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ADDRESSING FEARS AND PET PEEVES OF INVESTMENT TREATY ARBITRATION

by Margarita Rosa Arango

I. INTRODUCTION

A. Thesis

The U.N. General Assembly's Resolution A/78/168 (the "Resolution") addresses several concerns about investor-state arbitration and its effects on environmental protection and human rights. The Resolution suggests that states are consistently vulnerable to Investor-State Dispute Settlement (ISDS) claims when implementing policies to mitigate climate change and protect human rights, posing a danger to their sovereignty.¹

A primary concern stated in the Resolution is that foreign investors use investor-state disputes as a weapon to win millions (or even billions) of dollars from the host state.² Additionally, the Resolution indicates that International Investment Agreements (IIAs) prioritize the interests of foreign investors over the state and its internal actors, such as domestic investors and local communities.³ Consequently, IIAs represent a risk for the state's policy agenda and its protection of human rights and the environment.⁴

It is critical to note that although investor-state arbitration is a dispute mechanism activated by foreign investors, it is established by sovereign states through treaties.⁵ Therefore, states' representatives have power to negotiate these

¹ David R. Boyd, *Paying polluters: the catastrophic consequences of investor-State dispute settlement for climate and environment action and human rights*, A/78/168, 13 July 2023, G.A. Res A/78/168, ¶ 2 (July 13, 2023).

² *Id.* ¶ 1.

³ *Id.* ¶ 12.

⁴ *Id.* ¶ 14.

⁵ C. L. LIM et al., *INTERNATIONAL INVESTMENT LAW AND ARBITRATION: COMMENTARY, AWARDS AND OTHER MATERIALS* 25, 64 (2d ed. 2021).



instruments, stating the terms and conditions for the protection of foreign investment and taking into consideration the socio-economic needs of their nations.

The underlying purpose of IIAs is to encourage foreign investment in a host state, providing the investors with stability to carry out their economic activities and protections to their private foreign investment.⁶ These investment protections are intended to act as a counterbalance to the plenary power of the state. Thus, even though it is important to acknowledge the concerns raised in the Resolution about the ISDS and certain flaws the system might have, it is equally important to recognize the role that IIAs play in promoting investments, including investments that are critical to combating climate change and encouraging human rights such as the use of alternative energies.

For a state to comply with environmental obligations, it must have economic support, some of which comes from foreign investment. A strong IIA seeks to provide investors with the assurance needed to undertake substantial investments in a foreign nation.⁷

B. Objective

This paper addresses the main concerns about the ISDS system raised in the Resolution and critically analyzes the Special Rapporteur's arguments therein, particularly the ones related to "foreign investors using investor-state dispute settlement to seek exorbitant compensation from states that strengthen environmental protection,"⁸ resulting in a "regulatory chill,"⁹ to determine whether his allegations about the "catastrophic"¹⁰ consequences of ISDS for climate and

⁶ *Id.*

⁷ See UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*, at 16 (2009), https://unctad.org/system/files/official-document/diaeia20095_en.pdf; G.A. Res. 78/168, *supra* note 1, ¶ 2.

⁸ *Id.* at 2.

⁹ *Id.*

¹⁰ *Id.* ¶ 1.



environment action and human rights are sustained. Additionally, it will explain the role of the ISDS system in stimulating foreign investment and how IIAs can in fact assist states in meeting environmental and human rights obligations.

C. Context

The ISDS system is a conflict resolution mechanism to settle controversies arising from the alleged breach of IIAs.¹¹ These agreements are bilateral or multilateral treaties, through which states commit to grant certain protections and standards of treatment to foreign investments. They usually provide that qualifying investors may have recourse to international arbitration to resolve disputes arising out of the agreement.¹² In addition to IIAs, investment contracts between an investor and the state may entitle the investor to seek remedies against the host state through international arbitration.¹³ Thus, the foundation of ISDS lies in international public law and contract law intending to ensure protection and reparation from wrongful acts—breach of the investment treaty or contract—by states.¹⁴

Investment treaty arbitration is intended to provide an international unbiased forum where foreign investors and host states¹⁵ can settle their differences outside of local courts.¹⁶ Like all arbitration, it is a private method of conflict resolution based on consent and the will of the parties. The state's offer to go to arbitration is in the dispute settlement provision in the IIAs, and consent is perfected when the foreign investor accepts that offer, usually by submitting a notice of claim or request for

¹¹ LIM, *supra* note 5, at 2.

