THE MAIN POLITICAL QUESTIONS OF INVESTOR STATE DISPUTE SETTLEMENT

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Abstract
Investor-state dispute settlement has been in sharp focus for the past ten years. Most of the scholarly work on the topic is being done within the framework of legal analysis. This article focuses instead on the most important political question of the ISDS. Based on the relevant sources form the policy arena and academic texts, the article concludes that the three most important political issues of the ISDS regimes are: "regulatory chill", inconsistency of tribunal decisions, and transparency. The aim of this article is to provide a critical analysis of these three questions, and to sketch out possible solutions. These goals will be accomplished through analysis of relevant documents, mainly scholarly publications and policy texts of the main political actors. The overarching conclusion of the analysis is importance of analyzing the ISDS regimes from the viewpoint of the political sciences.

Keywords: investor-state dispute settlement, international investment law, regulatory chill, inconsistency, transparency.

1 Introduction

In this paper, we will explore the investor-state dispute settlement regimes from the viewpoint of the political science. Investor-state dispute settlement is a mechanism of international arbitration that allows foreign investors to sue host governments at international tribunals. The ISDS regimes draw their legal basis from international investment treaties (BITs, multilateral trade treaties, and other), which usually contain a section on settlement of disputes. On the level of theory, the regimes are based on 1) the neoliberal theory of development, more specifically the hypothesis that foreign direct investment is the major driver of development, and 2) the "home bias" hypothesis, which asserts that domestic courts are biased in favor of executive power in investment disputes. ISDS regimes represent a logical synthesis of these two assumptions. Their goal is to protect the foreign investors from the whims of the domestic courts by moving the investment arbitration to the international level, thus stimulating foreign investment.

This area of international law has become a political issue of increased importance in the last decade, in response to perceived failings of the system, especially in the context of developing nations. The objective of this paper is to identify the main political issues of the current debate over the ISDS and analyze their relevance and the proposed solutions. Therefore, the main question that the paper will attempt to answer is: What are the main concerns of the main actors and scholars in relation to the ISDS regimes in the context of political analysis? And how do the main policies being promoted in relation to these concerns stand up to an analysis? The questions being sketched out in this way limit the scope of the inquiry to the arena of the political science, which means that the paper will explicitly not deal with questions of international law that have no political implications.

2 Methodological Considerations

Although the paper has a simple research design, there are some methodological considerations that will be briefly addressed in this chapter. The question that has been stated in the introduction will be answered by analyzing relevant texts. These will be selected from scholarly literature and political texts, such as the papers from the major international organizations and major political players. These sources are easily accessible and therefore do not present a challenge from the point of view of source access. What I will be concentrating on in analyzing the selected texts will be identification of the main issues with direct political implications (excluding the issues that are solely of concern for the field of international law) and analyzing the main courses of action that are being pursued in relation to these issues. This ought to enable us to successfully fulfill the objective of the paper.

3 Description of achieved results

3.1 Regulatory Chill

The main issue of the current system of ISDS comes in the form of the so-called *regulatory chill* hypothesis. There is naturally many definitions of the phenomenon that the hypothesis describes, but the main idea is remarkably consistent, a rare thing in the social sciences. The most widely used definition was presented by Tietje and Baetens in their study of the impact of ISDS in TTIP for the ministry of foreign affairs of Netherlands.

They define regulatory chill as the situation in which "a state actor will fail to enact or enforce *bona fide* regulatory measures because of a perceived or actual threat of investment arbitration". Furthermore, they distinguish between 1) not drafting particular legislation in anticipation of arbitration, 2) chilling legislation upon awareness of arbitration risks, and 3) chilling legislation after the outcome of a specific dispute (Tietjem, Baetens 2014: 68). It follows from the definition that the regulatory chill is a phenomenon with significant political implications and will therefore be of interest to us in this paper.

In other words, the ISDS may in certain instances work as a deterrent against government regulation, including in the case of legitimate public interest measures. The most studied cases (Philip Morris v. Uruguay, Philip Morris. Australia) are concerned with the plain packaging laws for tobacco products[1]. The definition provided above highlights the main problem of the hypothesis. The problem consists of the fact that while the hypothesis is internally consistent, appealing and politically relevant, there is no reliable methodology to demonstrate a cause of absence of a phenomenon, in this case government regulation. The efforts aimed at proving the hypothesis are thus limited to detailed case studies.

