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### Inconsistency's Many Forms in Investor-State Dispute Settlement and Implications for Reform

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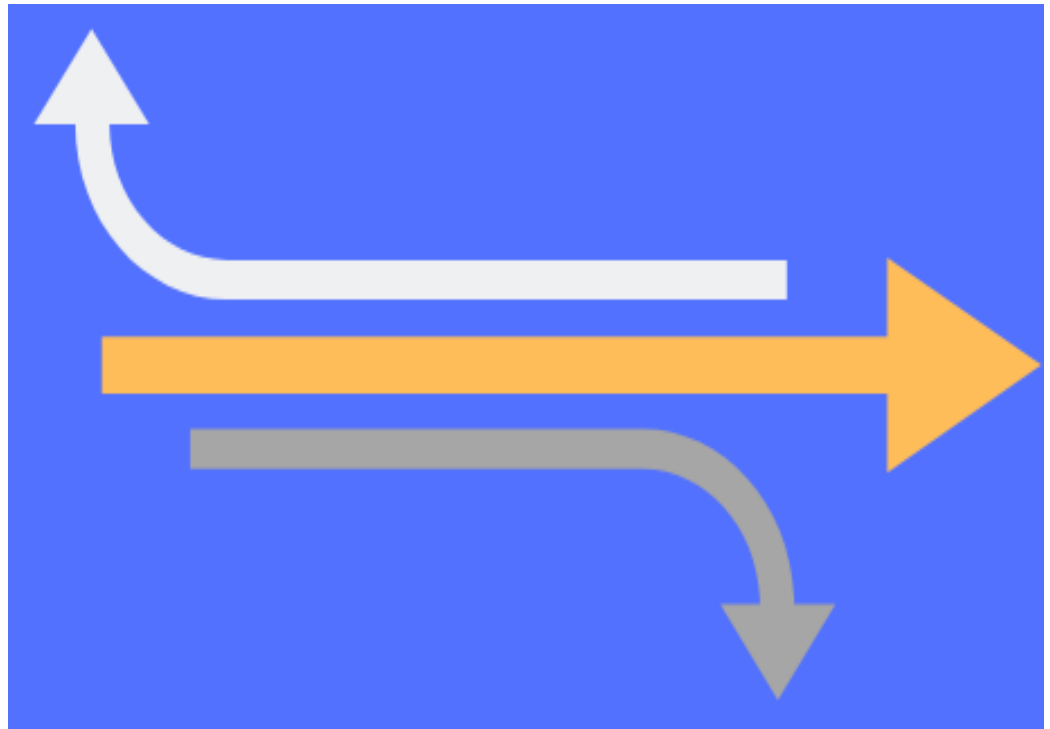
Lise Johnson and Lisa Sachs <sup>1</sup>  
November 2018

## Key Points

**1** Inconsistency in investor-state dispute settlement awards is a problem meriting reform at the multilateral level.

**2** "Inconsistency" has several dimensions: divergent interpretations of provisions; decisions inconsistent with state party intent; and decisions inconsistent with societal objectives or other areas of law.

**3** Some aspects of the inconsistency problem may be best addressed through state-to-state dispute settlement.



## Inconsistency’s Many Forms in Investor-State Dispute Settlement and Implications for Reform

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### 1. Introduction

Delegates in the United Nations Commission on International Trade Law (UNCITRAL) Working Group III have concluded that investor-state dispute settlement (ISDS) has several problems serious and systemic enough to merit reform at the multilateral level. One of those issues is that ISDS decisions and awards pronounce inconsistent outcomes on a range of

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issues.<sup>i</sup> Critics and supporters of ISDS alike have, not surprisingly, highlighted differing decisions as an issue (or symptom of a problem) in the current ISDS system that needs to be addressed. Because of this legal uncertainty, both regulatory conduct by states and investment decisions by private sector actors may be unduly chilled, and disputing parties must spend unnecessary time and money litigating and relitigating the same legal questions. Indeed, the only “stakeholder” that arguably benefits from this inconsistency is the arbitration industry.

The issues regarding consistency fall into several different, sometimes overlapping, categories: There is the issue of divergent interpretations of the same treaty; the issue of inconsistent interpretations of the same or similar provisions across treaties; the issue of arbitral decisions that are inconsistent with state party intent; and the issue of arbitral decisions that are inconsistent with *broader societal objectives and commitments*, including the Sustainable Development Goals (SDGs), international treaty commitments, or other areas of domestic or international law. Each of these types of inconsistency merits attention and consideration of appropriate reforms. It may be that some types of reform might reduce one aspect of inconsistency but expand the others.

One proposal put forward to resolve an aspect of the inconsistency issue is to create an investment court. The European Commission has said, for instance, that a key benefit of a court as opposed to the present ad hoc system of investment arbitration is that it will result in more consistent and predictable decisions.<sup>ii</sup> Another proposal is to create an appellate body, which would review decisions by the proposed investment court and/or arbitration tribunals. The proposals envision that these new bodies, the court and/or appellate body, would steer the law more uniformly in one direction or another.

