FIXING THE BROKEN LEGS OF INVESTOR-STATE ARBITRATION

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ABSTRACT

Many countries have expressed their concern regarding balance between the twin pillars of protecting foreign investment and the host State’s regulatory power within the system of investor-State arbitration. Post the adverse award against India in the White Industries case, India also has been compelled to re-think its Bilateral Investment Treaty program.

This article argues that currently, the setup of investor-state arbitration is suffering a deep ‘legitimacy crisis’ and without some sweeping changes, this mode of dispute resolution may become unpopular with the host countries who see this mode of dispute resolution as pro-investor.

This article does not go into the merit of allegations made by host countries of investment. The article, briefly analyzes the various reasons of this ‘dissatisfaction’ and how it can be solved. Measures to enhance the perceived legitimacy and impartiality of the system form the core of the discussion in the article. Towards the end, we conclude that that the success of investor-state arbitration as a mode of dispute resolution will mostly depend upon the ease of negotiations between the countries and the recognition of genuine demands of all the participants in the process.

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I. INTRODUCTION

The White Industries\(^1\) award which granted 4 million Australian dollars to the Claimant was a bitter awakening to India’s obligations under its various Bilateral Investment Treaties (BITs). As a result of the adverse White Industries award and multiple notices under different BITs,\(^2\) there is a renewed focus on India’s BIT program. Questions have been raised about balancing investment protection with India’s regulatory power, compelling India to re-think its BIT program. Subsequently, the government has undertaken a review of the text of its 2003 Model. In March 2015, the government made public a new draft Model Indian Bilateral Investment Treaty which laid more stress on the regulatory power of the State. India’s concern regarding balance between the twin pillars of protecting foreign investment and the host State’s regulatory power within the system of investor-State arbitration is shared by many countries.

The aim of this article is to analyze the problems with the current mode of investor-state dispute resolution and suggest implementable solutions. The process of investor-state arbitration starts with an investment treaty. An investment treaty is an agreement between two or more States that safeguards investments made by qualifying investors in the territory of other State signatories.

Substantively, through investment treaties, governments guarantee investors certain treatment, such as the right to be free from expropriation without just compensation, the right to fair and equitable treatment or a guarantee that the government will honor its contractual commitments.

Procedurally, the existence of an investment treaty means that if investors believe that their substantive rights have been violated they can seek redress against the host state through the treaty’s dispute resolution mechanism. It has been noted by Dolzer and Stevens that “virtually all modern treaties provide for the arbitral settlement of investment disputes.”\(^3\) Providing direct right to action to the investor, independent of the host country, brings structural equality between the host government

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\(^2\) There are 14 known claims pending against India, See Gourab Banerji, GAR Investment Treaty Know-How, India (Adwaita Sharma, George Pothan & Sriharsha Pechhara, 2015); Indian Tax Dispute, CAIRN ENERGY, (March 10, 2015) available at http://www.cairnenergy.com/index.asp?pageid=27&newsid=471 (last seen January 5, 2016)

\(^3\) RUDELFO DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES 2 (1995) [hereinafter “DOLZER & STEVENS”]
and the investor. The result of the proceedings, if the investor succeeds, is a monetary award in its favor.

The significance of BITs can be understood from the fact that France and Germany - major capital exporting countries - insist on BITs as a pre-requisite for investment insurance. In a recent report by the Organization for Economic Co-operation and Development ("OECD"), the "existence of a bilateral investment treaty" has been specifically mentioned by over 10% of the business community, as an influential factor in their decision to invest. Hence, we can opine that a signed BIT acts like a confidence building measure. According to a report published by the Washington based Institute for Policy Studies, and Food and Water Watch, there are more than 2,500 BITs today, compared to 385 in 1989.

International Centre for Settlement for Investment Disputes ("ICSID"), set up under the Washington Convention, is the most frequently used institution for the conduct of investment arbitration. BITs also often provide for ad hoc arbitration under UNCITRAL, Stockholm Chamber of Commerce, ICC etc. These institutions only provide for the rules of conduct of arbitration.

With an exponential increase in the number of disputes, millions and sometimes billions of dollars at stake and national sovereignty and public policy measures in line, within the last decade, investment treaty arbitration has moved from a matter of peripheral academic interest to a matter of vital international concern.

