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Primer: International Investment Treaties and Investor-State Dispute Settlement

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What Are International Investment Agreements (IIAs)? IIAs are bilateral or multilateral treaties that commit state-parties to afford specific standards of conduct to foreign investors from the other state-parties. These treaties grant foreign investors certain benefits, including recourse to Investor-State Dispute Settlement (ISDS) to resolve disputes with host states. Over 3,300 agreements have been concluded worldwide, including NAFTA and the Comprehensive and Progressive TransPacific Partnership.

What is Investor-State Dispute Settlement (ISDS)? IIAs allow foreign investors (individuals and companies) to allege treaty violations by suing states through ad hoc arbitration. Arbitration tribunals are composed of party-appointed (and party-paid) private lawyers. Tribunals are not bound by precedent, and can order remedies (usually in the form of monetary awards) to investors if they find that states have breached treaty obligations. Notably, in most cases investors are not required to attempt to resolve disputes through available domestic remedies before filing ISDS claims. This is extraordinary and unusual: by contrast, the WTO only permits states to raise claims against other states, and international human rights courts require claimants to attempt to exhaust domestic remedies before raising disputes at the supranational level.

Why do countries sign IIAs? States often ground support for IIAs in their perceived ability to: (1) promote investment flows, (2) depoliticize disputes between investors and states, (3) promote the rule of law, and (4) provide compensation for various harms done to investors. However, some state and other stakeholders have begun to question whether IIAs are in fact strategically tailored to deliver on these objectives effectively and efficiently, and worry about the costs that IIAs may impose on states and stakeholders within them. Empirical evidence is, for instance, indeterminate as to whether IIAs actually stimulate new investments, let alone whether those investments in fact benefit host (or home) countries, or whether the benefit of any new investment outweighs the costs that may be associated with investment treaties (e.g., in the form of lost regulatory space, costs of defending disputes, and costs of paying adverse awards).

What privileges do IIAs provide to investors? IIAs typically require states to provide foreign investors certain standards of treatment. Provisions include:

- Requirements to compensate investors in the event of direct or indirect expropriations,[1]

[1] Indirect expropriations are defined as one or a series of government measures that substantially deprive investors of the value of their investments. Under international investment law, the aim or intent of the government measure (ie., whether it is taken in the public interest) is not a defense to liability. There are similar protections under the US Constitution, but the doctrines are not coextensive, with decisions under US law generally more deferential to government action than decisions of ISDS tribunals. See here, n 69 (and associated text).

- Protections against "unfair" or "inequitable" treatment by government actors, which have been interpreted to cover investors' "legitimate expectations" about future business activities and government conduct, and
- Protections against "discrimination," which have been interpreted to prevent disparate treatment even in the absence of nationality-based discrimination.

How does ISDS affect states' ability to govern? One way of thinking about the treaties is that they provide internationally enforceable substantive protections for covered investors' economic rights and interests that are akin to the "Lochnerism" of the US Supreme Court until the 1930s. This approach privileges the economic rights and interests of international investors/ multinational enterprises (MNEs) over competing economic and non-economic interests of other entities and individuals. (Distinct from Lochnerism, however, where the US Supreme Court was able to shift course, it is particularly difficult to cause course corrections in international investment law when concerns arise that interpretations or applications of the law are misguided). The deferential treatment afforded to economic interests increases the cost of regulating, and as USTR recently acknowledged may even chill good faith action in the public interest.

Cases have been brought against states to challenge myriad actions, including, among other things:

- Efforts to combat tax evasion and money laundering;[2]
- Efforts to strengthen environmental laws or enforcement thereof;[3]
- Government regulation of the price and quality of essential public services such as provision of water and energy;[4]
- Government regulation of health care products and services;[5]
- Government efforts to set intellectual property protections at a level that balances private and public needs;[6]
- Government initiatives to try to mitigate the effects of historic discrimination;[7]and
- Government efforts to ensure foreign investment catalyzes domestic development.[8]

[2] *Federal Elektrik Yatirim v. Uzbekistan,* ICSID Case No. ARB/13/9; *Quiborax v. Bolivia*, ICSID Case No. ARB/06/2, Award, 16 September 2015.

[3] *Glamis Gold Ltd. v. United States,* Award, 8 June 2009; *Lone Pine Resources v. Canada,* ICSID Case No. UNCT/15/2 (UNCITRAL); *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Germany, ICSID Case No. ARB/09/6.*

[4] *United Utilities (Tallinn) B.V. and Aktsiaselts Tallinna Vesi v. Estonia,* ICSID Case No. ARB/14/24; *Suez, Sociedad General de Aguas de Barcelona, S.A. and Vivendi Universal, S.A. v. Argentina,* ICSID Case No. ARB/03/19, Award, 9 April 2015*; TECO Guatemala Holdings, LLC v. Guatemala,* ICSID Case No. ARB/10/23, Award, 19 December 2013, and Decision on Annulment, 5 April 2016.