These reform proposals might indeed improve consistency of decisions arising out of specific treaties or, more complicated and controversially, could improve consistency of decisions across treaties. But they do not necessarily tackle, and may even exacerbate, the other key issues at the heart of these diverging decisions, which relate to the question of consistency between, on the one hand, what arbitrators say the treaties mean and, on the other, what states consider that investment protection means, as well as consistency between treaty

interpretations and other areas of law and public policy.

It is instructive to highlight that the European Commission is also pursuing different reforms in order to address the issue of inconsistency across different areas of law and policy. Specifically, in light of the issue of inconsistency between intra-EU investment treaties and the law and principles of the EU, the Commission is exploring how to support its Member States in jointly terminating all intra-EU BITs and excising those agreements’ survival clauses.<sup>iii</sup>

In order to more fully explore these issues of inconsistency and relevant reform options, we can use one particular example of inconsistency – a dispute in which two different tribunals heard claims arising out of the very same facts and domestic measures but came to opposite conclusions about whether the state was liable and had to pay. The relevant example comes from *TECO v. Guatemala*<sup>iv</sup> and *Iberdrola v. Guatemala*.<sup>v</sup> In these disputes, two different foreign shareholders in one Guatemalan electricity distribution company, Empresa Eléctrica de Guatemala (EEGSA), brought two different ISDS suits to challenge the same government conduct. When Guatemala’s electricity regulator decided not to grant EEGSA its requested tariff increases, the two corporate investors used treaty-based ISDS to sue the government. The tribunals in those two cases came to opposite conclusions on what the treaties mean and do. Exacerbating the confusion arising from those diverging decisions, each tribunal award was subject to requests for annulment, with the different annulment committees (and their members) coming to different conclusions about the merits of the underlying decisions, and the committees’ power to review those decisions. Using this particular example of inconsistency, we can further explore the nature of the different inconsistency problems, and the promise and peril of different reform solutions.

## 2. The Context

In the mid-1990s, Guatemala was beginning to come out of a thirty-year civil war. After concluding a peace agreement to halt the conflict in 1996, the healing country took various steps to improve its citizens’ lives and livelihoods, including by improving access to and quality of public services and infrastructure. In order to advance those social objectives, Guatemala adopted regulatory reforms to privatize and attract investment

in its energy sector (generation, transmission, and distribution). This shift toward privatization, reflected in a new regulatory framework, aimed to promote competition, ensure rates were based on costs, and also improve quality and availability of energy services.

The legal framework that was erected to promote private investment – including the General Electricity Law that came into effect in 1998 and individual power-purchase agreements (PPAs) negotiated with energy generators – offered “favourable conditions” and “generous fiscal incentives” to investors, and were successful in attracting significant attention from foreign companies. Indeed, in the roughly 10 years following privatization, foreign direct investment (FDI) in the electricity sector amounted to over USD 1.5 billion.<sup>vi</sup>

In 1998, a consortium of foreign investors, including Iberdrola and TECO, purchased a majority stake in EEGSA, one of Guatemala’s two state-owned energy companies, responsible for providing power to Guatemala’s central region, including its capital city. TECO also invested in separate coal- and oil-fired power generation facilities in Guatemala, selling the power it generated to EEGSA.<sup>vii</sup> Private investment brought “solid growth” in generating capacity that had been “unmatched in Guatemala’s history.”<sup>viii</sup> Proceeds from the sale of formerly state-owned assets were also used to expand the network and connect the rural population to electricity grids.

But in other measures of success, the government’s energy reforms were less positive.

In particular, due in part to the terms of the PPAs, post-privatization electricity prices were unusually and exceedingly high. As UNCTAD reported, by 2008, average electricity rates to commercial and residential end users were “the least competitive in the region.”<sup>ix</sup> These rates, in turn, drove heavy government subsidies to low-income consumers, and threatened “the country’s competitiveness across all sectors.”<sup>x</sup>

Notably, much of the new private foreign investment was in installing fossil fuel-based rather than renewable capacity. The new investment shifted the country from one that primarily had relied upon hydropower for energy sources to one that sourced most of its energy from thermal plants.<sup>xi</sup> While such fossil-fuel based power sources were attractive to foreign firms as they “see faster returns to investment,” the energy they generate is less climate-friendly than

renewable sources, and “is more expensive given the volatility of international prices for fossil fuels.”<sup>xii</sup> Furthermore, as UNCTAD also noted, the consumer subsidies provided by the government to help ensure access to affordable electricity under the investor-friendly legal framework reduced the resources available to the government to further invest in expanding its renewable energy supply.<sup>xiii</sup>

### 3. Guatemala’s Tariff Dispute

Under the legal framework Guatemala adopted in the late 1990s to govern its reformed energy sector, electricity tariffs were to be reviewed every 5 years. In the first five-year review under that legal framework, covering 2003-2008, the government regulator (CNEE) approved an increase in EEGSA’s tariff schedule without dispute.

Things did not go so smoothly in the next review process. Disputes arose regarding

- the Terms of Reference governing the relevant underlying study EEGSA was required to prepare and submit to CNEE to be used in developing the tariff schedule,
- the content and conclusions of that study submitted by EEGSA to CNEE, which would have produced further tariff increases,
- the process for resolving disagreements regarding the study, including the role of an “Expert Commission” in resolving disputes between EEGSA and CNEE, and
- whether CNEE could, as it did, contract for and use a separate study should it determine that EEGSA’s study did not meet legal requirements.

