standard arbitration rules. Variations introduced in the instruments of consent have thus served to inject changes into rules that have been in existence for years and which, for reasons of predictability and consistency that make them appealing to their users, are not always capable of evolving fast enough to keep pace with contemporary practices.

The standard sets of arbitration rules are amended from time to time by the respective institutions responsible for them. Understandably, these amendments tend to be few and far between and only occur

13 ICSID, Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 18 March 1965, 575 UNTS 160, Can TS 2013 No 24 (entered into force 14 October 1966, accession by Canada 1 December 2013) [ICSID Convention], online: <<https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/main-eng.htm>>.

14 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, 1 April 2014 (New York: United Nations, 2014) 1976; revised in 2010, as adopted in 2013 [UNCITRAL Arbitration Rules], online: <www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2010Arbitration_rules.html>.

15 The purpose extends to addressing public policy concerns of the states-parties to the disputes, especially regarding transparency of proceedings, reducing costs and increasing efficiency, and controlling the scope of the arbitration agreement, especially to preserve the state's regulatory freedom.

16 Examples include sunshine laws and freedom of information-type laws, through which the public in certain countries can demand information about arbitration proceedings that would otherwise have remained out of the public domain.

when absolutely necessary.¹⁷ Indeed, the process for amending the rules is tedious. The amendments to the ICSID rules, which came into effect in 2006, were the result of a two-year process of consultations and deliberations leading up to the required approval by at least a two-thirds majority of the entire membership of the ICSID Administrative Council. Likewise, amending the UNCITRAL rules involves a process of reviews and consultations and formal approval of the UNCITRAL member states.¹⁸

More than the arbitral institutions, users (especially states) have been, of necessity, at the vanguard of the relevant changes that have kept the system evolving and apace with the times. In the long periods between rule changes by the institutions, states have routinely introduced clauses in the ISDR provisions of their investment treaties. This has had the effect of modifying and updating the standard body of arbitration rules as they apply to particular sets of disputes. The practice has been much more pronounced in the past two decades, resulting in some of the most significant changes that the system has witnessed in its history.

RECENT DEVELOPMENTS

Transparency

One of the most important recent developments in the way ISA is conducted relates to the transparency of the process. The ICSID system, being designed for use by governments, has always made accommodations for the peculiarities of state-related arbitration. On the other hand, proceedings conducted outside of the ICSID system have tended to pay more attention to the confidentiality of the process.

In the past two decades, however, attitudes toward transparency of ISA as a whole have changed. Starting with NAFTA and the ensuing investment-related treaties of Canada and the United States, provisions have routinely been included in instruments of consent to arbitration, to ensure transparency of the process. This has inspired some of the modifications that ICSID introduced to its rules in 2006 — in particular those relating to the ability of non-disputing parties to observe proceedings;¹⁹ to *amicus curiae* submissions;²⁰ and to prompt publication of excerpts of legal reasoning in awards.²¹ It has also inspired the 2014 passage of the UNCITRAL Rules on Transparency,²² and led to the wider adoption of transparency practices by other users of the system apart from the Canadian and US governments and investors.

As a result of these changes, today the existence of an ISA proceeding is more likely to be public knowledge than not, especially if it is conducted on the basis of provisions in a treaty as opposed to a contract or national law.²³ Documents in arbitration proceedings conducted under NAFTA, and later treaties modelled after it, are now published. Such documents include not only decisions and awards, but also pleadings, minutes, statements of witnesses and experts, and transcripts of hearings that are generated in the course of the proceeding. Hearings are open to the public. In practice, this is accomplished by providing access through live Internet or video feed to participants in a satellite, but proximate, location.²⁴ Third parties have the opportunity to file written submissions. Other (non-disputing) state parties to the treaty also have the right to provide submissions. They can, in some cases, even provide joint clarification statements, which would be binding on the tribunal.²⁵

17 The last formal amendments to the ICSID Rules, for example, occurred almost 10 years ago. Similarly, since coming into effect in 1976, the UNCITRAL Rules were amended for the first time in 2010.

18 The package of amendments that concluded in 2013, including the UNCITRAL Rules on Transparency, was conducted over a period of three years.

19 ICSID Convention, *supra* note 13, Arbitration Rules, rule 32.

20 *Ibid*, rule 37.

21 *Ibid*, rule 48.

22 The UNCITRAL Arbitration Rules, *supra* note 14, contain provisions on publication of documents, participation by non-disputing parties and open hearings, *inter alia*.

23 It used to be that proceedings brought under the ICSID Convention and Rules were the only ones that were publicly reported as a matter of course, due to the provisions requiring ICSID to maintain a public register of all its cases.