[5] *Achmea B.V. v. The Slovak Republic,* PCA Case No. 2013-12 (UNCITRAL); *HICEE B.V. v. The Slovak Republic,* PCA Case No. 2009-11 (UNCITRAL), Final Award, 17 October 2011; *Apotex Holdings Inc. and Apotex Inc. v. United States of America*, ICSID Case No. ARB/AF/12/1, Award, 25 August 2014.

[6] *Eli Lilly and Company v. Canada*, ICSID Case No. UNCT/14/2 (UNCITRAL), Final Award, 16 March 2017.

[7] *Piero Foresti, Laura de Carli & Others v. South Africa*, ICSID Case No. ARB(AF)/07/1, Award, 4 August 2010.

[8] *Mobil Investments Canada Inc. and Murphy Oil Corporation v. Canada*, ICSID Case No. ARB(AF)/07/4.

How are the rights of third-parties impacted by ISDS disputes? ISDS proceedings are relatively opaque, secretive, and exclusive compared to the US and other domestic legal systems, with the latter providing for transparency and mechanisms to take into account the rights and interests of non-parties. Tribunals often have discretion to accept, or not, third-party amicus briefs, which are frequently rejected even when the rights or interests of the non-parties/amici are directly at stake in the ISDS claim. Unlike common legal protections that allow affected non-parties to participate in cases (e.g. as impleaders or interpleaders), and/or require cases to be dismissed if third-parties will be affected but cannot join the proceedings, affected third parties in ISDS have no clear ability to effectively intervene in an ISDS proceeding, and there are no rules ensuring that ISDS cases will be dismissed when they threaten third-parties' rights. Governments recently affirmed that international reform efforts should address concerns that the rights or interests of third parties can be affected by ISDS disputes.

How many cases have there been? Through the end of 2018, at least 942 cases had been filed.[9] There has been a rapid proliferation of these cases in recent years; while the first ISDS case was initiated in 1987, over half of all cases to date were filed between 2012 and 2018.

Who usually brings ISDS cases? Who usually defends them? Successful claims are typically brought by large multinational corporations: companies with over US$1 billion in annual revenue and individuals worth more than US$100 million have received about 94.5% of the aggregate ISDS-ordered financial transfers (93.5% if pre-award interest is included).[10] The vast majority of ISDS claims are brought against low- and middle-income states.[11]

Who decides cases? ISDS cases are typically decided by panels of three arbitrators, jointly appointed and paid for by the investor and the respondent state (one arbitrator is selected by each party and one selected jointly). Arbitrator selection is generally not subject to any qualification requirement (e.g. areas of expertise), nor meaningful conflict of interest or impartiality requirements. A small pool of arbitrators are appointed and reappointed in the vast majority of cases. Some arbitrators also "double-hat," representing claimants in ISDS disputes while also sitting as arbitrators in other cases. This can and has led to scenarios in which attorneys have used awards they have issued as "arbitrators" to support their legal positions when arguing as counsel. (*As noted below, the European Union is currently leading an effort to replace party-appointed and party-paid arbitrators by a standing body or roster of adjudicators and is*

[9] However, not all cases or filings are public because rules requiring transparency are not consistently adopted or applied. Disputing parties, and/or the arbitrators, could still decide to try to keep the arbitrations partially or totally confidential, though in such cases, journalists and other may try to use Freedom of Information laws to try to access the relevant information.
[10] Gus Van Harten & Pavel Malysheuski, 'Who has benefited financially from investment treaty arbitration? An evaluation of the size and wealth of claimants' (2016) Osgoode Hall Law School Legal Studies Research Paper Series 12(3), Research Paper No. 14, 1.
[11] Daniel Behn and Ana Maria Daza, "The Defense Burden in International Investment Arbitration" (2019) PluriCourts Working Paper (*forthcoming*).

also working to prevent "double-hatting" in treaties currently under negotiation as well as through the process at the United Nations Commission on International Trade Law).

What do arbitrators consider in deciding cases? Arbitral tribunals look first and foremost at the provisions of the relevant investment treaty in deciding cases. Whether or not a challenged governmental action (or inaction) is consistent with domestic law (or even other areas of international law (e.g. UNFCCC, human rights frameworks, etc.) is generally not considered to be a defense to claims or liability under the IIA (but a breach of domestic law may be deemed to violate the IIA). Conversely, because treaties almost universally place enforceable obligations only on states, not investors, meaning that states can generally not initiate claims nor bring counterclaims in ISDS, an investor may win a case even if it has violated domestic law or other international human rights or environmental norms in relation to its operation of the investment. To influence interpretation, the state defending itself, as well the other state party or parties to the treaty (including the investor's home state) can offer joint (and unilateral) interpretations to clarify what treaty provisions mean. But what a defendant state says about the meaning of the treaty is generally not binding (nor necessarily persuasive) for the tribunal interpreting the agreement. Tribunals may draw from prior ISDS decisions but are not bound by precedent.