Throughout the process and after CNEE issued its pricing decision rejecting EEGSA’s requested increases, these disagreements generated significant litigation within Guatemala, with EEGSA raising its concerns about Guatemala’s regulatory actions through administrative and court proceedings. In some phases, EEGSA prevailed but, ultimately, the Constitutional Court ruled in favor of the regulator CNEE on the different challenged aspects of the tariff dispute. In two decisions rendered in November 2009 and February 2010, the Constitutional Court determined that the regulator had acted appropriately in commissioning and relying on its own tariff review study (and rejecting the study that had been prepared

and submitted by EEGSA's consultants). The Constitutional Court also determined that the regulator had appropriately treated the Expert Commission's findings as advisory, and not binding, and that CNEE had acted legitimately in terms of how it used the Expert Commission in helping to resolve disputes on tariff issues.

In October 2010, TECO, Iberdrola, and other private investors in EEGSA sold their interest in EEGSA (and affiliated companies) to another foreign investor for USD 605 million in cash, plus the purchaser's assumption of existing debt.<sup>xiv</sup>

#### 4. The ISDS Claims

In 2009, while the domestic proceedings were pending, EEGSA's investors, TECO and Iberdrola, each notified Guatemala of their intent to use ISDS claims to challenge CNEE's tariff decision. TECO brought its claim under the US-Dominican Republic-Central America free trade agreement (US-CAFTA-DR), and Iberdrola under the bilateral investment treaty (BIT) between Spain and Guatemala.

##### *Iberdrola v. Guatemala*

Iberdrola formally initiated its ISDS claim against Guatemala on April 17, 2009, while EEGSA's domestic legal challenges were still pending. It argued that Guatemala's actions violated several of the country's obligations under the Spain-Guatemala BIT, including those arising under the treaty's provisions on expropriation, fair and equitable treatment (FET), and full protection and security.

But according to the *Iberdrola* tribunal in its August 2012 decision, most of the investor's complaints simply did not belong before the ISDS panel. "[B]eyond labeling the behavior of CNEE as violating the Treaty," Iberdrola's complaints about the regulator's pricing decision and the courts' acceptance of that decision "did not raise a dispute under the Treaty and international law, but a technical, financial and legal discussion on provisions of" Guatemalan law.<sup>xv</sup> The tribunal added:

It is true, as the Claimant notes, that the legality of the conduct of a State under its domestic law does not necessarily lead to the legality of such conduct under international law. But the fact remains that if the State acted invoking the

exercise of its constitutional, legal and regulatory powers, by which it interpreted its domestic legislation in a certain way, an International Centre for Settlement of Investment Disputes (ICSID) tribunal, constituted under the Treaty, cannot determine that it has the competence to judge, under international law, the interpretation made by the State of its domestic legislation, simply because the investor does not share this or considers it arbitrary or in violation of the Treaty.<sup>xvi</sup>

The tribunal therefore rejected most of Iberdrola's claims on jurisdiction. However, the tribunal determined that one of Iberdrola's claims fell within the scope of the treaty – Iberdrola's arguments that the administrative and judicial processes and determinations, individually and collectively, amounted to a denial of justice under the treaty actionable under the FET clause.

The tribunal identified several scenarios that could support such a claim:

(i) the unjustified refusal of a tribunal to hear a matter within its competence or any other State action having the effect of preventing access to justice; (ii) undue delay in the administration of justice; and (iii) the decisions or actions of State bodies that are evidently arbitrary, unfair, idiosyncratic or delayed. ... '[D]enial of justice is not a mere error in interpretation of local law, but an error that no merely competent judge could have committed and that shows that a minimally adequate system of justice has not been provided.'<sup>xvii</sup>

But in Iberdrola's case, the tribunal concluded, there was no such denial of justice. Rather, from the regulatory decisions up through the Constitutional Court proceedings, Iberdrola simply disagreed with the domestic process and the outcomes, and wanted the tribunal to insert itself in the complex domestic dispute and produce a different result. According to the tribunal, however, there were no grounds for it to provide such relief.

In the end, the tribunal rejected the claimant's claims in their entirety, and ordered Iberdrola to pay Guatemala for the USD 5.3 million it spent defending itself in the three-year arbitral proceeding. The *Iberdrola* decision therefore sent a relatively clear message that

investment arbitration tribunals are not places where disgruntled private investors can go when they disagree with domestic outcomes on sensitive issues such as tariff decisions. Rather, something more, such as a clear denial of justice in domestic proceedings, is required.

However, Iberdrola's bid to annul the arbitral decision muddled the message. Although Iberdrola's annulment application was ultimately unsuccessful, the company succeeded in getting one of the three annulment committee members to agree that the *Iberdrola* tribunal had too narrowly viewed its powers of review. The fact that one of the annulment committee members issued this opinion is particularly significant given that the scope of review on annulment is supposed to be exceedingly narrow<sup>xviii</sup> and applications for annulment rarely granted.<sup>xix</sup> Since the annulment decision was rendered, Iberdrola has re-submitted its claim against Guatemala in a proceeding under the UNCITRAL arbitration rules.<sup>xx</sup> While little information about the dispute is publicly available, it has been reported that Iberdrola is trying again to recover compensation for the same tariff-related measures.

