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SESSION 4

Preventing a backlash against investment arbitration: could the WTO be the solution?

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Let me start by making a few remarks about the term "backlash against investment arbitration". I know there is a volume that bears that title and I admit that I have contributed to it. Nevertheless I believe that this expression is a bit of an exaggeration. This, of course, is no criticism of the organiser of this conference. On the contrary, we have a very interesting concept here to discuss.

I would describe the phenomenon as disenchantment with investment arbitration in some quarters, or perhaps as a partial retreat, primarily regional. Latin America obviously is more strongly affected than other parts of the world. On the other hand, isn't it surprising that Latin America has come as far as it has considering its history in international arbitration? Anybody who has studied international law has heard about the Calvo doctrine. I don't know what Carlos Calvo would have thought about most Latin American countries joining the ICSID Convention. This in itself is a surprising phenomenon.

The most dramatic phenomenon that we have seen in the last couple of years in this regard is the denunciation of the ICSID Convention by two Latin American States, Bolivia and by Ecuador in 2007 and 2009 respectively. But this step, although it was hailed as a major dramatic event, is not nearly as dramatic as it appears at first sight. First of all, consent to ICSID arbitration that has been perfected before the date of the denunciation remains in place. So you cannot just run away from ICSID arbitration by denouncing the ICSID Convention. Second, most BITs providing for investment arbitration do not just provide for ICSID arbitration and, as Bolivia had to learn the hard way in a recent case, there remain other options. Therefore, if you turn your back to ICSID arbitration, you will probably be sued in some other forum, for instance in an UNCITRAL arbitration.

Another interesting phenomenon is that while the denunciation by these two countries of the ICSID Convention has attracted a lot of attention nobody has given

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much attention to the fact that in the same period of time, namely in the last three years, three countries have actually joined the ICSID Convention:

Serbia, Qatar and Kosovo – two of which have not only signed but also ratified it. So there is at least a levelling up.

More dramatic might be the termination of BITs, of bilateral investment treaties. Some States have made announcements to the effect that they want to terminate their BITs. Most BITs do provide for termination. After ten years there is usually a period of twelve months within which a State can terminate a particular BIT. However, that too is not going to have effects as dramatic as one might think at first glance. Most of these BITs have so-called survival or sunset clauses continuing the protection of the terminated BITs for investments that have been effected before the termination for another ten or even twenty years. So even if a State terminates a BIT, that BIT is going to have effects for a certain period of time. So this strategy is not going to turn out quick results.

In addition, terminating BITs is going to send out negative signals. If a State starts systematically and publicly to terminate BITs it is likely to incur negative side effects. It is giving the message to the world: "Look, your investment will not be protected in this country". Another side effect might actually be that it fuels litigation. Investors may start arbitrations while the chance is still in existence. So this may have the opposite effect of what is intended, at least in the short-term.

Of course countries can terminate bilateral investment treaties by agreement at any time. But that too is not going to be a promising strategy. BITs can be terminated among a group of like-minded States but the major capital exporting countries are unlikely to go along with this strategy. The countries of origin of investments have no incentive to do this.

Again, if you look at the number of BITs being terminated and concluded, my impression is – although this is a bit difficult to ascertain empirically – that the number of BITs is still growing. There are more BITs being concluded than terminated. Perhaps the rise is not as dramatic as it used to be but perhaps we have also reached a saturation point.

Another indicator is the number of cases. As we have heard earlier on from Leonardo Giacchino there is no indication of a backlash against ICSID arbitration. Statistically the numbers are either constant or actually growing.

One big factor of uncertainty is the plans of the EU with regard to BITs. Since the entry into force of the Lisbon Treaty the EU has considerable influence in terms of terminating existing BITs and concluding new BITs. As you know, under the Treaty of Lisbon the EU has exclusive competence in this area and the Commission has very ambitious plans. One should also be aware of the fact that about 50% of all BITs

worldwide have at least one EU member State as a party. So the EU is a very important player in this field and should not be dismissed lightly. The Commission has plans to call upon member States to denounce and terminate all intra-EU BITs, that is BITs between EU members. Here we are talking of about 190 BITs, not a negligible number but still relatively small. When it comes to extra-EU BITs, that is BITs of member States with third countries, we are talking about a much higher figure, in fact over 1000 BITs. The plan of the EU is to first grandfather and then gradually replace these extra-EU BITs as the EU concludes its own bilateral investment treaties or FTAs (free trade agreements) with third countries. This is a process which is going to take a considerable amount of time but the EU is determined to do this.

Of course, the big question is: what is this going to do to investment arbitration? That is what we are most interested in. My impression is, at least at the moment, that the prospects for investment arbitration look fairly good. I quote from a EU Council paper that was adopted in October of 2010, called "Conclusions on a comprehensive European international investment policy" and there you find the following sentence: "The EU Council stresses in particular the need for an effective investor-to-State dispute settlement mechanism in the EU investment agreements and invites the Commission to carry out a detailed study on the relevant issues concerning international arbitral systems." So at present the thinking seems to be towards including effective investor-State or effective investor-EU arbitration clauses in future EU investment treaties.