¹² COLUMBIA CENTER ON SUSTAINABLE INVESTMENT, *A Primer on International Investment Treaties and Investor-State Dispute Settlement* (updated January 2022), <https://ccsi.columbia.edu/content/primer-international-investment-treaties-and-investor-state-dispute-settlement>.

¹³ LIM, *supra* note 5, at 2.

¹⁴ *Id.* ¶ 3.

¹⁵ Kaj Hobér, *Investment Treaty Arbitration, and Its Future—If Any*, 7 Y.B. ARB. & MEDIATION 58, 3-4 (2015).

¹⁶ Wanli Ma & Michael Faure, *Is Investment Arbitration an Effective Alternative to Court Litigation? Towards a Smart Mix of Litigation and Arbitration in Resolving Investment Disputes*, 48 BROOK. J. INT'L L. 1, 3 (2022), <https://brooklynworks.brooklaw.edu/bjil/vol48/iss1/1>.



arbitration.¹⁷

Each IIA sets forth various jurisdictional requirements that an investor must meet to establish the arbitral tribunal's authority to decide the case. For instance, the investor must show it is a qualifying investor with a protected investment in accordance with the applicable law in each case. Additionally, investors may need to comply with certain conditions to qualify for arbitration, such as notice requirements and negotiation periods, for the claim to proceed.

Regarding the merits, the investor bears the burden of showing that the respondent state breached the investment treaty by enacting a measure that unlawfully harmed its investment. Furthermore, investors can claim expropriation or breach of standards such as fair and equitable treatment (FET), most favored nation (MFN), or full protection and security (FPS). But in all cases, the investor must establish a breach of an international obligation as a result of the state's action.¹⁸ Beyond that, investors need to demonstrate causation between the alleged breach of the treaty and quantifiable damage to the investment, to recover damages or receive compensation.¹⁹

The respondent state may raise various defenses in response to an investor's claim. One of the state's strongest defenses is that it has the right to regulate the general welfare of its territory. Consequently, respondent states might raise their legitimate and sovereign right as a defense to enact policies aimed at complying with environmental obligations or protecting human rights. For example, in the recent ICSID award of *Eco Oro v. Colombia*, the arbitral tribunal held that the environmental measures taken by Colombia to protect the Santurban ecosystem were a rightful exercise of its police powers. Thus, it dismissed the investor's claim for indirect

¹⁷ LIM, *supra* note 5, at 95.

¹⁸ *Id.* ¶ 276.

¹⁹ *Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award, ¶ 779 (July 24, 2008).



expropriation.²⁰

Moreover, if the investor obtains compensation, that does not mean that the state will be forced to change its policy. In fact, arbitral tribunals try not to interfere with the exercise of sovereign powers by the host state.²¹

II. ANALYSIS OF THE MAIN CONCERNS OF THE ISDS SYSTEM RAISED BY THE SPECIAL RAPPORTEUR IN THE U.N. GENERAL ASSEMBLY'S RESOLUTION A/78/168 ON ENVIRONMENTAL PROTECTION AND HUMAN RIGHTS

In light of climate change, governments have been implementing strategies to lower carbon emissions and meet international environmental commitments.²² These commitments involve enacting laws and regulations to limit carbon dioxide emissions, designating certain regions as protected areas,²³ and banning the extraction of natural resources such as oil, gas, and metals.²⁴ As these measures could impact foreign investments, there is a potential risk that investors might resort to an applicable IIA to pursue compensation through ISDS.²⁵

The Resolution focuses explicitly on the impact of ISDS on climate, environmental efforts, and human rights.²⁶ It highlights the vulnerability of states to the threat of ISDS claims when adopting legitimate climate and environmental policies, resulting in a “regulatory chill”²⁷ that impedes the state’s sovereignty and inhibits it from complying with environmental and human rights obligations.²⁸

²⁰ *Eco Oro v. Colombia*, ICSID Case No. ARB/16/41, Award, ¶ 698-99 (July 15, 2024).

²¹ *Toto Costruzioni Generali S.p.A. v. The Republic of Lebanon*, ICSID Case No. ARB/07/12, Award, ¶ 233 (June 7, 2012).