This article argues that currently, the setup of investor-state arbitration is suffering a deep 'legitimacy crisis' and without some sweeping changes, this mode of dispute resolution may become unpopular with the host countries who see this mode of dispute resolution as pro-investor. At the same time, recognizing the merits of investment arbitration, the solutions suggested maintain the essence of investor-state arbitration while simultaneously addressing the concerns of host States.

4 DOLZER & STEVENS, Supra note 3 at 13
This article does not go into the merit of allegations made by host countries of investment. The paper, briefly analyzes the various reasons of this ‘dissatisfaction’ and how it can be solved. Measures to enhance the perceived legitimacy and impartiality of the system form the core of the discussion in the paper. The paper shall proceed as follows: the second part of the paper will briefly touch upon the emergence of investor-state arbitration as the dominant and preferred mode of dispute resolution. Part three describes the legitimacy crisis which the system faces and its repercussions. Part four of the article analyzes the various problems with the current system. Part five proposes various solutions to the same. And Part seven concludes.

II. INVESTMENT ARBITRATION VIS-À-VIS OTHER MODES OF RESOLVING INVESTMENT DISPUTES

Understanding the factors which made investor-state arbitration the preferred dispute resolution mode for international investment disputes will bolster our understanding of the problems plaguing it today and ways to solve them. Other modes of dispute resolution have either become outmoded or impractical due to various reasons as enunciated below.

i. GUNBOAT DIPLOMACY

Gunboat Diplomacy is the pursuit of foreign policy objectives by the threat of warfare. It tilts the outcome in the favor of the more powerful party in utter disregard of merits. It was widely practice by the European States especially against South American countries. For obvious reasons, protecting investments by threat of warfare has become unacceptable in international context.  

ii. LOCAL REMEDIES RULE

Local remedies refer to any redress available from the governmental apparatus within the host State including courts, administrative agencies or other authorities. According to the International Court of Justice (“ICJ”), the purpose of the rule is to give the respondent State an opportunity to redress the alleged injury before having to defend an international claim. This

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10 Ibid.
benefits the respondent State by allowing it to avoid the costs and adverse publicity associated with international proceedings.

There is wide agreement that modern investment accords have eliminated the local remedies rule in arbitrations arising under them. For example, Article 26 of the ICSID Convention states, “Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.” Such clauses effectively eliminate the rule for exhaustion of local remedies unless the respondent contracting state i.e. the host state has made it a condition precedent to arbitration.

The fundamental reason that the great majority of modern investment protection treaties have opted for international adjudication is that domestic courts are often in fact, and just as important, usually are perceived to be, biased against alien investors. Secondly, corruption and inordinate delays in courts are daily business in developing countries. Thirdly, domestic judges may not have the requisite expertise and skill to deal with international investment disputes.

In certain cases, pursuing local remedies may make it more difficult for the investor to succeed in his claim for compensation because the investigation of the arbitral tribunal shifts from the act of the government to the court decision. The investor may be required to establish “denial of justice or a pretence to achieve an internationally wrongful act” rather than the expropriatory effect of the governmental acts on the investment. In Robert Azinian and Ors. v. The United Mexican States, the ICSID Additional Facility held that in the event that the investor has pursued the local remedies, he must show that the court decision itself constitutes a violation of the treaty.

### iii. DIPLOMATIC PROTECTION

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11 KENNETH J. VANDEVELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION 430 (2010)
12 Robert Azinian and Ors. v. United Mexican States, ICSID Case No. ARB(AF)/97/2, Award, ¶97 (1999) [hereinafter “Robert Azinian”]
13 Robert Azinian, Supra note 12, ¶99
Diplomatic Protection is the invocation by peaceful means of one State’s responsibility by another State on behalf of its nationals whose rights have been violated with a view to implement such responsibility.\(^{14}\)

Diplomatic protection has its own disadvantages. Firstly, diplomatic protection requires that local remedies be exhausted first.\(^{15}\) Secondly, the process is inefficient and arbitrary because government has absolute discretion in pursuing some selected claims or to waive, amend or settle dispute with the host State.\(^{16}\) Thirdly, the remedy, if any, goes to the state and not the affected investor.\(^{17}\) The situation can be contrasted with investment arbitration where the investor sues the host State at his own will and is entitled to the monetary compensation, if any.