What happens when investors win cases? ISDS tribunals do not generally purport to overturn or require reversal of state conduct; instead they typically award monetary damages to investors (often in cases where monetary damages would not be the remedy under comparable domestic law, where remand or other equitable remedies may apply). But the line between those categories of relief has become increasingly blurred. Tribunals have, for instance, ordered injunctive relief against states (e.g., telling the executive to halt tax collection efforts, cease criminal proceedings, and preclude enforcement of domestic court judgments) and have then found states monetarily liable for government decisions not to comply with those tribunal orders. Awards against states regularly climb into the hundreds of millions of dollars, and have reached billions of dollars.[12] The average claim against states (removing outliers) is at nearly US$300 million, and in cases won by investors, the average award is just over US$120 million.[13] Low and middle income countries are often subject to awards that consume large portions of their annual budgets (i.e., resources that could otherwise be spent on health, education, and other national priorities). Awards are highly enforceable and cannot be "appealed" as such, even if there was a mistake of law or fact. If states don't pay the awards, and the investors face trouble enforcing awards through, e.g., seizure of government assets, investors may try to get their "home" states to place diplomatic pressure on the host government.

[12] Ibid.

[13] Ibid. (including all claims analyzed, including outliers, the amount claimed would be US$ 1,476,000,000 and amount awarded US$ 472,795,000).

What are costs to states of defending against these claims? The average ISDS proceeding costs $5 million per side in legal and tribunal fees.[14] Complicated cases can cost more. For states defending multiple claims in short order, these fees can add up -- consider Colombia, where 11 cases (and counting) have been filed since 2016.

Moreover, there is some evidence that the mere filing of an ISDS claim can inflict reputational harm to host countries, reducing their attractiveness as destinations for foreign direct investment.[15]

What is "Third-Party Funding" and why does it matter? Financial firms increasingly fund and even recruit investors to bring ISDS cases, covering the claimants' legal costs in exchange for a stake in potential awards. This raises additional questions, including whether the introduction of third-party funding leads to an increase in overall claims, an increase in frivolous claims, alters win-loss ratios, impacts legal outcomes and overall development of the law, and has broader effects on international flows of capital and taxation of that capital. Moreover, while third-party funding in claims against governments is currently almost entirely unregulated in investment arbitration, the US government, for example, with the US Anti-Assignment of Claims Act,[16] prohibits "a transfer or assignment of any part of a claim against the United States Government or of an interest in a claim," as well as "authorization to receive payment for any part of the claim." There are exceptions, such as permitting interest in claims to be transferred *after* they have been determined to be valid and *after* the amount owed has been decided. The Anti-Assignment aims to serve several policy objectives:

> first, to prevent persons of influence from buying up claims which might then be improperly urged upon Government officials; second, to prevent possible multiple payment of claims and avoid the necessity of the investigation of alleged assignments by permitting the Government to deal only with the original claimant; and third, to preserve for the Government defenses and counterclaims which might not be available against an assignee.[17]

Those policy objectives are not protected under the current laissez-faire approach to third-party funding in ISDS.

What now? Approaches to reform:

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[14] Ibid; Matthew Hodgson, 'Costs in Investment Treaty Arbitration: The Case for Reform' in Jean E. Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System: Journeys for the 21st Century* (Brill 2014) 756; Behn & Daza (n 10).

[15] Todd Allee & Clint Peinhart, 'Contingent Credibility: The Impact of Investment Treaty Violations on Foreign Direct Investment' (2011) 65 Int'l Organization 401 (calculating drops in FDI associated with even ultimately unsuccessful claims); *but see* Andrew Kerner and Krzysztof Pelc, 'Do Investor State Disputes Harm FDI?' (2019) Working paper, McGill University.

[16] 31 USC § 3727

[17] *Kingsbury v. United States* [1977] 563 F.2d 1019, 1024.

A number of states are considering various ISDS reforms and new IIA models, or even in some new treaties. Importantly, UNCITRAL's Working Group III -- the first major multilateral negotiations on investment that have occurred since the OECD's failed attempt in the mid-1990s to establish a Multilateral Agreement on Investment -- is also considering the issue and effectively decided in April 2019 that its efforts will include at least some further work on the European Union's proposed multilateral investment court. For the most part, however, all of these efforts have focused on relatively small changes to ISDS and have not considered more fundamental reforms to shift course on an IIA/ISDS system increasingly considered to be ineffective, lack legitimacy, and have unintended and undesirable effects on other regulatory prerogatives.

At CCSI, we contend that it is important to more broadly assess the costs and benefits of investment treaties and ISDS, and rethink the role of international investment agreements as tools for advancing sustainable development, from home and host country perspectives. This means looking more closely at the objectives of these agreements, as well as alternative modes of dispute settlement that might better serve identified objectives.

Even assuming that the multilateral court is a desirable way forward (which is a premise open to question), it will likely take at least a decade to negotiate creation of such a court and actually establish it. It is also unclear whether it will ever attract enough signatories, or the right signatories, to make a difference for countries defending claims. In the interim, investors will continue to bring, and states will continue to defend, claims in an ISDS system now widely recognized as suffering from perceived and actual concerns going to its very legitimacy. Therefore CCSI is exploring shorter-term ways for states to exit or mitigate the recognized adverse effects of the more than 3,300 treaties that have been concluded to date. Chief among these options, we've advocated for termination (or withdrawal of consent to ISDS arbitration) of these treaties, as a near-term solution, alongside any longer-term project.