²² *Koch Industries, Inc. and Koch Supply & Trading, LP v. Canada*, ICSID Case No. ARB/20/52, Respondent’s Counter-Memorial on Jurisdiction and the Merits, ¶ 14 (Feb. 17, 2022).

²³ *Eco Oro v. Colombia*, ICSID Case No. ARB/16/41, Award, ¶ 126 (July 15, 2024).

²⁴ *Lone Pine Resources Inc. v. The Government of Canada*, ICSID Case No. UNCT/15/2, Claimant’s Memorial, ¶ 154 (April 10, 2015).

²⁵ G.A. Res. 78/168, *supra* note 1, ¶¶ 2-3.

²⁶ *Id.* at 2.

²⁷ An effect that results from the state’s response to the threat of investment treaty claims, forcing the government to withdraw or reverse regulatory measures intended to address climate change, comply with environmental obligations or protect human rights.

²⁸ *Id.* ¶¶ 10, 49.



The Resolution concludes that ISDS is incompatible with human rights law and environmental compliance.²⁹ Furthermore, it urges states to take action to address the environmental crisis and recommends withdrawing their consent to participate in the ISDS system. The Special Rapporteur called for “specific actions that States must take” to overcome ISDS and its threat to climate, environmental and human rights issues.³⁰

A. *ISDS is One-Sided and Incompatible with International Human Rights*

One concern expressed in the Resolution is that the ISDS system is one-sided and incompatible with international human rights, since IIAs assign rights only to foreign investors and responsibilities only to the state.³¹ Thus, it highlights that victims of human rights violations must exhaust local remedies before going to the international realm, while foreign investors do not face such a requirement, thus creating a “justice bubble for the privileged” (foreign investors).³² It also blames the ISDS system for prioritizing the interests of the “elite” foreign investors over domestic investors, local communities, human rights, environmental compliance obligations, and even the host state’s interests.³³

The Resolution suggests that ISDS undermines democracy when legitimate state acts are subordinated to arbitral tribunals, collegial bodies that render decisions not bound by the domestic law of the state in question.³⁴ Hence, ISDS represents a threat to sovereignty and police powers of the host state since arbitral tribunals are not required to apply domestic law.

The Special Rapporteur is correct that IIAs create an asymmetrical framework in which the host state is burdened with responsibilities, while the foreign investor is

²⁹ *Id.* ¶ 11.

³⁰ *Id.* at 2, ¶ 75.

³¹ *Id.* ¶ 12.

³² *Id.*

³³ *Id.*

³⁴ *Id.* ¶ 16.



given specific rights to engage in economic activities in certain country. However, it is important to understand the reasoning: IIAs aim to counterbalance state power, providing the investor confidence necessary to foster large-scale investment and promoting sustainable development.³⁵ One way in which IIAs do this is by offering a neutral and impartial forum to solve controversies through investment treaty arbitration.³⁶ This mechanism allows investors to seek remedies in an international venue, which is perceived to be more independent of host state influence and inter-state politics than other options, such as local courts or the diplomatic protection process.³⁷

As discussed above, IIAs generally set forth the state's consent to arbitration, whereas the investor's consent comes only later with a notice or request for arbitration. Consequently, states generally lack the ability to initiate arbitration under the applicable treaty.³⁸ However, in some cases, it is important to recognize that states have the right to file counterclaims against the investor once the proceeding has begun.³⁹ Counterclaims work as autonomous claims in which the state can exercise its right of action in investment treaty arbitration.⁴⁰ Additionally, they can be used to safeguard the exercise of a state's power in regulating human rights and environmental matters, to protect the state's interest, and as a strategy to enforce domestic law.⁴¹ Nevertheless, specific procedural and substantive requirements must be satisfied for the tribunal to assert jurisdiction over a

³⁵ Canada-Colombia Free Trade Agreement, Nov. 21, 2008.

³⁶ Lauge N. Skovgaard Poulsen, *The Politics of Investment Treaty Arbitration*, in *THE OXFORD HANDBOOK OF INTERNATIONAL ARBITRATION* ¶ 742 (Thomas Schultz & Federico Ortino eds., 2020), <https://doi.org/10.1093/law/9780198796190.003.0031>.

³⁷ *Id.* ¶ 743.

³⁸ LIM, *supra* note 5, at 95.