Fourthly, as *Barcelona Traction*\(^{18}\) has brought to notice, bringing a diplomatic action on behalf of an investor has many legal problems. In the case, Belgium was not allowed by the ICJ to bring forth a claim on behalf of its shareholders in a company incorporated in Spain. The ICJ affirmed that “even if a company is no more than a means for its shareholders to achieve their economic purpose, so long as it is in existence it enjoys an independent existence.”\(^{19}\) Such a situation is unlikely to arise in investment arbitration where BITs routinely include ‘shares’ in the definition of ‘investment’.

Finally and most importantly, diplomatic protection pits two states against each other, leading to unnecessary politicization of the dispute and long standing ill will and resentment between the nations.\(^{20}\) To remove the conflict from the “realm of politics and diplomacy to the realm of law” was one of the main purposes behind the ICSID Convention.\(^{21}\) The biggest achievement of investor-state arbitration has been to remove investment disputes from the bilateral diplomatic agendas of treaty countries.

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17 CHITTHARANJAN F. AMERASINGHE, DIPLOMATIC PROTECTION 27 (2008)
18 Barcelona Traction, *Supra* note 16
19 Barcelona Traction, *Supra* note 16 ¶66
Hence, BITs have come into picture as a neutral and depoliticized mode of dispute resolution. In the light of the limitations explained above, the espousal of direct-access and binding investor state dispute resolution was deemed to be necessary and worthwhile. The objective of these procedural rights is to move beyond war, gunboat diplomacy, and politicized forms of dispute resolution to provide a neutral forum for the resolution of investment conflicts.

III. **Legitimacy Crisis in Investor-State Arbitration**

There is a perception among some Latin American countries, that the current international investment regime is but a modern version of gunboat diplomacy against national sovereignty. Ecuador, Bolivia and Venezuela, have announced their decision to denounce the ICSID Convention. The Bolivian President, Mr. Evo Morales, complained that in ICSID, governments of Latin America always lose and investors always win. Among various ideological reasons to denounce ICSID, he pointed out that lack of appeal process, bias in favor of corporations and lack of transparency in proceedings as the main reasons.

Canada, United States and Australia have also expressed their concerns over the wide protection offered to foreign investment and challenge to regulatory authority. Twelve members of the US House of Representatives submitted a letter to the then President, Mr. George W. Bush, expressing their concern that vague and overly broad language of Chapter 11 NAFTA could result in unfavorable outcomes and restrict regulatory authority of the government over measures like health, safety and environment.

In *CME v. Czech Republic*, Mr. Jaroslav Handl, the Czech Republic appointed arbitrator, in his scathing dissent accused the other 2 members in the panel of unethical conduct, bias, collusion with each other and deprivation of chance to proceed in the deliberations. Cases like these hardly

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25 Carlos Garcia, *Supra* note 5
26 CME v. The Czech Republic, UNCITRAL, Final Award (March 14, 2003)
boost the legitimacy of investor-state arbitration. The Guardian, a British Newspaper, has reported on the *Biwater Gauff v. Republic of Tanzania*\(^\text{27}\) case that the interests of the developing countries have been “trampled”\(^\text{28}\).

Though the argument that some countries always lose in investor-state arbitrations has been found to be baseless,\(^\text{29}\) the perception (perhaps correctly so) remains that investors lose cases not because of the restrictive interpretation of the rights but due to the specific facts of the case.\(^\text{30}\) Thus, there is a serious problem of perception of bias, if not actual bias in the investment arbitration system.

Left with no remedy in the adjudication system, countries are responding in whatever way possible to effect changes. Certain States, like Venezuela, have withdrawn from BITs while some, as named above, have denounced the ICSID Convention. Some countries, for example, United States have changed the language of treaty provisions so as to stress the regulatory rights of the host state.\(^\text{31}\)

The gravest consequence, however, is the weakening of the motivation to respect arbitral awards. Dissatisfaction of remedy available has led states either not complying with the award or vigorously fending off execution efforts. Indonesia, Pakistan, Congo, Ukraine and Russia have made enforcement of award by finding and seizing assets a long and arduous process.\(^\text{32}\)\(^\text{33}\) FG Hemisphere Associates has still not been able to enforce its $150 million award against the Republic of Congo. In another case, even after 3 years since the pronouncement of award, a company has been unable to

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\(^\text{27}\) Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/02, Procedural Order No. 3 (2006)


\(^\text{33}\) Dominic Pellew, *Recognition and Enforcement of Foreign Arbitral Awards in Russia*, MONDAQ BUS. BRIEFING, January 8, 2002 available at http://www.mondaq.com/x/15098/Recognition+And+Enforcement+Of+Foreign+Arbitral+Awards+In+Russia (last seen January 5, 2016)
enforce its $45 million award against Ukraine.\textsuperscript{34} If the enforcement of arbitral awards becomes difficult, it will undermine the very existence of investment arbitration as a dispute solving mechanism.

