Investor-State Arbitration: Exploring Conteporary Issues and Remedy

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Abstract
In recent years there has been rapid expansion of investments by foreign investors in countries around the world. For addressing the investment-related disputes, the Investor-State Arbitration (ISA) has been frequently resorted to by the parties. Arbitration is thus the preferred and widely used ADR mechanism in the sphere of commercial disputes between foreign investor and host state. However, of late there has been increasing criticism of ISA coming from the disputants (parties) and various stakeholders. These criticisms have mainly to do with the over delays, costs, unsatisfactory results, loss of harmony-which many a time follow with arbitration. Arbitration in this sense has become comparable with litigation. Foreign investors may find it hard to continue with their business in the host state if the dispute resolution remains slow, tardy, costly and foremost unsatisfactory. Further, host state also risks losing key investments to the detriment of its national economy.
Not to speak of delays, costs and other attendant problems, the major challenge to ISA remains the political issues which many times rights-based arbitral process might generate. That is to say, if the arbitral award is against the host state's national interest, the same might create contentious issues, thus challenging the entire mechanism of ISA.
In the light of the above, the present paper will first discuss the current global trend of ISA and will highlight the problems associated with it. It will then explore the ways and means of strengthening the ISA mechanism in addressing the investor-state disputes. Thus it will primarily offer analysis of the critical aspects of ISA. To this end it will discuss the 'other' consensual forms of dispute resolution like mediation, conciliation and negotiation and how they can effectively help in dispute prevention and management. In this way, it is supposed, the present paper will analyse critically the growing discussion surrounding the utility of Investor-State Arbitration as currently happening at the global level.
Keywords: Arbitration, Investment, Investor-State Arbitration, Alternative Dispute Resolution

1. Introduction

In recent years there has been rapid expansion of investments by foreign investors in countries around the world. For addressing the investment-related disputes, the Investor-State Arbitration (ISA) has been frequently resorted to by the parties. Arbitration is thus the preferred and widely used ADR mechanism in the sphere of commercial disputes between foreign investor and host state. However, of late there has been increasing criticism of ISA coming from the disputants (parties) and various stakeholders. These criticisms have mainly to do with the over delays, costs, unsatisfactory results, loss of harmony-which many a time follow with arbitration. Arbitration in this sense has become comparable with litigation. Foreign investors may find it hard to continue with their business in the host state if the dispute resolution remains slow, tardy, costly and foremost unsatisfactory. Further, host state also risks losing key investments to the detriment of its national economy.

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2. INVESTOR-STATE ARBITRATION: SOME PRELIMINARY OBSERVATIONS

In contemporary international investment law, international arbitration has established itself as the main option through which foreign investors can pursue claims that they have against a host State resulting from an investment dispute. Provisions on investor–State dispute settlement (ISDS) are enshrined in almost all contemporary international investment agreements (IIAs)[1] . To provide in IIAs that arbitration and not litigation in national courts should constitute the main method to resolve investment disputes is considered as an important element of investment protection.

Furthermore, international arbitration has long been seen as the optimal way to address and resolve disputes between investors and States, and is to some extent still considered as such today. It depoliticizes investment disputes, assures adjudicative neutrality and independence, and was often perceived as a swift, cheap, flexible and familiar procedure. Moreover, international arbitration is seen to be offering the parties a possibility to exercise a substantial amount of control over the litigation procedure. It further assures that awards are enforceable and creates a sense of legitimacy

Raison D'être For Settling Investment Disputes

The Settlement of disputes between host states and foreign investors is a particularly important aspect of the legal protection of foreign investments. In the absence of other arrangements, a dispute between a host state and a foreign investor will normally be settled by the host state's domestic courts. From the investor's perspective, this is not an attractive option. Rightly or wrongly, the courts of the host state are not seen as sufficiently impartial in this type of situation. In addition, domestic courts are usually bound to apply domestic law even if that law should fail to protect the investor's rights under international law. In addition, the regular courts will often lack the technical expertise required to resolve complex international investment disputes.