³⁹ Maxi Scherer et al., *Environmental Counterclaims in Investment Treaty Arbitration*, 36 ICSID REVIEW-FOREIGN INVESTMENT LAW JOURNAL 413, 414 (2021), <https://doi.org/10.1093/icsidreview/siab006>.

⁴⁰ *Id.*

⁴¹ *Id.*



counterclaim.⁴²

In *Perenco v. Ecuador*, the State filed a counterclaim, arguing that the corporation breached Ecuadorian environmental regulations during its oil extraction activities, due to inadequate oil field and equipment maintenance.⁴³ The tribunal focused on the environmental concerns, warning the investors about the importance of due diligence and environmental protection during the life of their investment.⁴⁴ Furthermore, the tribunal ruled in favor of Ecuador on the counterclaim, respecting its right to adjust environmental policies according to the country's needs and exercise its policy powers and recognizing the importance of environmental protection.⁴⁵

As for the concern stated by the Special Rapporteur on the issue of ISDS being a “justice bubble for the privileged,”⁴⁶ based on the assumption that victims of human rights violations must exhaust local remedies before going to the international realm, while foreign investors do not, it is important to acknowledge that investment law does impose conditions on investors seeking to access arbitration.⁴⁷ Since states have the capacity to negotiate the IIAs, they have the power to agree on the conditions to access arbitration that suits them best, conditioning investors to meet those terms before initiating the procedure; otherwise, investors risk rejection of the claim. For instance, in *Generation Ukraine, Inc. v. Ukraine*, the arbitral tribunal held that the American investor failed to exhaust local remedies under the U.S.-Ukraine BIT, since it did not take reasonable steps to seek redress in Ukrainian courts. Therefore, the

⁴² Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, art. 46, 17 U.S.T. 1270, T.I.A.S. 6090, 575 U.N.T.S. 159.

⁴³ Scherer, *supra* note 39, at 430.

⁴⁴ *Id.*

⁴⁵ *Perenco Ecuador Ltd. v. Republic of Ecuador and Empresa Estatal Petróleos del Ecuador*, ICSID Case No. ARB/08/6, Award, ¶ 1014 (Sept. 27, 2019).

⁴⁶ G.A. Res. 78/168, *supra* note 1, ¶ 12.

⁴⁷ Southern African Development Community Protocol on Finance and Investment, Aug. 18, 2006, art. 28, https://www.sadc.int/sites/default/files/2021-08/Protocol_on_Finance__Investment2006.



tribunal declined its jurisdiction over the claim.⁴⁸

Moreover, tribunals seek to respect domestic legislation, even if they are not bound by it, since they do not want to undermine democracy or threaten the legitimate exercise of policy powers.⁴⁹ A recent case that illustrates the above is *Red Eagle v. Colombia*, in which investors argued that Colombia breached the Canada-Colombia FTA by enacting environmental measures that banned mining in the Santurban Paramo ecosystem, allegedly depriving Red Eagle from performing its economic activities in that constitutionally protected area.⁵⁰

The tribunal concluded that the environmental measures taken by Colombia to protect Santurban ecosystem were a rightful exercise of policy powers in defense of the environment and general welfare. Therefore, the case was decided in favor of the State, acknowledging the legitimate use of sovereignty and authority to regulate.⁵¹ Similarly, *Eco Oro v. Colombia*, which upheld that the environmental measures to protect the Santurban ecosystem did not represent an indirect expropriation of the claimant's investment.⁵² Thus, it can be said that both cases safeguarded the interest and regulatory power of the state.

B. *Massive Damages Awards and “Regulatory Chill”: Effects of Pro-Investor Bias in the ISDS System*

The Resolution suggests that ISDS tribunals exhibit “pro-investor bias” in their decisions; awarding large damages that can burden states and lead to “regulatory chill” where governments hesitate to exercise its policy powers. According to the text, awards are likely to result favorably to investors, bearing the state with the

⁴⁸ *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award (Sept. 16, 2003).

⁴⁹ See Eyal Benvenisti & George W. Downs, *National Courts, Domestic Democracy, and the Evolution of International Law*, 20 *EUROPEAN JOURNAL OF INTERNATIONAL LAW* 59, 70 (2009), <https://doi.org/10.1093/ejil/chp004>.

⁵⁰ *Red Eagle v. Colombia*, ICSID Case No. ARB/18/12, Request for Arbitration (March 21, 2018).