Another reason that the lessons from Iberdrola are not clear is the contradictory outcome in the parallel case, *TECO v. Guatemala*.

### ***TECO v. Guatemala***

TECO filed its notice of arbitration on October 20, 2010, the day before selling its stake in EEGSA. As compared to the *Iberdrola* tribunal, the *TECO* tribunal was much more open to the claimant's claims. According to the tribunal, the Constitutional Court decisions did not address CNEE's alleged failure to provide satisfactory reasons regarding its tariff decisions. For the tribunal, the key issue was that the regulatory body failed to provide reasons regarding its decision to adopt the tariff study proposed by its consultant, as opposed to adopting EEGSA's proposed formula as amended after input by the Expert Commission. The tribunal determined that CNEE had a duty to provide additional reasons for its tariff decision as a matter of both domestic and international law, and had violated that obligation.<sup>xxi</sup> A failure to give reasons, the tribunal opined, indicated that the decision taken was arbitrary and lacked due process.<sup>xxii</sup>

Notably, after the tribunal found fault with the regulator's failure to give reasons, the tribunal did not

stop at declaratory relief. Rather, the tribunal effectively overrode CNEE's decision on the merits, substituting the regulator's conclusions on the tariff formula with the investor's proposed approach. The tribunal determined that TECO was entitled to its share of the difference between the high revenues it would have received if it had been able to charge its requested tariffs, and the lower revenues it in fact received between the time of the tariff decision in August 2008 and TECO's sale of the company roughly two years later. That amount equaled roughly USD 21 million. The tribunal also ordered Guatemala to bear its own legal costs of roughly USD 5 million, and 75% of the TECO's roughly USD 10 million in fees and costs, adding an additional USD 12.5 million to Guatemala's liability.

Guatemala challenged that decision in annulment proceedings, arguing in part that even if there were a procedural error – a breach of some unwritten international norm of administrative law – there was no evidence that the failure to give reasons actually caused the investor any harm or entitled the investor to the tariff scheme it had proposed.

TECO also sought annulment, arguing that the damages the tribunal awarded were inadequate. Among its arguments, TECO asserted that, in addition to being entitled to the revenue it would have received under its requested tariff formula, the company should have been awarded an additional USD 220 million. TECO alleged that amount represents the difference between (1) the depressed price at which it sold its interests in EEGSA, and the (2) price it could have received if EEGSA had been permitted to charge its requested higher tariffs.

The annulment committee rejected Guatemala's arguments. It did, however, accept several of TECO's pleas for partial annulment. The annulment committee determined that the tribunal had failed to state reasons for rejecting TECO's claims that it should be compensated for having to sell its interest in EEGSA at price lower than it might have received had the higher tariff formula been approved. The annulment committee also annulled the *TECO* tribunal's decision rejecting TECO's request for pre-sale interest, as well as the tribunal's decision to require TECO to bear 25% of its legal costs. TECO has since resubmitted its case for damages; that case is currently pending before a new ISDS tribunal.<sup>xxiii</sup>

## 5. What Does This Mean for Stakeholders and Reform Paths?

The EEGSA disputes are not the only examples of inconsistent outcomes in investment law, but they are useful for putting important issues into relief regarding what we mean by “inconsistency” and for highlighting opportunities and challenges of potential solutions. One tariff decision produced two different cases arising out of the exact same facts and underlying domestic law. In one, the tribunal said relatively clearly that the claims put forth by the investor were neither issues international investment law is meant to solve, nor questions that respondent states should be asked to spend resources defending. In the other, the tribunal determined that international investment law gave it the power to step in and essentially redo the domestic regulatory tariff proceedings.

These diverging outcomes have important (if confusing) implications for foreign investors and regulators around the world. They also have important implications for the individuals and entities who use and depend on essential services provided by the private sector, and who rely on the government to ensure services provided by those private entities meet public needs, including affordability and accessibility.

For the foreign shareholders, the extra opportunity to seek a positive outcome through ISDS is no doubt favorable. In contrast, for the regulators and captive customers, the investor’s ability to sue, and to do so in a forum that the citizens and regulator may be hard-pressed to follow, much less participate in, is disconcerting. The *TECO* tribunal in particular had viewed the process as unfair to the private investor because, in the tribunal’s view, the regulator did not give EEGSA adequate or satisfactory reasons for its decision. But it is far from clear that the ISDS process is fair to the citizens, the regulator, or other government bodies (such as human rights ombudspersons in Guatemala and elsewhere tasked with helping ensure access to energy) who have much less of a practical or legal voice in ISDS proceedings with so much power over on-the-ground outcomes.

Moreover, in Guatemala and beyond, there remain fundamental concerns and unanswered questions about whether, when, and under what circumstances it is appropriate to enable investors to circumvent domestic substantive and procedural rules for challenging government measures, and instead to

bring their claims in asymmetrical and de-localized ISDS proceedings irrespective of the complex governance questions the disputes (and their outcomes) implicate.