Domestic courts of other states are usually not a realistic alternative. In most cases, they lack jurisdiction over investment operations taking place in another country. In addition, sovereign immunity or other judicial doctrines will often make such proceedings impossible.

Diplomatic protection was a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his or her home state and the pursuit of this claim against the host state. This may be done through negotiations or through litigation between the two states before an international court or arbitral tribunal. But diplomatic protection too has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with states against which it is exercised and may lead to tensions in international relations. Not surprisingly, developing countries do not like being leaned upon by powerful industrialised nations. Therefore this method carries political disadvantages for the investor and for both states. It may cause diplomatic friction between the states concerned and cast a shadow over their relations.

Content and Trend of ISA

As is understood, "Investor-state arbitration is a provision in international trade treaties and international investment agreements that grants investors the right to initiate arbitration proceedings against foreign governments in their own right under international law."[2] Therefore, the presence of arbitration clause in the investment agreements provide a sort of rather quick and efficient mechanism of dispute resolution. There is more often a pre-existing agreement to arbitrate which flows from the parties own willingness, and which exists due to parties' accession[3] to investment treaty in general. However, the lack of pre-existing agreement to arbitrate does not mean that arbitration cannot happen. Parties may choose to rely on arbitration any time,

[1] Countries concluding IIAs commit themselves to adhere to specific standards on the treatment of foreign investments within their territory. IIAs further define procedures for the resolution of disputes should these commitments not be met. The most common types of IIAs are Bilateral Investment Treaties (BITs) and Preferential Trade and Investment Agreements (PTIAs). International Taxation Agreements and Double Taxation Treaties (DTTs) are also considered as IIAs, as taxation commonly has an important impact on foreign investment. See generally, UNCTAD Series on Issues in International Investment Agreements, IIA Issues Paper Series, United Nations Publication Document (United Nations), October 2008

[2] Rudolf Dolzer, Christoph Schreuer, Principles of international investment law, Oxford University Press, 2008, 122.

[3] "Ratification", "acceptance", "approval" and "accession" mean in each case the international act so named whereby a State establishes on the international plane its consent to be bound by a treaty, Article 2 of Vienna Convention on the Law of Treaties, 1969.

provided the parties have given their free consent.

One of the reasons behind ISA is that the investors cannot afford to take recourse to the traditional litigation because the national court system of host state, as has been experienced widely, can be overly delayed, costly, and most importantly, ineffective in rendering harmonious justice to the parties concerned[1]. This is also desirable on the part of host state to see the dispute getting resolved quickly, for the simple reason, that a long trial in the court can ill-impact the national economy.

Another aspect in ISA is the nationality issue which is very important part of the investment arbitration. The investor's nationality determines from which treaties it may benefit. If the investor wishes to rely on a BIT (Bilateral Investment Treaty) it must show that it has the nationality of one of the two States parties. If the investor wishes to rely on a regional treaty, such as NAFTA (North America Free Trade Agreement)[2] or the ECT (Energy Charter Treaty)[3] or SAFTA (South Asia Free Trade Agreement), it must show that it has the nationality of one of the States parties to the treaty. If the investor wishes to rely on the ICSID Convention[4] it must show that it has the nationality of a State party to the ICSID Convention. In addition, it must show that it does not have the nationality of the host State.

The growing significance of ISA can be understood from the fact since the late 1990's the number of investor-state disputes has increased sharply: In 1997, 19 known cases were brought against states. By 2007, there were over 250 known cases, and more than 450 by the end of 2012.[5]Some of them are enormous in terms of the amounts at stake and potential impact on the parties to the dispute. Others are just large. In the history of ICSID, the lowest awarded amount ever was US$ 460,000 in Asian Agricultural Products Ltd. v. Sri Lanka[6], and the highest – US$ 1,769,625,000 in Occidental v. Ecuador[7], As of 30 June 2012, ICSID's registered cases were distributed across the economic sectors as follows: oil, gas, and mining (25%), electricity and other energy (13%), other industries (12%), transportation (11%), construction (7%), financial (7%), information and communication (6%), water, sanitation, and food protection (6%), agriculture, fishing, and forestry (5%), services and trade (4%), and tourism (4%).[8] The data above shows that investor-state disputes are burgeoning at a quick scale in a range of economic areas.