No one seems to be questioning the internal logic of the hypothesis, which seems undeniable. The ISDS regimes put a price in form of a potentially costly ISDS case on the regulation of foreign investment. The only questions are whether the lawmakers, the executive and the relevant administrative capacities are aware of this price, and whether they take it into consideration when taking decisions on regulation. These questions can only be answered through careful case study research, although there are examples of government actions that hint at the acuteness of the problem of regulation, as evidenced in the processes of abandoning the ISDS regimes by some, mainly Latin American countries (Equator, Bolivia, Venezuela). Cases that are sometimes used as examples of the regulatory chill include *Ethyl v Canada*, *Achmea v Slovak Republic*, and others.

Finally, there is a criticism of the *regulatory chill* hypothesis which doesn´t go as far as denying the existence of *regulatory chill* but states that the importance of impact of the ISDS regimes on the legislature of sovereign governments are overstated. As an example, we can take a look at what the European Federation for Investment Law and Arbitration (EFILA) wrote in defense of the ISDS regimes. Their contention was that the hypothesis "appears to presuppose that ISDS impacts on legislative processes" (EFILA 2015). They then go on to cite the 2014 research of Cadel and Jensen, claiming that only about 9% of the cases relate to legislative acts[2] (Caddel, Jensen 2014). Their conclusion is that if real, the *regulatory chill* phenomenon is a marginal one. Leaving aside the issue of how does one determine the relevance of impact of the regulatory chill on legislative acts compared with executive and administrative ones, the main problem of the argument is in the presupposition that regulation does not include executive and administrative action. In fact, there are countless executive and administrative measures that can be seen as bona fide regulation of foreign investment in public interest, ranging from indirect expropriation (under specific conditions) to non-renewal of a mining permit. To claim that only legislative action can be affected by the regulatory chill is patently false and doesn´t need further discussion. It is true that the effects on the decision-making process of relevant institutions might still be marginal, however, that has yet to be determined.

Lastly, there is a paradox involved here, when more awareness about the effects and potential costs of ISDS arbitrations means at the same time a more powerful *chilling* effect of the ISDS regimes. This, however, should not discourage further research into the matters of impact of investment arbitration on the regulation in public interest. Deep understanding of the causes and effects of the processes involved is the only way to come up with an achievable solution to the problem.

If we come to admit that the regulatory chill is a real phenomenon, there are no simple solutions. A partial remedy consists of reforming and modernizing the existing international investment agreements to include in their ISDS clauses a right of the host government to regulate for legitimate public purposes. Many of the most recently signed agreements already include such clauses, or similar paragraphs, referring to protection of health and safety, labor rights, environment or sustainable development. Examples include such diverse agreements as CETA, Iran – Slovak Republic BIT or Nigeria – Singapore BIT (UNCTAD 2017: 121). You will no doubt notice, that the concept of "legitimate public purposes" is a rather vague one, and open to interpretation. However, that alone should not prevent the efforts to include these paragraphs in all new investment agreements, since the UNCTAD´s 2017 World Investment Report concludes convincingly that it is "the *old treaties* that bite" (UNCTAD 2017: 125) (italics mine).

3.2 Inconsistency in the Decision-Making Process

[1]For details, see Philip Morris v. Uruguay, (Award), International Court for Settlement of Investment Disputes (ICSID), ARB/10/7, 8.7.2016, available at http://investmentpolicyhub.unctad.org/ISDS/Details/368, and Philip Morris v. Australia, (Award On Jurisdiction And Admissibility), Permanent Court of Arbitration (PCA), Case No. 2012-12, 17 December 2015, available at http://investmentpolicyhub.unctad.org/ISDS/Details/421.

[2] The 9% claim of Cadel and Jensen is dubious, since UNCTAD supplies a figure of 25% cases related to legislative changes in 2014. See UNCTAD, World Investment Report 2015 pp. 152.

Second main political issue of the current practice of ISDS regimes is the question of inconsistency. In this article, we will not be concentrating on the specifics of cases where the inconsistencies can be observed, we will instead settle for quoting the main organizations, nation states and academic work, in order to establish the existence of this political issue. The evidence given here consists of analysis of texts mostly issued by UNCTAD who identify it as a crucial policy area. For example, UNCTAD wrote in its 2013 Issue Note: "Those arbitral decisions that have entered into the public domain have exposed recurring episodes of inconsistent findings. These have included divergent legal interpretations of identical or similar treaty provisions as well as differences in the assessment of the merits of cases involving the same facts" (UNCTAD 2013: 3).