The EEGSA tariff dispute therefore highlights not only inconsistent outcomes arising of a single investment project and a single treaty standard (FET), but also inconsistencies between state and tribunal understandings of the provisions, and inconsistencies with other areas of law, including rule of law norms, and public policy.

Current reform proposals referenced at UNCITRAL may address a few of these issues but also risk ignoring and exacerbating the most systemic problems with ISDS. For instance, in the discussions at UNCITRAL, there were calls to address the problematic fact that, as in *TECO* and *Iberdrola*, shareholders could bring parallel claims for the losses that the company they had invested in allegedly had suffered. If reforms actually tackle that important issue of shareholder “reflective loss” claims, then future ISDS disputes may not produce such clearly inconsistent outcomes in different cases arising out of the *very same project*. But there are still the concerns that outcomes produced, including decisions by any future investment court or appellate body, will be inconsistent with the intent of any particular treaty, or inconsistent across treaties. And, more fundamentally, there is the ongoing risk that any decisions issued, or law generated or solidified by these proposed bodies, will be inconsistent with domestic or international laws, rule of law norms, and other public policies, including, for example, the global commitment to ensure affordable access to energy for all.

Regarding inconsistency within and across treaties, one arguable reason for the diverging interpretations is that the cases were brought under two different treaties with two intentionally different approaches to investor protections. In the EEGSA tariff example, however, if the different standards had played a role in producing the different outcomes, one would have expected the *TECO* case to have been the less favorable, not the more favorable, decision from the perspective of the investor. In *Iberdrola*, the dispute was brought under the bilateral investment treaty (BIT) between Spain and Guatemala, which includes a so-called “autonomous” FET obligation. In *TECO*, the case was filed under the US-CAFTA-DR, which ties the FET obligation to the minimum standard of treatment (MST). Generally, the MST-tethered

standard such as is included in the US-CAFTA-DR is considered to be narrower than the “autonomous” approach such as in the Spain-Guatemala BIT. Moreover, in the fall of 2012, after the *Iberdrola* award in favor of Guatemala had been issued under the Spain-Guatemala BIT, several non-disputing state parties to the US-CAFTA-DR – the United States,<sup>xxiv</sup> El Salvador,<sup>xxv</sup> Honduras<sup>xxvi</sup> and the Dominican Republic<sup>xxvii</sup> – weighed in with submissions to the *TECO* tribunal noting the limited role of the FET obligation under that treaty, and highlighting how tribunals’ interpretations of that MST-tied standard are different from, and generally constrained as compared to, interpretations of “autonomous” provisions. Given that those non-disputing state party submissions came after the *Iberdrola* tribunal had already issued its decision adopting relatively narrow reading of the FET clause, the *TECO* award in December 2013 is even more surprising for its broader approach to state liability. It appears that, rather than arising from differences in the underlying treaties or state views thereof, the different outcomes in *TECO* and *Iberdrola* reflect the tribunals’ different perspectives regarding the roles of domestic and international law (and their associated remedies) in governing foreign investment.

How, then, to reduce inconsistency between, on the one hand, what the states intend and broader societal objectives warrant and, on the other, what tribunals decide? Neither proposals for a court nor an appellate body, alone, will serve either of those objectives. If, out of the UNCITRAL reform process, countries create a court and/or appellate body to more clearly send investment law in one direction or another, what law will this body or bodies develop? Those bodies may improve consistency by directing international investment law to play the role seen by the *Iberdrola* tribunal, providing a check against clear unremedied wrongs and injustices but otherwise taking a deferential approach to domestic regulatory approaches. Or, problematically, they may construct international investment law in the form as envisioned by the *TECO* tribunal, and with which the *TECO* and *Iberdrola* annulment committees seemed to sympathize,<sup>xxviii</sup> developing and imposing a system of administrative rules designed to protect the interest of international capital, noncompliance with which enables the tribunal to step in, adjudicate a dispute in a relatively closed forum removed from the local context, pronounce what the domestic outcome should have been, and award compensation it deems appropriate. A key implication of a court and/or appellate body system is that the law that develops will

likely be more difficult to shift or depart from than the current mess of decisions, which are not binding on subsequent tribunals or on anyone else other than the relevant disputing parties. Thus, the consequences of promoting consistency can be severe, as the wrong type of consistency can be more systemically damaging than undesirable outcomes that are not binding on subsequent tribunals. Simply shifting or consolidating the decision-makers does not inherently give confidence in their interpretations. Rather, it raises concerns that, as these bodies of yet uncertain makeup, rules, power, and accountability shape and harden the law in a more “consistent” direction, they may be generating incorrect outcomes as judged from what states intend and their stakeholders expect from the system.

Relevant discussions in and around UNCITRAL have highlighted other approaches for potentially overcoming the issue of inconsistency with states’ aims and broader objectives. One is to increase the role of states in shaping the meaning of their treaties through, for instance, increased unilateral or joint interpretations on relevant provisions. A second is to ensure that adjudicators do not have financial, professional or other incentives to develop investor-friendly approaches irrespective of treaty intent. Here as well *TECO* and *Iberdrola* highlight limits to those solutions.