Commercial Arbitration and Investment Arbitration

In the realm of international arbitration of disputes, two terms are frequently used, namely, commercial arbitration and investment arbitration. Both are sometimes interchangeably used, but they do not carry the same meaning. Commercial arbitration has, of course, a tradition of many centuries, both at the domestic, but also at the international level. Investment arbitrations have also existed to some extent for quite some time as we know from older cases. But it became a widely used general field of international dispute settlement only when

[1] Delays in justice are rampant in almost all the countries of the world. This is considered, inter alia, the main rational behind the modern evolution of Alternative Dispute Resolution mechanisms like arbitration. See generally, Gary B Born, International Commercial Arbitration, Vol. 1, 2009, Kluwer Law International, 50-55.

[2] North American Free Trade Agreement

[3] The Energy Charter Treaty (ECT) is an international agreement which establishes a multilateral framework for cross-border co-operations in the energy industry. The treaty covers all aspects of commercial energy activities including trade, transit, investments and energy efficiency. The treaty is legally binding, including dispute resolution procedures.

[4] ICSID is an autonomous international institution established under the International Convention on the Settlement of Investment Disputes between States and Nationals of Other States with over one hundred and forty member States. The ICSID is a member of the World Bank Group and is headquartered in Washington, D.C., United States. It was established in 1966 as a multilateral specialized dispute resolution institution to encourage international flow of investment and mitigate non-commercial risks. Although the ICSID is a member of the World Bank Group and receives its funding from the World Bank, it was established as an autonomous institution by a separate treaty drafted by the International Bank for Reconstruction and Development's. For in-depth understanding of the working and functions of ICSID visit https://icsid.worldbank.org/ICSID/FrontServlet (Last accessed April 3, 2013); Also see, Christoph H. Schreuer, Loretta Malintoppi, August Reinisch and Anthony Sinclair, The ICSID Convention- A Commentary, 2nd Edn., Cambridge University Press, 2009

[5] See the Report containing the latest development in Investor-State Dispute Settlement available at the website of UNCTAD http://unctad.org/en/PublicationsLibrary/webdiaeia2012d10_en.pdf (Last accessed April 4, 2013)

[6] ICSID Case No. ARB/87/3, Award of June 27, 1990, available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC676_En&caseId=C140 (Last accessed April 5, 2013)

[7] ICSID Case No. ARB/06/11, Award of October 5, 2012, available at https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC810_En&caseId=C80 (Last accessed April 5, 2013)

[8] Supra note 8

the first bilateral investment treaties (BITs) were concluded starting in 1958 and when the World Bank initiated the ICSID-Convention in 1966.[1] Back in the early days there were just few cases of ISA, but the amount and volume of ISA cases have grown manifold. Investment arbitration is by now chosen as the dispute settlement mechanism in thousands of treaties and investment contracts and leads to hundreds of cases per year in practice between states and foreign enterprises.

Further, Commercial arbitration has close parallels to litigation.[2] Cases arise when the parties to a dispute have a pre-existing agreement, often enshrined in the contract giving rise to the dispute, to settle any difficulties by arbitration rather than litigation. The parties to commercial arbitration are mostly private companies and, to a lesser extent, state-owned enterprises.

Investment treaty arbitrations on the other hand arise out of one of the various existing investment treaties. Many of this second category of disputes, however, arise out of Bilateral Investment Treaties (BITs),[3] under which pairs of countries have agreed to reciprocal obligations toward investors from each other's jurisdictions. There are as many as 3,000 such treaties in existence.[4] Further the term 'investor' may be taken to mean all kinds of private enterprises which have invested in different sectors of the host state. There can be investment made by a public agency of one country in another country. So state-owned corporations can also be involved in ISA.

3. INVESTOR-STATE ARBITRATION: GROWING CRITICISM

The initial euphoria about ISA has in the recent years subsided substantially. This is mainly because of the evident shortcomings and problems which have now come to characterise the ISA mechanism. To put it mildly, in the words of Professor Christopher Schreuer: "the initial enthusiasm has given way to a more sober assessment."[5]

Increasingly, states and investors express concerns regarding the costs associated with the arbitration process. Some states are refusing to comply with arbitral awards. Other states hesitate to sign new bilateral investment treaties, or even rescind from old ones. Related issues attract the attention of the public.