24 As with the publication of documents, sensitive information can be protected from the public, even in open hearings.

25 See, for example, the September 7, 2003, statements of the NAFTA Free Trade Commission on Notices of Intent to submit a Claim to Arbitration; on Third Party Participation; and on Transparency (Canada and the United States only).

Indeed, today, ISA is a lot more visible, transparent and accessible than it was 20 years ago; and there is little doubt that this transparency will only increase, especially as the UNCITRAL Rules on Transparency gain wider application.²⁶

Other Areas of Recent States-Driven Developments in ISA

Other areas abound in which changes are being proposed or have recently been introduced to the ISA system through the use of the opportunity provided by treaties.²⁷

Rules Governing Arbitrators

Some of these changes are designed to ensure increased fairness of the system by further defining the rules concerning those tasked with deciding the disputes — the arbitrators. There are now more detailed provisions dealing with the eligibility of arbitrators, the way they are appointed and the way disqualification applications are decided. In particular, many treaties now identify the ICSID secretary general as the appointing authority and the authority to decide challenges to arbitrators, even in cases conducted outside of the ICSID Convention.

Some of the treaties provide for the establishment of lists of potential arbitrators from whom the appointing authority can select.²⁸ Besides being on a roster, arbitrators must, according to the specifications in some treaties, have certain experience, usually in aspects of international law, which is otherwise generally not required under the ICSID or UNCITRAL rules. Provisions are also typically included that allow for the appointment of co-nationals of the disputing parties as arbitrators. In some cases, the provisions allow for the exclusion of certain nationalities. For example, the Colombia-Japan BIT provides that unless the parties otherwise agree, the presiding arbitrator “shall not be a national of either Contracting Party, nor have his or her usual place of residence in the territory of either Contracting Party, nor be affiliated with either of the disputing parties, nor have dealt with the investment dispute in any capacity.”²⁹ Beyond all this, the CETA text contains a code of conduct for arbitrators. This is a novel idea that could very likely be adopted in future treaties, and may even be adopted as part of arbitration rules going forward, even if by reference. Such provisions would help in bringing much-needed clarity to the standard for arbitrator challenges.

Scope of the System

Over the past two decades, some changes in the approach of its users have also emerged to the scope of the system. As would be expected, investors have argued before tribunals, with some success, for the expansion of the system’s scope from where it was. On the other hand, states have continued to push back, introducing provisions designed to limit the scope of ISA under the treaties. CETA, in particular, limits its scope primarily to claims for breach of nondiscrimination and expropriation provisions. It prohibits the use of MFN clauses when importing consent to arbitration from other treaties as well as parallel proceedings. It also prohibits any attempt by investors to take advantage of the treaty’s provisions to structure the national identity of the investor/investment, for treaty-shopping purposes. Limitation periods for claims are now standard in new-generation treaties, as well as initial steps that must be taken before proceedings can be commenced.

Like recent US and Canadian treaties, CETA includes provisions specifying a clearly limited scope for the tribunal’s award. Other US and Canadian treaties provide that the tribunal may only award monetary damages, plus applicable interest; and/or restitution of property, with the option of monetary damages in lieu of restitution; and that punitive damages may not be awarded. CETA, however, goes

26 The UNCITRAL Rules on Transparency, *supra* note 14, apply to treaties concluded on or after 1 April 2014. Their application to other treaties is by agreement of the disputing parties or states parties to the relevant treaty.

27 At present, a good treaty example for this is CETA. Being a treaty between developed countries, like NAFTA before it, CETA will present a real prospect of proceedings being brought against developed states. Under the current text, proceedings could be brought against the European Union or an individual member state, on the one side, or against Canada on the other. It thus contains all the usual provisions that have become common in the post-NAFTA treaties of Canada and the United States, as well as new provisions that reflect recent lessons learned from proceedings under those and other treaties. Other examples include TTIP and the TPP, the negotiations of which are not yet as advanced as CETA’s.

28 Although appearing in US and Canadian treaties since NAFTA, no such lists have yet been established and appointments by the ICSID secretary general continue to be made from the ICSID panel of arbitrators, as allowed by those treaties. Disputing parties remain free to appoint whom they want, as long as they meet the usual independence criteria under the applicable arbitration rules.

29 Colombia-Japan BIT, signed 12 September 2011, not yet in force (at the time of writing); online: <www.sice.oas.org/Investment/BITSbyCountry/BITS/COL_JPN_e.pdf>.

further — providing that the unsuccessful disputing party will bear the cost of the arbitration, except where, in exceptional circumstances, the tribunal considers it appropriate to apportion costs.