Let me shift my attention to the actual practice of tribunals. How have tribunals reacted to concerns about investment arbitration? My impression is that tribunals have understood the signs of the time and have become relatively cautious, certainly more cautious than initially. Let me give you just a few examples. For instance, investment tribunals have become very hesitant and even restrictive about findings of expropriation. Nowadays it is very difficult to convince an investment tribunal that an expropriation, even an indirect expropriation, has occurred. Unfortunately, restraints of time prevent me from going into more detail.

Also, investment tribunals have become very sensitive to States' public order functions. There is a series of cases involving environmental issues in which investment tribunals have shown much awareness of environmental concerns. That at least is my reading of the case law.

Another aspect is that investment tribunals have dealt with improprieties or illegalities on the part of investors rather decisively. In other words, an investor who does not come with clean hands will be thrown out without mercy. Again I can only make the statement without going into detail.

Another interesting phenomenon is the creeping return of domestic remedies. This is controversial and it may not be a felicitous development but it is also a sign of the

cautious attitude of investment tribunals. All of this, I believe, is a reaction to growing concerns and is designed consciously or unconsciously to prevent a backlash against investment arbitration.

Let me now say a few words about the second part of the title: "Is the WTO a solution?" Here I agree wholeheartedly with Professor Mavroidis, perhaps even more wholeheartedly than he himself. My answer is "no" and let me explain why. I think two factors are particularly distinctive about WTO dispute settlement as compared to investor-State arbitration. One is the State versus State nature of WTO dispute settlement as compared to the investor-State dispute settlement in investment arbitration. The second factor is the appellate mechanism in the WTO system which has no counterpart in investment arbitration.

There are very important distinctive features in investment disputes that distinguish them from trade disputes. Investment disputes are usually, though not always, highly individualised. You don't often get general measures that hit all foreign investors or even all foreign investors in a particular field. In the majority of cases investment disputes are more individualised in the sense that they are more directed at particular investors than in trade. A second distinctive feature is the different type of risk. Don't forget that an investor typically has to sink in a lot of capital at the beginning of its activities. It becomes captive in a sense to the host State. It usually cannot simply withdraw and turn elsewhere once it has sunk in its investment. So the investor's risk is typically higher and more long-term than the trader's risk.

If investors were to be deprived of direct access to a dispute settlement system, what would be the consequence? They would have to fall back on diplomatic protection. Diplomatic protection of course means that the investor's home State would have to espouse or take up the claim of the investor and pursue it in its own name. This sounds very comfortable, but it is not because the investor completely loses control over the claim. The host State may, but need not, take it up. The host State may pursue for a while but then drop it. It may settle for a reduced amount. It may completely waive the investor's claim and the investor may completely lose out on this. So the prospect of becoming dependent on one's home country is not very appealing for the investor.

I have so far spoken about investors' interests. But what is the deal for the States? Why should States consent to investment arbitration? Isn't all of this rather unpleasant for them? Why should a State expose itself to being sued by any investor? I believe that there are three main reasons why overall investment arbitration is an attractive proposition for the States concerned. At any rate more attractive than the alternatives.

The first reason is relatively obvious: the State, by offering investment arbitration creates a stable legal climate which is designed to attract investment. This, in turn, will hopefully lead to economic development. The development dimension in investment arbitration should not be underestimated. It was at the cradle of investment arbitration.

After all, the most important document in investment arbitration, the ICSID Convention, in its preamble in the very first sentence speaks of economic development and the role of private international investment. It is not a coincidence that the ICSID Convention was drafted in the framework of an international development institution, the International Bank for Reconstruction and Development. So legal security, leading to an attractive investment climate and to economic development is the first argument.

The second argument in favour of investment arbitration from the perspective of the host State is that the host State gets rid of diplomatic protection. That is a major advantage for a host State. It takes the dispute out of the political arena and transfers it into the legal arena. Or to put it differently: being a respondent in an investment arbitration is far less unpleasant for a developing country than having the State Department or the European Commission lean upon you. So it is essentially choosing the lesser of two evils.

The third proposition I put forward somewhat more tentatively but also with a certain degree of confidence. The protection of foreign investments may also have positive side effects on the introduction of good governance in the host States. Investment protection treaties require the rule of law and its implementation with regard to foreign investors but this may well have a positive spill-over effect on the internal system of the country concerned.

Finally, let me just make two short remarks on the appellate mechanism. As many of you know, there has been talk and even some clauses in bilateral investment treaties concerning the introduction of an appellate system in investment arbitration. I fully agree with Professor Wang that the current discrepancy in the practice of investment tribunals is rather worrying and there is need for a harmonisation of the practice. Tribunals are going into all sorts of different directions and this is most undesirable from the perspective of legal certainty. But I do not think that an appellate body is the best solution for this. Apart from the technical difficulties of creating such a body, the biggest obstacle is Article 53 of the ICSID Convention which very specifically says that an award "shall not be subject to any appeal or to any other remedy except those provided for in this Convention." That really rules out an appellate body. You would have to amend the ICSID Convention which is close to impossible.

A better solution in my view would be the introduction of a system of preliminary rulings in investment arbitration. Under such a system investment tribunals would have the possibility of submitting legal questions before them to a body and getting a binding ruling. This method is well tested in European Law. The idea is that it is much better to prevent an undesirable situation than to fix it after it has occurred. In our case the undesirable situation would be a wrong decision or a discrepancy in the case law. I am a strong supporter of the idea of preliminary rulings in investment arbitration although I fully realise that there are a number of technical difficulties.