First, with respect to the issue of interpretation, evidence shows that home states in bilateral treaties are exceedingly unlikely to make submissions to tribunals on issues of interpretation. Whether this is because of resource constraints, political reasons, or other factors, non-disputing state parties to BITs do not generally weigh in to help tribunals understand treaty intent when their treaty counterparties are being sued. This means that the sole inputs on treaty interpretation by any BIT party are typically the briefs and arguments by the respondent state, and such respondent state submissions appear to carry no special weight for arbitrators.

If the UNCITRAL process ultimately creates a court and/or appellate body, it is questionable whether home states will become more active in making such interpretations, especially if the relevant dispute arises under a treaty under which the home state is itself unlikely to be sued. Additionally, as *TECO* illustrates, even when non-disputing state parties submit briefs on interpretation, those briefs may have little practical effect on actual outcomes.<sup>xxix</sup>



In order to ensure states can exercise effective control over the interpretation and application of their treaties, one option would be to ensure that state interpretations carry more weight with tribunals. This could be done by ensuring that joint interpretations issued by the treaty parties are actually binding on tribunals. But while this may prevent tribunals from departing from the state parties' interpretations, it would not address the many cases in which home states decline to intervene.

Thus, a crucial reform option is to develop mechanisms to *compel* greater home country engagement in filing or arguing claims. Rather than continuing to permit home states to allow their investors essentially unfettered litigation latitude under the treaty, and legally and politically distance themselves from the positions those investors take, one reform approach would be to give home states a greater responsibility to filter relevant claims. This could mean adopting a two-step process: sending all disputes or all claims under particular standards (e.g., FET) to state-to-state screening mechanisms before they are permitted to proceed to international dispute settlement (which could be ISDS or state-to-state proceedings).<sup>xxx</sup> This could also mean simply limiting allegations of treaty breach to state-to-state dispute resolution only. Criteria could also be developed at the domestic level regarding when a state will/will not pursue a claim on behalf of a relevant investor, reducing inconsistency, uncertainty and consequences of purely discretionary decisions.<sup>xxxi</sup>

Second, regarding the issue of adjudicator incentives, one critique of the current ISDS system is that the practice of party appointment creates inappropriate incentives for adjudicators to hear and favor investor claims. There have been suggestions that, if the current system of adjudication by party-appointed arbitrators is replaced by adjudication by non-party-appointed salaried judges, then the decisions rendered will more closely align with states' understandings of IIAs and be more disciplined. Hence the proposed reform within the UNCITRAL discussions to create a standing court, roster and/or appellate body of individuals to be appointed by states or intergovernmental institutions.

While proposals regarding adjudicator appointment may reduce some of the improper incentives driving arbitral outcomes, *TECO* and *Iberdrola* highlight those reforms' limits. The annulment committee decisions in *TECO* and *Iberdrola* were rendered by individuals

drawn from ICSID's Panel of Arbitrators, which means they were either designated by ICSID Contracting States or by the Chairman of the Administrative Council.<sup>xxxii</sup> Of the six annulment committee members, four (three from *TECO* and one from *Iberdrola*) favored granting the investor the rather exceptional annulment remedy.<sup>xxxiii</sup> Of course, having state-appointed adjudicators (or adjudicators appointed by intergovernmental organizations (IGOs)) should not mean that states' voices always or even more frequently prevail over investors'. But it is nevertheless important to highlight that, if the aim to ensure treaties align with state party intent, moving away from party-appointment to state- or IGO-appointments will not necessarily improve that alignment.

Furthermore, a system of state- or IGO-appointment may not do anything to better align investment treaties with broader objectives beyond (and potentially inconsistent with) investor protections. Indeed, a powerful court and/or appellate body established specifically to hear concerns of investors, unable to hear complaints by other citizens or entities (except to the extent they may be represented by their states' positions), and structurally isolated from other areas of domestic and international law and policy and relevant expertise, exacerbates concerns that any law developed by a new court or appellate body will be unduly ignorant of or unconcerned with non-investor rights and interests.<sup>xxxiv</sup>

Overall, providing some future set of decision makers the definitive (and binding) say on the meaning of investment protection may reduce some types of inconsistency. But by giving those bodies the opportunity and power to develop the relevant law, other stakeholders lose their own voice and power to shape it. These issues are essential to consider as ISDS claims can be used to challenge or supplant a vast range of government conduct, from general regulation to specific discretionary decisions. Issues that are extremely sensitive and hotly contested in domestic legal systems – such as frameworks for regulating pricing and quality of essential public services, the powers of corporations to lobby government actors, and ability of citizens to sue and seek compensatory or punitive damages for corporate harms – are issues that may increasingly find their way into international investment law fora as this field continues to grow. When desired outcomes under domestic or other areas of international law are not ideal for covered investors, those investors can seek different, i.e., *inconsistent*, outcomes from investment

treaty tribunals. The question of when investors should be able to use investment law to trump other “inconsistent” spheres of law and policy is at the heart of concerns regarding investment law that have driven calls for reform. Unless meaningful discipline is placed on the nature of inconsistencies that can be challenged, including by limiting or barring direct investor claims (while maintaining state-to-state dispute settlement), those concerns about investment law will not be assuaged. Rather, moving resolution of these issues to a standing specialized international investment court or appellate body may only intensify critiques about the substantive contours of the law.