The effect of these provisions is to limit the scope of the disputes that can be brought to ISA — hence limiting the exposure to arbitration of the host state of the investment — while giving the treaty parties greater control over proceedings. However, the model BIT template of the Southern African Development Community (SADC)³⁰ includes provisions that permit investment arbitration proceedings to be brought by the state against the investor. The India model BIT includes an obligation on the part of the home state of the investor to ensure that it is possible for the host state to bring proceedings against the investor in the home state's courts.

More controversially, the recently released EU TTIP investment chapter text — an internal document that has yet to be formally proposed to the United States in the TTIP negotiations — includes provisions for a public investment court system composed of a first instance tribunal and an appeal tribunal.³¹ Without going into the merits or feasibility of such a proposal, it is worth noting that the proposal would appear to be made, presumably, under the exercise of party autonomy liberties. It remains to be seen whether such a potentially fundamental change can be seen to be an adaptation of the existing rules and/or system, or the creation of something completely new, and how this would be compatible with certain mandatory provisions of the ICSID Convention, including article 53, which prohibits appeals.

From the preceding, one can see that the landscape of ISA has changed over the past couple of decades, and continues to change with the introduction of more detailed provisions in the treaties currently under negotiation. Whether the developments have all been positive depends on the prism through which the issue is considered. The question is, however, not altogether relevant when considering that the main value of these developments is to make the system more palatable to all its users. Without them, some developed states would have exited the system, potentially triggering its eventual collapse.

INVESTMENT TREATY-DRIVEN DEVELOPMENT OF THE SYSTEM: LIMITING FULL PARTICIPATION OF SOME STATES IN ISA

From their early days, investment treaties have provided equal opportunities for investors of either country to bring proceedings against the other state party to a treaty. However, in reality, ISA has typically featured developing countries as respondents. In the early days, there was little input from the users of the system on how it functioned. This began to change when developed countries started to face the prospect of appearing as respondents in ISA proceedings.

Since the NAFTA parties, especially Canada and the United States, could easily be both exporters and importers of investments vis-à-vis the other, NAFTA presented the first real prospect that proceedings could be brought against a developed country under an investment treaty.³² The prospect of being respondents in such arbitrations appears to have been the catalyst for the detailed ISDS provisions in that treaty, which were by far the most extensive of such provisions in investment treaties of its time.³³

30 *SADC Model Bilateral Investment Treaty Template* (July 2012), Southern African Development Community, online: <www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf>. SADC is a regional organization in Southern Africa consisting of 14 member countries: Angola, Botswana, Congo (DR), Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

31 See European Commission, Press Release, “Commission proposes new Investment Court System for TTIP and other EU Trade and Investment Negotiations” (16 September 2015), online: <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1364>>. See also the Commission's draft text TTIP-investment, European Commission, “Transatlantic Trade and Investment Partnership: Trade in Services, Investment and E-Commerce, Chapter 11 – Investment” (n.d.), online: <http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf>.

32 See: *Energy Charter Treaty*, 2080 UNTS 95; 34 ILM 360 (1995). Although the Energy Charter Treaty includes developed as well as developing countries, at the time it was being negotiated, and by 1994 (when it was signed), there would have been little expectation that it would be used to bring proceedings against developed countries. Hence there would have been little incentive to include the types of provisions now under discussion. The treaty's objective was effectively to bring together energy-poor developed countries of Western Europe and former Soviet states, which were rich in energy, but in need of investments. It came into force in 1998, but it was not until 2009, after 23 cases had already been brought under the treaty against Eastern European states, that the first case was brought against a Western European country (*Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG & Co. KG (Sweden) v Federal Republic of Germany*). Other cases have since followed, including those against Italy and many recent ones against Spain.

33 The ISDS and related provisions in NAFTA covered 39 articles and 4 annexes (NAFTA Chapter 11). See online: <www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/nafta.aspx?lang=eng>.

From their experience as respondents in the initial NAFTA proceedings, the United States and Canada each began including even more detailed provisions in their later treaties, as well as in their respective model BITs of 2004 to complement the ICSID and UNCITRAL arbitration rules applicable to their disputes. They also began to take other steps to adapt the system to suit their needs. For instance, after increased pressure from civil society groups concerning public access to proceedings and related information, the NAFTA Free Trade Commission issued statements in 2003 on third-party participation, on transparency (Canada and the United States alone), and on notices of intent to submit a claim to arbitration. In effect, while NAFTA provisions reflect the variations to the arbitration rules that were imagined to be necessary at the time the treaty was drafted, the post-NAFTA treaties and model treaties contain provisions informed by the reality of appearing as respondents in those proceedings.

