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THE CURRENT INVESTMENT ARBITRATION REGIME: A SYSTEM OF THE PAST OR FUTURE?

by Karandeep Khanna

I. INTRODUCTION

The UNCITRAL Working Group III was set up as a forum to discuss possible reform to the investor-state dispute settlement system that exists today. The forum brings together state representatives, practitioners and leading academics in the field of international arbitration, with a view towards implementing reforms and recommending fundamental changes to the current system. This article makes the case for the current system of investment arbitration and argues that there is no need for structural change. It also offers a critique of two proposals that are being advocated. First, dismantling the system as a whole. Second, replacing the current system with a Multilateral Investment Court.

II. THE ORGANIC EVOLUTION OF THE CURRENT SYSTEM AND A COMPARISON WITH THE FRONTRUNNERS

The fundamental structure of investment arbitration (IA) as it exists today should endure as the primary mechanism for resolving disputes between foreign investors and states. The likelihood of its endurance rests fundamentally on preserving its current form and structure. It does not require a new global consensus over its replacement, despite the existence of stakeholders that are committed to this cause. The system has demonstrated a capacity for self-correction, and it is responsive to criticism—indicating that it does not have a mind of its own. At its core, it has proved itself supple and adaptable in a broad range of circumstances.

The organic evolution of a system aimed at addressing changing needs while retaining core principles is a preferable process that does not warrant structural overhaul. Evidence of this is seen in common law systems where evolution through jurisprudence spanning decades shows versatility and a tendency towards self-reflection. Certain reforms to the current IA system, for example, to improve transparency, equitable cost allocations and consolidation of multiple proceedings, show that the IA system is able to adapt. These reforms are evolutionary—and not

revolutionary in their aim to dismantle the underpinnings of the current system.

This post opposes the position of systemic reform which supports the establishment of a multilateral investment court (MIC) to replace the current system of ad hoc and institutional arbitration set up by the treaty system. It also opposes a paradigm shift that would prevent investors from bringing investment claims against states. This post, on the contrary, advocates for an incremental approach aimed at making modest reforms.

Much of the impetus behind the MIC and wholesale reform of IA is backlash from globalization and perceived encroachment on state sovereignty. Globalization is not a new phenomenon–IA was indeed born to facilitate foreign investment in a globalizing world as it continues to do so today.

Criticism arising from the negative impact of globalization should not be misinterpreted as criticism aimed at IA. While the negative impact of globalization is not debated, politicians have made the system of IA a focal point of criticism in their call to resist a foreign economic takeover. This targeting is misplaced and perhaps diverts attention from real issues. The decision of a state to permit foreign investment and the substantive obligations assumed by states under their investment treaties should be the focal point instead. IA is simply the mechanism for resolving disputes between foreign investors and states.

States determine the nature and text of treaty obligations. IA only kicks in when investors claim a potential breach of obligation. The rise of IA disputes, and states being exposed to large sums covered by taxpayer money, is not a reflection of the current system's performance. Instead, it indicates that treaty obligations were not articulated to correspond with the expectations of a state. Notwithstanding this experience and the accompanying risk, states continue to view the benefits of globalization as considerably outweighing its perceived harms and continue to facilitate foreign investment through policy and global co-operation.

Turning briefly to the system, a tribunal's jurisdiction is limited to issues arising under the treaty. A foreign investor does not become immune from independent obligations that arise from operating under the laws of the host state. For example,

a foreign investor cannot flout labor and environment laws, or commit criminal offences. It does not escape liability and remains accountable for the harm it causes within the territory it operates in.

A related concern is that IA undermines state sovereignty—a statement best described as simplistic. State sovereignty is what breathes binding force into the treaty system, and the decision to submit to the jurisdiction of an investor-state tribunal is itself an expression of that state sovereignty.

The driving force for such a decision remains unfettered. States acknowledge the need for co-operation at the international level for their own economic growth. This co-operation is facilitated through a voluntary compromise of absolute sovereign power to a degree. Consistent with this compromise is the premise of reciprocity, which could not be more evident under the current system, where nationals of both states benefit from the guarantees of an investment treaty. It is essential that any meaningful discourse on reforms to the current system takes place within this context.

To juxtapose the merits of the current system, the proposals for reform are broken down into three themes: *Optionality v. Rigidity*, *Flexibility v. Uniformity*, *Neutrality and Efficacy*.

A. *Optionality v. Rigidity*

The current system is an optional mechanism for states and foreign investors to access. States are not compelled to opt for IA. Proposals and experimentation with either systemic reform or a paradigm shift can take place without having to disturb the current system. However, states that advocate for either of the above simultaneously advocate for the replacement or abolishment of the current system.

The MIC looks for a middle ground between the current system and going before national court to resolve disputes. While the proposal does create a middle ground, it is canvassed as a "my way or the highway" solution, which compels other states to give up their existing system. But prudence would have states test the waters, making the adoption of the MIC an optional decision, before abolishing a pre-existing and robust system.

Like any contract, the terms of a treaty are based on the degree to which a state wishes to co-operate with another. The current system does not prevent systemic reformers from establishing a MIC or persuading other states to conform. If the MIC succeeds, states ought to gravitate towards it voluntarily.