All of the above enumerated responses by various countries are reflective of jurisprudential trends and the concerns of nations in investment arbitration. It is time to recognize that there is a perception of unfairness which can no longer be ignored. It would premature to say that the entire system is in crisis. However, the signs of dissatisfaction with the current regime are too hard to ignore. Cases of non-renewal of BITs and withdrawals from ICSID suggest that many developing countries do not consider it worth the bargain to enter into investment treaties and that the sweeping standards of protection are causing a greater loss of sovereignty and regulatory control than what was anticipated.

\textbf{IV. CONTEXTUALIZING THE BASIC ARGUMENTS AGAINST THE CURRENT REGIME}

The core of criticisms is that the current regime for international investment dispute settlement protects the interests of the investors at the cost of state’s competing interests, thus institutionalizing pro-investor bias with the help of an asymmetrical legal regime.\textsuperscript{35} The major factors for such perception are analyzed below.

\textbf{i. LOPSIDED TREATY MAKING PROCESS}

The treaty making process is not a discussion between two sovereign equals but a take-it-or-leave-it kind of deal.\textsuperscript{36} The competition between various potential hosts of foreign investment significantly reduces the bargaining power of the host country with respect to the core provisions of the treaty and results in extremely unequal terms of the agreement.\textsuperscript{37}

\textsuperscript{34} Ibid.
\textsuperscript{35} Charles N. Brower and Stephan W. Schill, \textit{Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?} 9 Chi. J. Int’l L. 476 (2008-09)
\textsuperscript{36} Gennady Pilch, \textit{Supra} note 20
A part of the blame lies on the host countries as well. Many times, they enter into such treaties without adequate thought and consideration. In the widely reported comments in 2006 of Mr. Makhdoom Khan, Pakistan’s then Attorney General, investment treaties provided an excuse for a photo opportunity with the visiting foreign dignitaries. It is only when a notice to arbitrate is served by an investor, do the countries realize the implications of what they have gotten themselves into.38

ii. REGULATORY CHILL

The crux of the argument relating to the regulatory chill of the BITs is that due to fear of high monetary awards against the state, the domestic regulators are unable to regulate to the extent they should be able to. Aaron Cosbey- a renowned specialist in trade and sustainable development- has asserted that investor-state dispute settlement “has gone from being a protective shield for defending investors against unfair and discriminatory treatment to a sword used by those investors to attack legitimate government regulation pursued in the public interest.”39 This attack is made possible by the overly broad interpretations of ‘investment’, ‘investor’ and of host state’s obligations in areas such as expropriation, non-discrimination and minimum standards of treatment. The intent of investor-state arbitration has been used by companies to attack domestic health, safety and environmental measures that might incidentally harm their interests.

iii. THIRD PARTY INABILITY

Inability of third parties to influence the outcome of the dispute is a major shortcoming of investor-state arbitration. Unlike commercial arbitration, international investment arbitration, discusses issues like health, environment, human rights etc. which directly and substantially affect the general public. Since the interests of non-disputing parties are being adjudicated, it makes sense to provide them with some sort of participation in the proceedings.

Lack of concrete amicus curiae provisions, strict rules of confidentiality of proceedings and party autonomy frequently restrict the participation of third parties in the proceedings. Provisions relating to amicus curie might be especially useful keeping in mind the fact that claimants routinely allege treaty violations, where the essence of the complaint turns on the municipal law of the state.

V. WHAT THEN IS THE REMEDY?

The solutions proposed to fix the broken legs of investment arbitration seek to balance the commercial arbitration and public international law approaches of international investment law. They can be easily incorporated into the existing system and do not require a radical alteration of the existing system. This ensures that they can be implemented swiftly while retaining the distinguishing features of investor-state arbitration which make it preferable to other modes of dispute resolution like local remedies and diplomatic protection.

i. EXTENSIVE APPEAL SYSTEM

Article 52(1) of the ICSID Convention which exhaustively lays down the grounds of annulment provides:

“(1) Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:

a) that the Tribunal was not properly constituted;
b) that the Tribunal has manifestly exceeded its powers;
c) that there was corruption on the part of a member of the Tribunal;
d) that there has been a serious departure from a fundamental rule of procedure; or
e) that the award has failed to state the reasons on which it is based.”