Not All States Have Impacted ISA through Their Investment Treaties

Countries have reacted differently to the prospect of being respondents in ISA.³⁴ Some countries have withdrawn from treaties they had already signed.³⁵ Some have tried to limit their exposure in their future treaties by, for example, not including ISA provisions at all in their investment treaties, or doing so selectively.³⁶ Others, following the examples of Canada and the United States, have reacted by redefining applicable rules, within the limits permitted by the exercise of party autonomy. This last reaction is what has mostly been behind the states-driven evolution that the ISA system has witnessed in the past two decades.

Investment-exporting countries, who have little or no chance of appearing as respondents in ISA, have generally taken few or no steps to introduce changes to the system through their treaties and have generally continued to conclude treaties in the pre-NAFTA format.³⁷ Such muted participation is understandable, given the limited chances of those countries being respondents in ISA proceedings. It is telling that some countries under the EU umbrella are now taking a different approach in CETA and TTIP, which present for them a real prospect of suit under an investment treaty.

POTENTIAL EFFECTS OF ABANDONING INVESTOR-STATE ARBITRATION BETWEEN DEVELOPED COUNTRIES

Investment Treaty-Driven Development of the System Would Be Stifled

Experience has thus shown that a mere prospect is not enough to spur much action by a state in negotiating detailed ISDR provisions in its investment treaties. Since it appears that the main driving force for countries to include extensive ISDR provisions in their investment treaties is the prospect of being respondents in ISA, it follows that in the absence of such a prospect, there would be little or no incentive for those provisions to be included in future treaties. This should hardly come as a surprise, since countries typically negotiate treaties on the basis of their national interest.³⁸

Indeed, if the prospect of a suit against the state is removed, it is possible that other interests of the state and its nationals would once again be primary in its negotiating objectives and priorities. In negotiating future treaties there would, for example, be no reason for the state to expend political and diplomatic capital on extensive terms designed to protect the position of the state in arbitration. Rather, the focus would be on advancing other interests, such as those of the business, labour and civil society communities. In that world, it would be left to such groups to argue and try to influence the priorities of the state.³⁹ Ultimately, the result would be a treaty that represents the priorities of the parties as achieved through their respective relative negotiating strengths. For the instances in which

34 Some have simply not signed up to or ratified the necessary treaties — for example, Brazil, India, Mexico, Russia and South Africa are among countries that have not ratified the ICSID Convention.

35 Ecuador, Bolivia and Venezuela have denounced the ICSID Convention. South Africa and Indonesia have cancelled their BITs with different countries.

36 Australia has adopted this approach, as seen in its investment treaties with, for example, the United States (2005), Japan (2015) and Malaysia (2015), respectively, which contain no ISA provisions as compared, for example, to the ones with Turkey (2009), Republic of Korea (2015) and Sri Lanka (2007), which contain such provisions.

37 See e.g. the Finland-Ethiopia BIT, which was signed in 2006 and came into effect in 2007.

38 In New Zealand, for example, a treaty being presented to Parliament for ratification is accompanied by, among other things, a “National Interest Analysis.”

39 This is not necessarily a bad thing. It reflects the workings of a truly democratic environment.

ISA survives — that is, between developed and developing states — it is not inconceivable that future model BITs would be light on the type of detailed ISA provisions to which we have now become accustomed. Indeed, even if treaties continue to be negotiated on the basis of the present model BITs, it is likely that further innovation would suffer and development of the system could stagnate, because there would be no incentive to evolve.

Developing Countries Would Likely Abandon ISA

Another consequence that would likely flow from the system being abandoned by states such as the United States and Canada in their future treaties is that, eventually, developing countries would also follow the same route. Countries are, naturally, likely to follow the examples of those who have had experience of the system. Indeed, reflecting on the reaction of some states that are already abandoning the system in their treaties, the 2012 SADC Model BIT Template contains a special note expressing a preference that ISDS not be included at all, since “[s]everal States are opting out or looking at opting out of investor-state mechanisms, including Australia, South Africa and others.”⁴⁰ Where it is to be included, limitations are applied to the scope similar to those in the newer Canadian and US model BITs, from which the SADC model borrows heavily.⁴¹

A LONG-TERM SOLUTION IS NEEDED FOR THE SYSTEM’S CONTINUED EVOLUTION

Ultimately, the decision whether to keep ISA in treaties between developed countries would be made by those governments, based on factors well beyond the scope of this paper. Whatever their decision, the system would continue to be used for the foreseeable future for disputes arising under the multitude of treaties already in existence, as well as for disputes arising under contracts and national laws. Indeed, the system will continue to serve both developed and developing countries, except that if developed countries decided to drop the mechanism from their treaties, such countries would increasingly feature less as respondents — until they stopped altogether.