## 6. Conclusions Regarding Work on “Consistency” at UNCITRAL and Beyond

ISDS is much maligned for its inconsistency problems. As we consider how to fix those problems, we must have a clear idea of the nature of those problems, and the advantages and disadvantages of different reform options. One aspect of the inconsistency issue that has driven public concern about ISDS relates to inconsistency of investment law *with other areas of law and policy*. As reflected by some delegates’ comments within the UNCITRAL process, these issues and concerns must be central in the reform agenda. Some state delegates to UNCITRAL, for instance, have emphasized the overarching need to ensure reforms are pursued in a manner that “promote[s] investment policies in line with the three pillars of sustainable development.”<sup>xxxv</sup> Other state delegates have highlighted that inconsistency in investment law threatens to undermine achievement of the

Sustainable Development Goals (SDGs),<sup>xxxvi</sup> and that the current system of ISDS may be having undue chilling effects on legitimate government policies adopted in the public interest.<sup>xxxvii</sup>

These interventions echo those made by the UN Secretary General in July of 2018:

Reform of international investment agreements (IIA) remains an important area for improving the sustainable development impact of the international financial system. While FDI remains a more stable form of cross-border financial flow, IIAs often result in unintended consequences, such as constraining regulatory space or countries becoming vulnerable to large financial penalties from arbitration panels set up to settle investor-state disputes.<sup>xxxviii</sup>

UNCITRAL has a vital role to play in exploring problems with and potential reform of ISDS, and in considering how to ensure its work better promotes, and does not undermine, rule of law, other domestic and international commitments and policies, and the globally agreed Agenda 2030. As the process moves forward, it is therefore essential for the work to take a broad approach to defining the problem of “inconsistency” and designing reform solutions. Reform proposals regarding limiting shareholder claims, increasing states’ interpretive power, and avoiding inappropriate adjudicator incentives are undoubtedly positive signs that reflect earnest desire for change. But it is unclear that anything short of a reversion to state-to-state dispute settlement will minimize the risk of inconsistency across law and policy spheres.

## Notes

<sup>i</sup> United Nations Commission on International Trade Law (UNCITRAL), Draft Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of Its Thirty-Sixth Session, November 6, 2018 (hereinafter “Draft 36th Session WGIII Report”), paras. 39-40.

<sup>ii</sup> See e.g., European Commission, “A Multilateral Investment Court” (2018), available at [http://trade.ec.europa.eu/doclib/docs/2017/september/tradoc\\_15604\\_2.pdf](http://trade.ec.europa.eu/doclib/docs/2017/september/tradoc_15604_2.pdf).

<sup>iii</sup> Other countries, such as Ecuador, have terminated their BITs for similar reasons. See, e.g., Comisión para la Auditoría Integral Ciudadana de los Tratados de Protección Recíproca de Inversiones

*The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is a leading research center and forum dedicated exclusively to the study, practice and discussion of sustainable international investment (SII) worldwide. Through research, advisory projects, multi-stakeholder dialogue and educational programs, CCSI constructs and implements an investment framework that promotes sustainable development, builds trusting relationships for long-term investments, and is easily adopted by governments, companies and civil society.*

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y del Sistema de Arbitraje Internacional en Materia de Inversiones (CAITISA), Final Report (May 2017); Christian Leathley and Daniela Paez, Ecuador's Legislative Branch Approves Termination of 12 Bilateral Investment Treaties, Herbert Smith Freehills Arbitration Notes, May 5, 2017; and Cecilia Olivet, Why Did Ecuador Terminate All Its Bilateral Investment Treaties, Transnational Institute, May 25, 2017.

<sup>iv</sup> *Teco Guatemala Holdings v. Guatemala*, ICSID Case No. ARB/10/2, Award, December 19, 2013.

<sup>v</sup> *Iberdrola Energía v. Guatemala*, ICSID Case No. ARB/09/5, Award, August 17, 2012.

<sup>vi</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 69.

<sup>vii</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 13.

<sup>viii</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 69.

<sup>ix</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 23-24.

<sup>x</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 75-76.

<sup>xi</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 69.

<sup>xii</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 69.

<sup>xiii</sup> UNCTAD, Investment Policy Review: Guatemala (2011), 76-77.

<sup>xiv</sup> *Iberdrola*, Award, para. 22; TECO Energy, News Release: TECO Guatemala Holdings LLC sells its interest in Guatemalan electric distribution company (October 21, 2010).

<sup>xv</sup> *Iberdrola*, Award, para. 353 (unofficial translation).

<sup>xvi</sup> *Iberdrola*, Award, para 363 (unofficial translation) (footnotes omitted).

<sup>xvii</sup> *Iberdrola*, Award, para. 432 (unofficial translation) (footnotes omitted).

<sup>xviii</sup> See ICSID Convention, art. 52; see also ICSID, Updated Background Paper on Annulment for the Administrative Council of ICSID, May 5, 2016.

<sup>xix</sup> See ICSID, Updated Background Paper on Annulment for the Administrative Council of ICSID, May 5, 2016, pp 10-11.

<sup>xx</sup> Luke Eric Peterson, Kaufmann-Kohler in Chair for New Effort by Iberdrola to Sue Guatemala under Spanish Investment Treaty, IARporter, June 13, 2018.