⁵¹ *Red Eagle v. Colombia*, ICSID Case No. ARB/18/12, Award, ¶¶ 399-400 (Feb. 28, 2024).

⁵² *Eco Oro v. Colombia*, ICSID Case No. ARB/16/41, Colombia's Press Release on Final Award (July 16, 2024).



responsibility to pay compensation.⁵³ These decisions are said to have a special impact on countries with fragile economies, leading them to deviate funds from essential policies such as human rights and environmental compliance to ISDS debt.⁵⁴

The Resolution asserts that ISDS claims are leading to a “regulatory chill” that results from the state’s response to the threat of investment treaty claims, forcing the government to withdraw or reverse regulatory measures intended to comply with environmental and human rights obligations.⁵⁵ This regulatory chill poses a barrier to states’ regulatory power since governments would rather change its behavior than face ISDS disputes.

To address the issues above, it is essential to understand the role of arbitrators and how the arbitral tribunal is composed. First, in arbitration proceedings with a sole arbitrator, the parties can agree on the identity of the person they would like to appoint. If there is no agreement between the parties, an arbitral institution will typically appoint the sole arbitrator or offer a list of names for the parties to choose from, and if an agreement is reached, that person is appointed.⁵⁶ Second, if the tribunal consists of three arbitrators, each party generally chooses one arbitrator and the third is appointed by agreement of the parties or the co-arbitrators. However, if the parties do not agree on the president of the tribunal, the institution will appoint one.⁵⁷

This appointment process of arbitrators seeks to guarantee impartiality during the proceeding. The president of the tribunal is either chosen by mutual agreement of the parties or by the arbitration center precisely to ensure unbiased awards. For that reason, it is a mistake to infer that ISDS tribunals exhibit “pro-investor bias” in their decisions. These statements challenging the legitimacy and impartiality of the

⁵³ G.A. Res. 78/168, *supra* note 1, ¶¶ 8, 30.

⁵⁴ *Id.* ¶¶ 8, 18.

⁵⁵ *Id.* ¶ 49.

⁵⁶ Victor Pey Casado and President Allende Foundation v. Republic of Chile, ICSID Case No. ARB/98/2.

⁵⁷ ICSID Convention, *supra* note 42, at art. 37(2).



tribunal undermines the credibility of both the individual performing as such and the ISDS system. Hence, allegations should be avoided unless supported by evidence.⁵⁸

Furthermore, the Resolution supposes that since tribunals display “pro-investor bias” awards are usually rendered against the states. The information given by arbitration institutions, such as the International Centre for Settlement of Investment Disputes (ICSID), show otherwise. According to ICSID’s caseload statistics for the period fiscal year 2023, it was found that 52% of all concluded ICSID arbitration cases resulted in decisions in favor of states.⁵⁹ The tendency remained relatively stable in the next year; based on FY 2024 caseload statistics, 51% of all concluded ICSID arbitration proceedings resulted in decisions in favor of states.⁶⁰

Nonetheless, the Rapporteur’s concern about developing countries and transition economies being easily affected by paying compensation is not wrong. According to UNCTAD statistics, about 75% of ISDS claims were brought against developing countries such as Peru, Venezuela, and Croatia. Developed country investors brought 70% of the claims.⁶¹ Although it is important to keep in mind that both emerging economies and developed countries benefit from foreign investment flows thus, being crucial to maintain IIAs that reinforce domestic and international legal frameworks.⁶²

As for the “regulatory chill” effect alluded to in the Resolution, the concern seems

⁵⁸ Charles N. Brower & Stephan W. Schill, *Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?*, 9 CHI. J. INT’L L. 471, 482 (2008).

⁵⁹ International Centre for Settlement of Investment Disputes, *The ICSID Caseload–Statistics*, Issue 2023-2, at 13, https://icsid.worldbank.org/sites/default/files/publications/2023.ENG_The_ICSID_Caseload_Statistics_Issue.2_ENG.pdf.

⁶⁰ International Centre for Settlement of Investment Disputes, *The ICSID Caseload–Statistics*, Issue 2024-2, at 13 <https://icsid.worldbank.org/sites/default/files/publications/2024-2%20ENG%20-%20The%20ICSID%20Caseload%20Statistics%20%28Issue%202024-2%29.pdf>.