As already posited, such a development would ultimately also have a chilling effect on the dynamism with which the ISDR system has evolved. It would again be left mostly to arbitral institutions and UNCITRAL to innovate and evolve the system. By their very nature, such institutions are not able, nor should they be expected, to change their rules with the frequency required to keep up with ever-changing trends. While parties could continue to adapt arbitration rules on a case-by-case basis, the effect would not be easily transferable across cases.

Thus, the continued development of the system will remain important for both developed and developing economies — whether developed economies decided to continue using the system for disputes arising under treaties with other developed economies or not. If it is abandoned in the coming treaties between developed economies, in the short term, the system would continue to apply to all states based on existing treaties that are not overridden by the new treaties. In the longer term, even if not used in disputes against developed economies, it would still be used by investors from those states in disputes with developing countries under existing/surviving treaties. The system would also continue to apply outside of the treaty context to disputes arising out of contracts and national laws. In this regard, it would continue to be available for use by and against investors from developed economies.

A unified appellate mechanism is one of the developments that remains to be resolved. The first comprehensive proposal in this regard was released by the European Union on September 16, 2015, but this is still a long way from achieving universal application, even if eventually incorporated into the TTIP. The subject would, however, become less of a priority if developed countries were no longer respondents nor likely to be. Other examples of areas in which further development is needed include the question of expansion of the pool of arbitrators, as well as the extension of transparency rules to contract- and law-based cases.

40 See SADC Model BIT Template, *supra* note 30, special note to art 29.

41 *Ibid*, art 29.9 and the accompanying commentary.

If these and other changes are to be dynamically tackled in the future, it would be helpful to start seriously considering independent means for addressing such issues. Indeed, the uncertainty arising from the current discussions highlights the need to insulate the system from such shocks in the future. A system that purports to exist to serve the interests of the global community should be able to evolve in the interests of all its users and not be left to swing between conflicting needs and interests at different times.

CONCLUSION

The most significant changes to the way ISA cases are conducted have occurred only in the face of a real possibility that developed countries could become respondents in investment arbitrations — due to ISA provisions in investment treaties between developed countries. The reality of that prospect has spurred the introduction of even more meaningful changes by way of rule variations in investment treaties containing consent to ISA.

Up till now, Canada and the United States have reacted to the risk of being respondents in the ISA system by getting more engaged in the system through adaptation and customization of the set arbitration rules in their treaties. Some of the changes they have introduced were essential for them to keep participating in the system and have hence helped save the system from the structural changes — if not collapse — that would likely have occurred with withdrawals, by developed countries first, then by developing ones. The increased engagement by Canada and the United States in the system has also, arguably, translated into advantages for its other states-users, even if some of the changes, such as limitation of scope, could be argued to be disadvantageous to investors.

Indeed, it is indisputable that the changes introduced to ISA through investment treaties have generally ended up transforming the system as a whole. These effects are recognized and acknowledged, with relevant provisions now appearing in treaties of countries that had otherwise not generally been very expressive in the ISDR provisions of their earlier treaties.⁴² Increased transparency, for example, has helped level the playing field by providing a window into the workings of the system to people around the world who would otherwise have remained ignorant of it.

Whether or not developed countries decide now to stop using the present ISA system between themselves, the system would remain relevant for some time since it continues to be relied upon by investors. There is, however, a risk that the system would lose this opportunity for dynamic evolution if the prospect of developed countries being respondents in ISA is removed. It is conceivable that if developed countries decreased its use, the vigour with which the system has been evolving would slow down as well. This would be an unwelcome situation as there remain short-term and long term-issues to be addressed: the question of an appellate mechanism for ISA, the expansion of the pool of arbitrators, a widely applicable code of conduct for arbitrators and counsel, and the possible expansion of the coverage of the current transparency rules are all areas that demand immediate attention.

Regardless of the outcome of the current discussions, there is a need for the system to be able to develop and evolve independently, and not simply be transformed by the reactions of only one segment of the community of users. Finding a solution for this requires every possible attention, and may be better addressed by users' councils or suitably qualified professional groups.

42 See, for example, the treaties signed by Japan in 2011 with Colombia and Papua New Guinea, respectively.

ABOUT CIGI

The Centre for International Governance Innovation is an independent, non-partisan think tank on international governance. Led by experienced practitioners and distinguished academics, CIGI supports research, forms networks, advances policy debate and generates ideas for multilateral governance improvements. Conducting an active agenda of research, events and publications, CIGI's interdisciplinary work includes collaboration with policy, business and academic communities around the world.

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