<sup>xxi</sup> *TECO*, Award, paras. 565, 583, 588.

<sup>xxii</sup> *TECO*, Award, para. 587.

<sup>xxiii</sup> ICSID registered TECO's new suit on October 3, 2016. As of November 1, 2018, it was still pending.

<sup>xxiv</sup> Submission of the United States of America, November 23, 2012.

<sup>xxv</sup> Non-Disputing Party Submission of the Republic of El Salvador, October 5, 2012.

<sup>xxvi</sup> Non-Disputing Party Submission of the Republic of Honduras, November 15, 2012.

<sup>xxvii</sup> Submission of the Dominican Republic as a Non-Disputing Party, October 5, 2012.

<sup>xxviii</sup> While two of the three members of the *Iberdrola* annulment committee rejected Iberdrola's application, they nevertheless "express[ed] skepticism with the tribunal's ultimate determination that Iberdrola's claims could only be viewed as local law claims (rather than capable of breaching the treaty's obligations." Clovis Trevino, Ad Hoc Committee Splits, but Majority Decides to Uphold Earlier Tribunal's Award in *Iberdrola v. Guatemala* Case, IARporter, January 15, 2015.

<sup>xxix</sup> There are various examples indicating that non-disputing party submissions may be having limited effect in cases. See examples cited in Lise Johnson, [New Weaknesses: Despite a major win, arbitration decisions in 2014 increase the US's future exposure to litigation and liability](#) (CCSI, January 2015), 8-9. See also, e.g.,

*Windstream Energy LLC v Canada*, PCA Case No. 2012-22, Award, September 27, 2016, paras. 329-62.

<sup>xxx</sup> For examples of some of these filter mechanisms, see, e.g., discussions in Lise Johnson, Lisa Sachs and Jesse Coleman, *International Investment Agreements, 2014: A review of trends and new approaches*, in *Yearbook on International Investment Law and Policy 2014* (OUP 2016), 44-47; Jesse Coleman, Lise Johnson, Lisa Sachs and Kanika Gupta, *International Investment Agreements, 2015-2016: A review of trends and new approaches*, in *Yearbook on International Investment Law and Policy 2015-2016* (OUP 2017), 65-68.

<sup>xxxi</sup> Relevant concerns about relying on states to pursue claims include that they may not pursue claims on behalf of smaller investors, or that the states may pursue claims on behalf of investors irrespective of those investors' (or the investors' claims') impacts in the host country. There are, however, potential means of addressing those issues. For instance, governments could adopt transparent policies regarding when and how they will engage on behalf of their foreign invested firms. In those policies, the home government could state it will prioritize action based on the nature of the harm (in addition to or instead of the size of the investor and its significance to the home state economy), and whether there is evidence that the investor has exhausted its domestic remedies. Additionally, governments could be more principled and transparent about when they will not intervene. The government of Canada, for instance, has said that it may withhold diplomatic support from those overseas investing companies not complying with the OECD Guidelines on Multinational Enterprises. One could envision similar policies as being adopted at the domestic level to guide state decisions on whether to pursue treaty-based claims on behalf of covered investors.

<sup>xxxii</sup> In the *Iberdrola* annulment decision, one of the three was from the state-designated list. (Dr. Enrique Barros Bourie (Chilean, designated by Chile), President Prof. Piero Bernardini (not from the state-designated list), and Dr. José Luis Shaw (Uruguayan, not from the state-designated list)). In *TECO*, the annulment committee members were Professor Bernard Hanotiau (Belgian, designated by Belgium), President Ms. Tinuade Oyekunle (Nigerian, not from the state-designated list), and Professor Klaus Sachs (German, designated by Germany). In the *TECO* annulment proceedings, which ruled in favor of TECO, two of the three annulment committee members were those nominated by states party to the ICSID Convention.

<sup>xxxiii</sup> Favoring the investor's annulment claims were, in *TECO*, Professor Bernard Hanotiau (Belgian, designated by Belgium), President Ms. Tinuade Oyekunle (Nigerian, not from the state-designated list), and Professor Klaus Sachs (German, designated by Germany), and in *Iberdrola*, Dr. José Luis Shaw (Uruguayan, not from the state-designated list).

<sup>xxxiv</sup> See Rochelle Dreyfuss, *The EU's Romance with Specialized Adjudication*, 47 *International Review of Intellectual Property and Competition Law* 887 (2016).

<sup>xxxv</sup> Draft 36<sup>th</sup> Session WGIII Report, para. 16.

<sup>xxxvi</sup> Draft 36<sup>th</sup> Session WGIII Report, para. 30.

<sup>xxxvii</sup> Draft 36<sup>th</sup> Session WGIII Report, para. 111.

<sup>xxxviii</sup> United Nations General Assembly. International financial system and development (Report of the Secretary-General 30 July 2018) para. 60, [http://www.un.org/esa/ffd/wp-content/uploads/2017/08/73GA\\_SGR\\_IFS\\_draft\\_2018-07-24\\_AUV.pdf](http://www.un.org/esa/ffd/wp-content/uploads/2017/08/73GA_SGR_IFS_draft_2018-07-24_AUV.pdf) Accessed 27 October 2018.