Again, in recent years the burgeoning growth in investment arbitration has not gone wholly unopposed with heavy criticisms coming from NGOs, media, and certain governments. Arbitral tribunals are accused of being 'shadow governments' dispensing 'justice behind closed doors'[6] The perceived lack of transparency and spiralling costs of investment treaty arbitration, coupled with the admittedly small pool of specialists from which the arbitrators are drawn and the alleged opportunism of investors,[7] have led to a so-called backlash. This 'backlash' has only been exacerbated as the number of investment arbitrations has grown, sometimes resulting in the 'the parallel existence of arbitral tribunals.[8] Parallel tribunals can give rise to awards with inconsistent conclusions, and which may even be scandalously contradictory'.

Apart from issue of lack of lack of transparency, other notable shortcomings also feature prominently in the ISA

[1] Id.

[2] See, Karl Heinz, Commercial and Investment Arbitration: How Different Are They Today? – The Lalive Lecture 2012, Arbitration International, Vol. 28, Issue 4, (2012) 577-590

[3] They can arise out of bilateral investment treaty (BIT), which is an agreement establishing the terms and conditions for private investment by nationals and companies of one state in another state. This type of investment is called foreign direct investment (FDI). BITs are established through trade pacts. See, Jarrod Wong, "Umbrella Clauses In Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries In Foreign Investment Disputes", 14 George Mason Law Review (2007) 135.

[4] Quantitative Data regarding existing investment treaties can be accessed at UNCTAD website, http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20%28IIA%29/Quantitative-data-on-bilateral-investment-treaties-and-double-taxation-treaties.aspx (Last accessed on April 10, 2013).

[5] Christopher Schreuer, The Future of Investment Arbitration, Available at http://www.univie.ac.at/intlaw/pdf/98_futureinvestmentarbitr.pdf (Last accessed April 10, 2013)

[6] Gabrielle Kaufmann-Kohler, In Search of Transparency and Consistency: ICSID Reform Proposal, I, Paper delivered at Investment Treaty Workshop held September 27, 2005 at IBA Annual Conference in Prague; published in 2 Transnational Dispute Management (November 2005)

[7] At least 39 arbitrations were brought against Argentina relating to its financial meltdown at the turn of the millennium. It remains to be seen how many new claims may arise out of the current economic meltdown or presently out of the Eurozone crisis, which has forced many governments to intervene in matters of investment.

[8] Investor-to-State arbitrations offer examples of Parallel Proceedings in which the responsibility of the State may be at stake with regard to the same facts, including the same state measures. The proliferation of bilateral investment treaties has increased the complexity of the different methods of dispute resolution in the international arena, including the number of forums in which individuals and private corporations may claim the responsibility of host States.

landscape. An important source of these shortcomings is the special nature of international investment arbitration, involving a sovereign as a defendant and challenging acts and measures taken by a sovereign State. The international arbitration procedure also differs from litigation in domestic courts in that the dispute is governed by international law and based on the violation of an international treaty, where arbitration is the main option made available to investors. Another peculiarity is that the nature of the relationship between the investor and the State involves a long-term engagement; hence a dispute resolved by international arbitration and resulting in an award of damages will generally lead to a severance of this link.

Moreover, the financial amounts at stake in investor–State disputes are often very high. Resulting from these unique attributes, the disadvantages of international investment arbitration are found to be the large costs involved, the increase in the time frame for claims to be settled, the fears about frivolous and vexatious claims, the general concerns about the legitimacy of the system of investment arbitration as it affects measures of a sovereign State, and the fact that arbitration is focused entirely on the payment of compensation and not on maintaining a working relationship between the parties.[1]