⁶¹ United Nations Conference on Trade & Dev., *Economic Development in Africa Report 2021: Reaping the Potential Benefits of the African Continental Free Trade Area for Inclusive Growth*, at 2, U.N. Doc. UNCTAD/ALDC/AFRICA/2021, U.N. Sales No. E.21.II.D.7, (2021), available at https://unctad.org/system/files/official-document/diaepcbinf2021d7_en.pdf.

⁶² Brower & Schill, *supra* note 58, at 474.



to assume that arbitral tribunals interfere with states' regulatory powers and hold a pro-investor bias. However, arbitral tribunals do not have the authority to order states to change its policies. Their role is to decide whether a treaty was breached and whether the investor has suffered damages.

In fact, considering Annex 2 of the Resolution, the list of examples of ISDS claims launched in response to climate actions, it must be emphasized that from the nineteen cases identified by the U.N., only one resulted in a monetary award in favor of the investors.⁶³ In *Rockhopper v. Italy*, the arbitral tribunal found that Italy breached the Energy Charter Treaty by unlawfully expropriating Rockhopper's investment after enacting an environmental measure banning oil and gas exploration and contemplating no compensation to those expropriated investments. Even though the case was decided against the State, the tribunal did not order Italy to withdraw its measure but focused on compensating the investor for the breach of the treaty.⁶⁴

In several ICSID cases, investors alleged the breach of treaty due to environmental measures adopted by the host State have been decided in favor of the states, recognizing states' exercise of regulatory power. For example, in *Urbaser v. Argentina*, the State filed a counterclaim arguing that the investors failed to fulfill their obligations concerning the right to water and environmental protection. The tribunal recognized that companies could be liable for the breach of human rights and environmental protection under international law. It asserted jurisdiction over the counterclaim and confirmed that the "right to water" was a human right under international law.⁶⁵ Furthermore, the tribunal observed that investment treaties should not be interpreted in a way that undermines a states' obligation to comply

⁶³ G.A. Res. 78/168, *supra* note 1, at Annex 2 (examples of ISDS claims launched in response to climate actions).

⁶⁴ *Rockhopper Italia S.p.A., Rockhopper Mediterranean Ltd, and Rockhopper Exploration Plc v. Italian Republic*, ICSID Case No. ARB/17/14, Award (Aug. 23, 2022).

⁶⁵ *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Award (Dec. 8, 2016).



with environmental protection and the defense of human rights. Therefore, this case reaffirms a state's right to regulate in public interest and exercise policy powers without necessarily breaching its IIA obligations.⁶⁶

The *Phillip Morris v. Uruguay* case is another example of how the “regulatory chill” is more a myth than a reality in the ISDS realm. The investors argued that Uruguay's strict tobacco regulations violated the Switzerland-Uruguay BIT, and in response, Uruguay argued that the measures were taken in the interest of public health and to raise awareness of the dangers of smoking. The tribunal held that the measures taken were a legitimate exercise of Uruguay's regulatory power. It highlighted that those regulations, adopted in good faith and aimed to protect public welfare, did not constitute expropriation even if they affected foreign investments, thus the case was decided in favor of the State and investors were ordered to pay Uruguay's legal costs and expenses.⁶⁷

III. PROPOSALS ON HOW INTERNATIONAL ARBITRATION CAN ADDRESS ENVIRONMENTAL PROTECTION AND HUMAN RIGHTS CONCERNS

Throughout this paper it has been stated that IIAs are international instruments which main purpose is to create favorable conditions to encourage foreign investment in a host state and how ISDS provides an international neutral platform to settle investment disputes. In addition, it is crucial to understand the benefits of foreign investment in the host state and how it can help to comply with environmental obligations and human rights. The International Monetary Fund (IMF) focuses on the positive impacts of foreign investment in developing countries such as: 1) promoting competition in the domestic market, 2) generating profits that contribute to corporate tax revenues, and 3) transferring new technologies. Foreign investment contributes to economic growth, facilitating the flow of capital between

⁶⁶ *Id.*

⁶⁷ *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award, ¶ 306 (July 8, 2016).



capital-importing and capital-exporting countries.⁶⁸ This economic dynamization is a tool for states to meet compliance obligations.⁶⁹

Foreign investment plays a fundamental role in promoting new technologies for green growth and to address environmental issues. “FDI is important for environmental technology transfer, as multinationals are usually the first to bring new environmental technologies to a country.”⁷⁰ It is also essential to promote renewable energy and green technologies, which often are not accessible by low-income countries without a boost from foreign investors. Even more, when public policies are shaped to reduce carbon dioxide emissions, they create an important framework for investors to pursue environmental innovation.⁷¹