Foreign investors are also not required to pursue IA. They have the option of bringing claims to the courts of the host state or any other prescribed forum. If investors were satisfied that they would be treated fairly and their perceptions were positive of the treatment before host state courts, or if they found domestic justice as convenient as IA, there would be no need for the current system. At the same time, states remain free to improve their own domestic dispute resolution mechanisms, thereby incentivizing foreign investors to engage with it.

B. *Flexibility v. Uniformity*

Consent is the cornerstone of IA. States have the greatest degree of flexibility within the current system. They precise the terms and conditions of their consent together with the treaty counterparty and delineate the standards against which their actions will be measured by a tribunal. The tribunal is generally bound by the ordinary meaning of the treaty text as stated in Article 31 of the Vienna Convention on the Law of Treaties.

States can also provide joint interpretations for any provision of a treaty, including interpretations for broad standards like fair and equitable treatment (FET) and expropriation. These joint interpretations then become binding. This dynamism permits states to re-shape a treaty, based on the development of IA law.

The MIC on the contrary, aims to unify the investment arbitration system with a view to enhance consistency, coherence, and predictability, and provide a review procedure. These are benefits that some critics would say are missing from the current system.

The systemic reformists presume that states want a uniform interpretation of treaty standards, across all treaties. Though if this were true, all states would adopt identical language in their treaties, which is simply not the case. Treaties might generally follow the same structure, but there are subtle differences between them

which critically delimitate state intent, and this intent can be decisive in disputes.

Treaty standards like FET and expropriation are generally left amorphous on purpose. The malleability of these standards and their inherent vagueness attracts foreign investment. These broadly phrased umbrellas of protection exist in their current form to protect investors, and a failure to provide protection would hamper the state's ability to attract foreign investment in the future. This has so far played out favorably in disputes, where tribunals have adopted the approach of carefully considering the facts of each case and applying the appropriate standard on that basis. The MIC on the other hand leads to a Catch-22 situation. If the uniform standard is too broad, there is a problem-solution mismatch. If it is too narrow, it defeats the purpose of incentivizing foreign investment.

A pertinent example of the current system's capacity for self-correction comes from a cluster of diverging views which arose from tribunals interpreting Article XI of the 1996 U.S.-Argentina bilateral investment treaty. Two observations are important. First, there was consensus on the fundamental issue that Article XI was not a self-judging clause because it did not contain self-judging language. Second, some of the awards under that instrument were annulled because tribunals equated Article XI with Article 25 of the International Law Commission Draft Articles on State Responsibility. The annulment committees expressly stated that this approach was contrary to the rules of interpretation, as it failed to give primacy to the treaty text– an indication of the current system striving to give effect to the intention of the states.

The MIC also seeks to adopt the doctrine of stare decisis, meaning that the decisions of the MIC would be binding for later cases to ensure uniformity of decisions. But the need for this is overstated. Tribunals often refer to and rely on previous decisions on the issue. If the decisions are well articulated, persuasive and not distinguishable on the facts, tribunals give them appropriate weight. To argue that tribunals might act illogically (or sporadically) simply because there is no system of precedent is misguided and lacks empirical evidence.

Furthermore, mandating such rigidity will make it difficult for tribunals to weigh

different factual scenarios. This is re-enforced by the benefit of having malleable and amorphous treaty standards, which enables tribunals to ensure that investors are protected when they ought to be.

C. *Neutrality and Efficacy*

The current system creates the option for foreign investors to access the neutral venue of ad hoc or institutional arbitration, as opposed to a court or domestic venue, which might have natural biases. The current system enables parties to choose their own decision makers, who by mandate must conduct proceedings in the interest of efficiency and effectiveness. Parties can choose these adjudicators based on their background, familiarity with the transaction or industry, or experience with the legal questions at issue, to name a few.

Under the MIC, however, parties are stripped of the ability to appoint their own arbitrators. The appointment of judges to this court is bound to involve political decision making, which in itself runs the risk of compromising neutrality, or at the very least—the perception of its neutrality.

Tribunals under the current system have the limited mandate of resolving the dispute at hand. It has no duty to resolve any other dispute. While the MIC may have multiple seats and rotating judges, it cannot match the efficiency of a decision making body with a single mandate. The MIC would still have the duty of serving others.

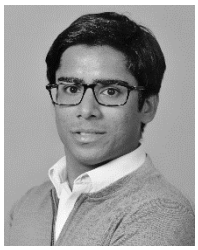
In conclusion, every system has its flaws and the current system is no different. A system accessed by a majority of states with different objectives is bound to lead to disagreement. Certain undesirable outcomes are likely to occur, but the past suggests that these instances are exceptions.

More importantly, an outcome might be viewed as undesirable by some states and acceptable by others. The specific outcome though does not bind anyone but the parties to the dispute. The system permits a state to take corrective measures by making changes to their treaty practice—each step further enhancing the predictability of the system from the standpoint of the state experiencing the negative impact. The current system is therefore not averse to change. Due to the

subjective nature of assessing these outcomes, the flexibility of the current system allows each state to act or react in a different manner, or not do either—a benefit that does not exist with the MIC.

III. CONCLUSION

The proposed reforms do not justify a systemic overhaul. As seen earlier, criticism arising out of the lack of consistency in decision-making is overstated. There is enough room in the current system for states to improve their IA experience. Their efforts should however be directed at co-operating with those who advocate incremental and organic reform, instead of building resistance and refusing to engage in meaningful discourse.



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INSTITUTE FOR TRANSNATIONAL ARBITRATION
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