OECD writes in its 2012 Public Consultation: "During the discussion at FOI Roundtable 15, a substantial number of State participants felt that there is a serious problem regarding consistency in ISDS" (OECD 2012: 61). One of the leading academics concerned with ISDS Susan Franck states: "because legal errors cannot be corrected in ICSID awards, the possibility of inconsistent awards is an accepted realty at ICSID, and the correctness of decisions has been sacrificed for the sake of finality" (Franck 2005: 1548). Thus, we have the international organizations, nation states and academics agreeing there is a problem with consistency in decisions of the IDS tribunals. This will suffice to establish the issue.

There are two important aspects in which the ISDS regimes can be viewed as inconsistent. 1) First is the case where tribunals come to differing decisions in similar cases, initiated under the same provisions. 2) Second is the case where tribunals come to differing decisions in cases initiated under different agreements and clauses but involving the same investor rights and principles.[3] In the first case, the problem is on the level of tribunals and their decision-making. In the second case, the problem is the diversity in investment agreements.

When it comes to the first problem of inconsistency in similar cases under the same provisions, there is not much that can be done to rectify the problem. It should be said that this issue arises in most, if not all legal systems. There is naturally a question of whether the structure of the ISDS regimes does not contribute to this type of inconsistency. One of the causes of inconsistency of ISDS decision-making is the absence of an appellate mechanism, which is universal. With no appeal available to either side of the conflict, the occasional wrong decision is not amenable to rectification. Adopting an appellate mechanism in the ISDS regimes is the obvious solution. However, it needs to be noted that this would further increase the already sky-high costs of arbitration.

Furthermore, there have been claims that the decision-making of the tribunals is influenced by their composition. Specifically, charges are made against the ISDS that the legal decisions are made by a very small group of lawyers who are from big corporations, developed countries, white, male, which contributes to a particular view of the investment arbitration process and its role. These charges will not be developed here, since there is very little evidence, other than correlation, supporting them. Moreover, these issues do not enter the political arena and as such find themselves outside the scope of this paper.

When it comes to the second type of inconsistency, that is the inconsistency across the ISDS regimes, the causes are rather obvious. The main one is the fact that the trade and investment treaties are diverse. With over 3000 BITs in existence at the present time, the differences in wording and language of these treaties make an important difference.

Statistical findings of the UNCTAD study for the Ministry of Foreign Affairs of Netherlands show that these differences in the BITs have impacts on the way the ISDS regimes function. There have, for example, been 54 claims initiated under Dutch investment treaties[4] before 2013. That is a significantly disproportionate amount given the economic power of Netherlands. For illustration only one country had more cases filed in the same period, that country being the United States. That means that the so-called "Dutch cases" amount for one fifth of the total number of ISDS cases before 2013. Rather unsurprisingly, the study finds that the ultimate owner of the companies filing suits is foreign in 74 percent of the cases (UNCTAD/DIAE 2013: 5).

The picture that the study paints is one of the investors structuring their ownership in such a way, that they are able to file a lawsuit against countries under bilateral investment treaties of their choosing. These will naturally be the treaties with the highest levels of investor protection, and the vaguest wording of rights of governments to regulate, such as the Dutch BITs. This phenomenon is called *treaty shopping* and represents a major consequence of inconsistency brought about by the diversity in BITs.

A partial solution to the problem is to replace the old BITs with multilateral treaties with consistent wording and precise language. This solution is being promoted by the main international organizations, such as the UNCTAD, but also by the European Union. The position of the EU is that the old treaties are incompatible EU law because of their overlapping and conflicting nature[5]. EU has gone as far as initiating infringement proceedings against states that are failing to terminate outdated intra-EU BITs[6].

[3] For a similar typology, see OECD, Investor-State Dispute Settlement: Public Consultation, 2012, available at http://www.oecd.org/investment/internationalinvestmentagreements/, last visited 14.11.2017.
[4] Some of these claims are initiated under the Energy charter and are not relevant here.
[5] UNCTAD, (2017), World Investment Report 2017, p. 144.
[6] i.e. the Austria–Czech and Slovak Federal Republic BIT (1990), the Netherlands–Czech and Slovak Federal Republic BIT (1991).