4. THE WAY OUT

Following such problems with ISA, the need to explore and emphasize more consensual forms of alternative dispute resolution assumes a great significance. In this connection, 'other' more consensual forms of ADR like conciliation and mediation[2] can provide effective answers to the ills inherent within the investor-state arbitral process. These 'other forms' are primarily interests-based in contrast to the rights-based arbitral process. It focuses on facilitating the parties' communication, negotiation and decision-making unlike arbitration which is focused on enabling the arbitrator's decision-making. Through facilitated dialogue and negotiation, there is a greater chance of harmonious resolution of the given investor-state disputes. Further, these 'other forms' being flexible, cheap, timely and less formal can potentially be more effective in addressing a wide array of investor-state disputes. Again, these can be used in substantial pre-arbitration work which can further ensure the quick establishment of communication between the disputants, which in turn can lead to substantial narrowing down of issues, thus helping the disputants in arriving at negotiated settlement of disputes. In any case, these 'other forms' can provide an excellent platform for carving out creative and harmonious solutions, to the advantage of both, foreign investor and host state.

Thus ISA mechanism needs comprehensive solutions for the problems which have typically characterised it in recent years. The set of solutions are set forth below:

(i) Methods of alternative dispute resolution (ADR) that seek to resolve existing disputes through negotiation or amicable settlement such as international conciliation or mediation should be first explored and given much emphasis.

(ii) Dispute prevention policies (DPPs)[3] *that attempt to prevent conflicts between investors and states from emerging and escalating into formal investment disputes, for example by establishing inter-institutional alert mechanisms within States or encouraging information sharing among government entities. The advantages of these alternative approaches are the flexibility offered by these approaches, including the possibility to find amicable grounds for settlement between investors and states, permitting the parties to continue a working relationship. The settlement process is also faster and less costly. ADR can be without prejudice to the right of the parties to resort to other forms of dispute resolution.*

(iii) Existing international rules on dispute resolution, most notably the conciliation rules of the International Centre for the Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL)[4] *and the International Chamber of Commerce (ICC)*[1] *, provide guidance on the use of*

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[1] Emphasis just on compensation to the aggrieved party or to the party whose rights have been vindicated by the arbitral award- does not guarantee re-start of the same level of trustworthy relationship. This scenario is more or less akin to the adjudicatory process which establishes right and wrong. In the arbitration of investor-state disputes, thus there is every likelihood of continued lack of harmony post arbitral award.

[2] For the sake of this paper, the subtle difference between conciliation and mediation is ignored. In any case both are interest-based dispute resolution mechanisms.

[3] Roberto Echandi, Towards a New Approach to Address Investor-State Conflict: Developing a Conceptual Framework for Dispute Prevention, NCCR Working Paper No 2011/46, August 2011, Swiss National Centre for Competence in Research, also available at http://www.wti.org/fileadmin/user_upload/nccr-trade.ch/wp2/publications/wp%202011%2046_Echandi.pdf (Last accessed April 15, 2013)

[4] Adopted by UNCITRAL on 23 July 1980, the UNCITRAL Conciliation Rules provide a comprehensive set of procedural rules upon which parties may agree for the conduct of conciliation proceedings arising out of their commercial relationship.

of ADR techniques. ICSID also maintains a set of fact-finding rules and the ICC published a set of rules detailing the establishment and function of "dispute boards".[2] Other institutions beyond the aforementioned three also provide their own set of conciliation or mediation rules, and hence procedural guidance on the use of ADR techniques is available for the parties involved in investment disputes. Many of these dispute resolution institutions further offer necessary logistical and organizational support, for example by making a venue and facilities available to disputing parties for the purpose of undertaking the conciliation or mediation process. Despite this assistance, research today suggests that rules on ADR have been rarely used in investor–state dispute resolution, [3] and hence more specific encouragement in ISAs towards considering the use of these rules may be an important way forward.

(iv) The sharing of information among government agencies on issues related to foreign investment in a well-structured and organized way can assure that the right government agencies are alerted at an early stage about possible problems faced by investors and allow for a timely response. Information sharing will generally increase awareness among government agencies and various levels of government (e.g. at the regional or municipal level) of relevant issues in international investment law.

(v) Governments can target specific sensitive sectors where disputes could arise, and monitor foreign activities in this sector more closely, addressing possibly emerging problems at an early stage.