The Organization for Economic Co-operation and Development (OECD) recognized that foreign investment is essential to achieve sustainable development goals and recommends that governments incentivize foreign investment because it drives projects that promote community welfare and environmental protection. Other benefits include additional revenue for the host state, enhanced innovation, job creation, development of human capital, etc.⁷²

Even if there are concerns about the ISDS system, it is a crucial tool to promote foreign investment that states can use to comply with environmental and human rights obligations. Since the 1990s, the use of investor-state arbitration has been increasing; by the end of the year 2020 “more than 1,104 known cases had been referred to the treaty-based ISDS mechanism.”⁷³ Instead of discarding it, let’s reform

⁶⁸ Prakash Loungani, *How Beneficial Is Foreign Direct Investment for Developing Countries?*, IMF Finance & Development, June 2001, <https://www.imf.org/external/pubs/ft/fandd/2001/06/loungani.htm>.

⁶⁹ INTERNATIONAL MONETARY FUND, *Global Trade Liberalization and the Developing Countries*, IMF Issues Brief, Nov. 2001, <https://www.imf.org/external/np/exr/ib/2001/110801.htm>.

⁷⁰ David Popp, *The Role of Technological Change in Green Growth*, NBER Working Paper No. 18506, at 19 (2012), https://www.nber.org/system/files/working_papers/w18506/w18506.pdf.

⁷¹ *Id.* at 32.

⁷² OECD, *Recommendation of the Council on Foreign Direct Investment Qualities for Sustainable Development*, OECD/LEGAL/0476, at 3 (2024), <http://legalinstruments.oecd.org>.

⁷³ *Id.* at 618.



it! UNCTAD has long promoted ISDS reforms, scholars and practitioners have been debating ways to improve IIAs, leading to proposals on how to address issues like environmental protection and human rights through dispute resolution.⁷⁴ The proposals to reform the system include different ideas such as 1) eliminating ISDS, 2) creating an ISDS tribunal, 3) establishing a court of appeals, and 4) reforming IIAs.⁷⁵

IIAs are the core of ISDS and investment treaty arbitration; since the early 2000s, a new generation of IIAs have been signed and have been entered into force. This new generation of IIAs seeks to balance the state's regulatory powers and investor's rights, including sustainable development and human rights-oriented provisions.⁷⁶ For example, the Canada-Colombia FTA asserts in Article 815: "It is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment."⁷⁷ Consequently, the article recognizes the state's right to adopt, modify or maintain environmental measures, balancing investment protection, and regulatory power on environmental protection.

This new generation of treaties have been nourished by the debates raised by different actors of the international community and by encouraging their improvement to preserve ISDS. The Netherlands BIT was reformed in the wake of criticism over the ISDS system.⁷⁸ The draft encouraged clauses that protect and

⁷⁴ Herbert Smith Freehills, UNCTAD Proposes ISDS Reforms, Arbitration Notes (July 2013), <https://www.herbertsmithfreehills.com/notes/arbitration/2013-07/unctad-proposes-isds-reforms>.

⁷⁵ Qingjiang Kong & Kaiyuan Chen, *ISDS Reform in the Context of China's IIAs*, 36 ICSID REVIEW - FOREIGN INVESTMENT L. J. 617, 620 (2023).

⁷⁶ PETER MUCHLINSKI, NEGOTIATING NEW GENERATION INTERNATIONAL INVESTMENT AGREEMENTS: NEW SUSTAINABLE DEVELOPMENT ORIENTED INITIATIVES 42 (2016).

⁷⁷ Canada-Colombia FTA, *supra* note 35, at art. 815.