The annulment process in place is inadequate because annulment unlike appeal is not concerned with substantive correctness but only with the legitimacy of the process of decision.⁴⁰

Firstly, the annulment procedure under ICSID guarantees integrity of procedure and not consistency of results and interpretation. It is generally regarded that ad hoc committees cannot review award’s findings for errors of fact or law. For example, the ad hoc committee held in Amco II that, “it is incumbent upon Ad Hoc Committees to resist the temptation to rectify incorrect decisions or to annul unjust awards.”⁴¹

⁴¹ Amco v. Indonesia, Resubmitted Case: Decision on Annulment, ¶1.18 (December 3, 1992)
Secondly, the annulment committee’s members are chosen from the ICSID list and in some cases have lesser experience than the very tribunal whose award they are reviewing. Thus, possibility for unwarranted reverence for the arbitral award under review cannot be excluded.

Thirdly, under the New York Convention which applies to the recognition and enforcement of foreign arbitral awards, State has very narrow grounds of annulment such as lack of notice, excess of jurisdiction, non-arbitrability of disputes and conflict with public policy. Thus, even at the stage of enforcement, an award cannot be reviewed on its merits.

Recently, in a rare instance of inter-state arbitration under a BIT, Ecuador submitted a dispute regarding the interpretation of the USA-Ecuador BIT dated 27th August, 1993 to Permanent Court of Arbitration. The case arises because of Ecuador’s dissatisfaction with the interpretation given to a particular provision of the BIT by the arbitral tribunal in *Chevron and Texaco Petroleum Company v. Republic of Ecuador*. The case highlights attempt on part of a State party to create a review mechanism for arbitral awards.

It may be argued that an extensive appellate system may erode the finality associated with an arbitration process. However, at this point the unique public-private nature of investment disputes must be kept in mind. The procedural design for the adjudication and enforcement of rights is not enough to tag investment arbitration as private. Drawing an analogy between commercial arbitration and investment arbitration on the similarity of procedural grounds would be confusing form from substance.

Commercial arbitration originates in an agreement between private parties to arbitrate disputes between themselves in a particular manner, and its authority is derived from the autonomy of individuals to order their private affairs as they wish. In commercial arbitrations where State is a party, the State acts in private capacity. Investment arbitration, by contrast, originates in the authority of the State to use adjudication to resolve disputes arising from the exercise of public authority. Investment arbitration is constituted by a sovereign act, as opposed to a private act of the

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42 Article 14(1), 52(3), Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 575 U.N.T.S. 159
43 Article 5, Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 330 U.N.T.S. 38
44 Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador, UNCITRAL, Final Award, PCA Case No. 34877 (August 31, 2011)
State and this makes investment arbitration more closely analogous to domestic judicial review of the State’s regulatory conduct.\textsuperscript{45}

Thus, the need for ‘quick dirty justice’ with limited judicial review must be trumped by the need for consistency and just decisions in investment arbitration. The nature of disputes in investment arbitration calls for an extensive appellate review of awards. For an investor, millions and sometimes billions of dollars are at stake and for the host State, essential questions of sovereignty and legitimacy of regulatory measures are in question. In such disputes, the objective of consistency should over-ride the object of finality of arbitral award.

ii. Participation of Third Parties

A criticism of investor state arbitration is that measures with substantial public issues in question are made in complete secrecy without public participation. “Public is more likely to accept the outcome of a process if they participated in it, or even had a right to participate in it.”\textsuperscript{46} An ICSID tribunal in \textit{Suez Sociedad General de Aguas de Barcelona S.A. v. Republic of Argentina} recognized that public access “would have the additional desirable consequence of increasing the transparency”\textsuperscript{47} but nevertheless, denied the participation due to opposition by the corporate claimant.

If the non-disputing parties are able to contribute perspectives to the issues in consideration beyond what the parties provide, it will enhance the overall fairness of the decision. Allowing active participation of the public acknowledges the fact that the measures in dispute have a regulatory character and certain perspectives can be put forth only by the public groups.