Replacing the old BITs is crucial mostly because it is the old treaties that "bite", as UNCTAD puts it. "All of today´s known ISDS cases are based on treaties that were concluded before the year 2010, most of which contain broad and vague formulations".[7] That suggests, that the replacement of the old treaties will bring the ISDS proceedings more in line with the current paradigms, such as the environmental protection, food safety etc.

To conclude, the inconsistencies inherent on the ISDS regimes are recognized on the highest levels of investment policy-making, be it on the level of international organizations or the level of nation states. Moreover, there seems to be a corresponding effort aimed at addressing the issue by promoting and implementing the reform of international investment agreements, which would mitigate some negative consequences of the current ISDS regimes in the area of inconsistency. The creation of an appeals facility is also on the cards but represents a problematic issue with regard to the costs.

3.3 Transparency of the Proceedings

Similarly to the problem of inconsistency, the issue of transparency is widely recognized in the arena of international investment policy-making. UNCTAD cites the transparency among the main issues of the regimes in all of its major publications[8]. The EU has already introduced full mandatory transparency of the arbitration process within the CETA and is expected to push for the same in the case of TTIP (EU 2015). Some progress has also been made on the level of the investment courts, especially the ICSID. In 2008, the ICSID Arbitration Rules have been amended to improve transparency of the proceedings among other things.

These amendments however, are limited in effectiveness, since while it is true that the awards are in some cases partially published through excerpts from the ICSID, and in other cases it is usually possible to obtain the awards, since the awards are not subject to confidentiality. This however doesn´t solve the problem of discontinued proceedings, which are usually settled out of court by the investors and the states. These cases, which are plentiful, are then potentially subject to full confidentiality (Wong, Yackee 2010: 259-260). It is worth pointing out at this point that as it is always the investor who is the claimant, the settlements usually amount to concession of defeat on the part of the government. Furthermore, since the claims can be as high as 16.5 billion dollars (Cosigo Resources and others v. Colombia[9]), even the settlement might consist of a significant compensation, which the government might want to make confidential to avoid potential public outcry. It is damning in this regard that when UNCTAD publishes the yearly World Investment Report, they always talk about the number of *known cases* (UNCTAD 2017: 125) (italics mine).

The practice in terms of transparency is diverse on the level of states, with some states applying full transparency and some states using different criteria for different cases, for example avoiding publicizing the tribunal awards in cases that they lose. These differences are made even more stark by the fact that the level to which information on the proceedings is publicly available is to a large extent dependent on which investment treaty the proceedings are based on. Some new BITs require mandatory full transparency, some BITs allow for an agreement between parties concerning transparency.

The transparency is crucial for two reasons. The first one is to assure public and political oversight of the process of the ISDS cases. The nature of the ISDS cases is such that there are cases where the interest of both parties is secrecy, which might be directly in opposition with the interests of general public. Transparency also gives the general public an opportunity to voice their opinion on the proceedings that enter the public arena (admittedly a small number). The second reason why it is important to ensure transparency within the IDSS regimes is the need of the researchers for complete data on all the cases. The studies done from a diluted sample of the cases that do have public records is necessarily going to provide incomplete conclusions. This problem is aggravated by the fact that the cases settled confidentially are for that reason the cases of potential political impact.

We can conclude in this part, that the reform of the IIAs is moving in the right direction when it comes to the issue of transparency, the model being the CETA agreement. Further progress is needed on the level of the permanent arbitration courts. Transparency still remains one of the main political issues of the ISDS regimes.

4 Conclusion

The questions that the paper offers an answer to are: What are the concerns of the main actors and scholars in relation to the ISDS regimes in the context of political analysis? And how do the main policies being promoted in relation to these concerns stand up to an analysis?

The answer to the first question is that the main political issues of the ISDS regimes are 1) regulatory chill, 2) inconsistency in tribunal decisions and 3) transparency of proceedings. The paper answers the second question by identifying the main policies and concluding that while progress is being made in all the aforementioned policy areas, more focused effort is needed in order to resolve the political issues of the ISDS regimes. The most significant progress seems to be made in the area of ensuring more consistent tribunal decisions,

[7] UNCTAD, World Investment Report 2017, 2017, p. 127.
[8] For an example, see UNCTAD 2013, Op. cit., pp. 3.
[9] See http://investmentpolicyhub.unctad.org/ISDS/Details/726.

while the progress in addressing the regulatory chill is being halted by absence on consensus about the nature and the existence of the phenomenon.

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