⁷⁸ Marike R. P. Paulsson, *The 2019 Dutch Model BIT: Its Remarkable Traits and the Impact on FDI*, KLUWER ARB. BLOG, May 18, 2020, <https://arbitrationblog.kluwerarbitration.com/2020/05/18/the-2019-dutch-model-bit-its-remarkable-traits-and-the-impact-on-fdi/>.



attract foreign investment, hence not losing sight of the main purpose of IIAs, but also promoted provisions strengthening environmental protection and human rights, such as regional and gender diversity: “the importance of incorporating a gender perspective into the promotion of inclusive economic growth. This includes removing barriers to women’s participation in the economy and the key role that gender-responsive policies play in achieving sustainable development.”⁷⁹

Even though it has been identified the trend in which environmental protection and human rights have been incorporated into the new generation IIAs, other paths that can be explored to reform the ISDS system and enhance the protection of sustainability and human rights in investment treaties such as: 1) harmonizing the conditions to access arbitration with environmental protections and human rights, 2) redefining investment in the IIAs as to include elements of environmental sustainability and human rights, and 3) rethinking damages calculation methods.

A. *Harmonizing the Conditions to Access Arbitration with Environmental Protections and Human Rights*

Imposing constraints that must be met before going to arbitration is one potential strategy to limit investors’ access to the ISDS system. As illustrated above, the most common ones are notice requirements, negotiation periods, and exhausting local remedies. What if IIAs require investors to show that their investment complies with the environmental regulations of the host state? Or that the economic activities performed in the host state contribute to sustainability and general welfare. These conditions would strengthen IIAs, promoting responsible and sustainable foreign investment.

B. *Redefining Investment in the IIAs as to Include Elements of Environmental Sustainability and Human Rights*

As previously discussed, for an arbitral tribunal to establish jurisdiction over a case, the investor must have a qualifying investment under the applicable law. Thus, the economic activity must meet the definition of “investment” given in the treaty.

⁷⁹ Netherlands Model Investment Agreement, Mar. 22, 2019, art. 6.



Therefore, states could encompass elements of social responsibility, compliance with environmental protection, and human rights in framing the definition of qualifying investment according to the IIA, compelling the tribunal to consider those elements before establishing jurisdiction over the case. Furthermore, they could require the investor to uphold the U.N. Guiding Principles on Business and Human Rights.⁸⁰

On the other hand, framing the definition of investment to meet elements of environmental protection and human rights standards allows the state to argue the compliance of these elements as a defense, or potentially as counterclaim if the treaty enables it. Moreover, if the treaty embodies domestic law obligations, then the state may be able to raise an investor's noncompliance as defense. For instance, in *Burlington v. Ecuador*, the State prevailed on its counterclaim based on the investor's accountability for environmental damages under domestic law.⁸¹

C. *Rethinking Damages Calculation Methods*

Besides improving the provisions previously mentioned, states could also negotiate better methods of calculating damages. As expressed by the Rapporteur, the amount of compensation awarded by tribunals is concerning—this criticism allows governments the opportunity to address the compensated amount award when drafting their IIAs.⁸² A possible course of action would be for states to include more straightforward guidance on calculating damages in their treaties. Similarly, states could agree on the maximum possible amount to be claimed through investment arbitration, considering whether the parties are countries with developed and stable economies or emerging economies. However, this would imply reviewing the international reparation system applied to international arbitration proceedings.

⁸⁰ Guiding Principles on Business and Human Rights, U.N. Doc. HR/PUB/11/04 (2011), available at https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf.

⁸¹ Scherer, *supra* note 39, at 429-30.

⁸² G.A. Res. 78/168, *supra* note 1, at 2, ¶ 18.



IV. CONCLUSION

ISDS is an evolving system with room for improvement that benefits from well-informed discussions that take place within the international community and allows it to adapt to the different worldwide issues such as climate change. As expressed by the Rapporteur, it is an asymmetrical mechanism that was designed to protect primary investors and provide them with favorable conditions for foreign investment. However, states can benefit from foreign investment since it facilitates compliance obligations and dynamizes the economy of developed countries and emerging economies.

Case law demonstrates that investment treaty arbitration seeks to balance between investor protection and state regulatory power, particularly in measures for public welfare. Arbitral tribunals cannot compel states to withdraw the adopted measures in compliance with its obligations. Furthermore, ICSID statistics demonstrated that most ISDS cases are resolved in favor states. Thus, the Rapporteur's claims about the "catastrophic" impact of ISDS on climate action and human rights are unsubstantiated and lack sufficient context in investment law.

Finally, ISDS plays a crucial role in promoting foreign investments in host states; thus, rather than discarding it, the international community must work throughout constructive ideas and legal ground to strengthen and improve the system. Encouraging the reforms of IIAs is a helpful way to maintain this international forum and articulate it with present concerns such as environmental protection and human rights.



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