(vi) States can provide the option of an administrative review of a measure deemed unsatisfactory by investors. The possibility of such a review can foster much needed confidence and trust in the host state's institutions.

(vii) The establishment of adequate inter-institutional arrangements among government agencies can allow states to address emerging investment disputes more effectively. Such inter-institutional mechanisms may involve the establishment of a lead agency responsible for dealing with investment disputes, with the right to obtain information from other government agencies and the authority to resolve a dispute through preferred means of settlement.

(viii) Specific public officials can be empowered with the authority to engage with investors, embark on negotiations or pursue amicable settlement.

(ix) Among government agencies, timely sharing of information and documents related to an investment dispute should be assured, even at a short notice.

(x) An ombudsman or "ombuds" office can function as an institutional interlocutor within the host country which investors can approach to have their grievances heard and addressed.

(xi) State–State cooperation on dispute prevention could be enhanced.

(xii) Attempts can be made to continue negotiating even while an arbitration procedure is already on-going.

Overall, ADR and DPPs can offer promising alternatives to the settlement of investment disputes through international arbitration, and hence states, investors, legal practitioners, arbitration institutions and international organizations should be encouraged to give these methods further consideration in the context of investment disputes emerging in the future.

5. CONCLUDING REMARKS

While resort to arbitration is the predominant approach in ISAs as the name itself suggests, alternative approaches have at times also been incorporated in them. But such incorporation of rules as a part and parcel of

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The Rules cover all aspects of the conciliation process, providing a model conciliation clause, defining when conciliation is deemed to have commenced and terminated and addressing procedural aspects relating to the appointment and role of conciliators and the general conduct of proceedings. The Rules also address issues such as confidentiality, admissibility of evidence in other proceedings and limits to the right of parties to undertake judicial or arbitral proceedings whilst the conciliation is in progress. See generally, Issak I Dore, Arbitration and Conciliation under the UNCITRAL Rules: A Textual Analysis, Martinus Nijhoff Publishers, 1986.

[1] ICC based in Paris offers a range of dispute resolution services to help solve difficulties in international business.

[2] A dispute board or dispute review board (DRB) or dispute adjudication board (DAB) is a 'job-site' dispute adjudication process, typically comprising three independent and impartial persons selected by the contracting parties. The significant difference between Dispute Review Boards and most other Alternate Dispute Review techniques (and possibly the reason why or Dispute Review Boards have had such success in recent years) is that the Dispute Review Board is appointed at the commencement of a project before any disputes arise and, by undertaking regular visits to the site, is actively involved throughout the project (and possibly any agreed period thereafter). See generally, Cyril Chern, Chern on Dispute Boards, 2nd Edn., Wiley Blackwell, 2011

[3] Supra note 22

institutional mechanism of ISA is still conspicuous by its absence. As a positive side-effect of the criticism against investment arbitration, investors and states as well as some international organizations such as UNCTAD[1] , ICSID[2] or IBA [3], are advocating for the increased use of conciliation or mediation to supplement investor-State arbitration. This change is significant. However, only time will tell whether the push for alternative non-adversarial, interest-based modes of ADR is adequately done or not. Again, the current mechanism for addressing investor-state disputes need not be substituted with a whole new dispute resolution system. However, as this paper has strongly advocated, there is a widely felt need, among the various stakeholders, for the increased use of interest-based consensual forms of ADR within the overall mechanism of ISA which should be further combined with Dispute Prevention Policy (DPP) and other amicable institutional means. The Mantra must be to preserve the interests of both the investors and states.

[1] Supra note 8
[2] Supra note 7
[3] The most recent development came in October 2012 when the International Bar Association (IBA) adopted new Rules for Investor State Mediation (the Rules). The Rules have been drafted by the IBA Subcommittee on State Mediation. The rules were prepared against the background of a significant increase in investor-state disputes arising from international investment agreements. See the IBA Rules for Investor-State Mediation, available at http://www.ibanet.org/LPD/Dispute_Resolution_Section/Mediation/State_Mediation/Default.aspx (Last accessed April 18, 2013)

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