There have been some half-hearted measures with respect to the participation of non-disputing parties as amicus curiae.\textsuperscript{48} The documents third parties have access to will determine how substantial and effective their submissions can be. However, the documents which may be available


\textsuperscript{46} P. Muchlinski, Oxford Handbook of International Investment Law 780 (2008)

\textsuperscript{47} Suez and others v Argentina, ICSID Case No. ARB/03/19, Order in Response to a Petition for Transparency and Participation as Amicus Curiae, ¶¶ 6, 7 (2005)

to a non-disputing party may be restricted by the tribunal on the grounds that it is privileged or failure by third parties to justify as to why they should receive information.\(^{49}\)

Nonetheless, the shift in the attitude of tribunals and participating parties with respect to increased participation of non-disputing parties is evident. However, the extent of transparency still continues to depend on the attitude of the tribunal, specific provisions of the treaty and the cooperation among both the parties. The need for a binding, well-developed and predictable set of rules to govern participation of non-disputing parties is felt.

### iii. Selection of Arbitrators

To address the criticism of the same group of arbitrators presiding over an increasing number of cases, bodies, especially ICSID, need a greater diversity of arbitrators, including more arbitrators from developing countries, and more women.\(^{50}\) Having better and more options to choose among the arbitrators will enhance the perceived legitimacy of arbitration. The need for many cultures and legal systems to be represented on the list of arbitrators is also felt because the concepts of property, expropriation and regulation are very different in different countries and cultures.

A part of the problem can be resolved by addressing the pipeline problem to enable a bigger pool of arbitrators available from the developing world. Young International Arbitrators Group (“YIAG”) by the London Court of International Arbitration (“LCIA”) is a case in hand. Setting up of foreign investment arbitrations moot court competitions which incentivize participation from developing countries will also help to identify and nurture legal talents among them. For example, the Frankfurt Investment Arbitration Moot Court Competition has a special award named ‘Best Team from a Non-OECD Member Country’.\(^{51}\)

There is concern that developing countries select their arbitrators by resorting to random selection criterion based on unreliable information.\(^{52}\) A publicly available database of arbitrators

\(^{49}\) Glamis Gold Ltd. v. The United States of America, UNCITRAL, Award, ¶ 222–23 (2009)


\(^{52}\) Catherine A. Rogers, The Arrival of the "Have-Nots" in International Arbitration, 8 NEV. L.J. 358 (2007)
containing information about them such as their nationality, gist of cases on which they have previously served, occupational background etc. maintained by respective institutions can help disseminate such information.

iv. **CONFLICT OF INTEREST RULES FOR ARBITRATORS**

Rules regarding conflict of interest of judges and arbitrators improve the perception of justice in a dispute settlement system. There are virtually no conflict of interest rules in ICSID proceedings.\(^5^3\) For example, Article 14 of the ICSID Convention requires “impartiality” and “independent judgment” from the arbitrators. Article 57 requires a “manifest lack” of the above qualities. Thus, there exists a very high burden of proof on the party proposing disqualification. Further, the ICSID rule under which the other two arbitrators decide on the disqualification places them in a very uncomfortable position and makes the disqualification even more difficult.

Resultantly, most arbitrators deciding on essential questions of State sovereignty and claims worth millions of dollars may have an interest in the outcome due to their association with one of the parties to the dispute. Many arbitrators practice on both sides of the bench,\(^5^4\) which can also be a source of conflict of interest since it requires an extremely high degree of compartmentalization. Investor state dispute settlement needs further guidelines to govern conflict of interest and duties of disclosure of the arbitrators.

v. **SHIFTING COSTS**

Financial resources of the parties can create an unequal playing ground in the field of investment arbitration. A survey conducted in 2007 brought to light that about 20% of the claims were filed by Fortune 500 companies. In many cases, the revenue of the claimants exceeded the GDP of the host country itself.\(^5^5\)

In the English rule of shifting costs, the unsuccessful party indemnifies the winning party for its legal costs. Under the American rule, which has been regarded as an ICSID tradition,\(^5^6\) each party

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\(^5^3\) Carlos Gracia, *Supra* note 5 at 7

\(^5^4\) Australian Government Productivity Commission, Bilateral and Regional Trade Agreements, Research Report 273, (December 13, 2010)

\(^5^5\) Anderson & Grusky, *Supra* note 6 at 14

\(^5^6\) EDF (Services) Limited v. Romania, ICSID Case No. ARB/05/13, Award (2009)
pays its own legal costs. The pro-claimant rule, as the name suggests, tilts the scale in the favor of the claimant i.e. the investor in our case.

The American rule incentivizes claimants to bring nuisance claims – claims which lack merits but are nevertheless cheaper to settle than to litigate- especially in the light of uncertain jurisprudence. By applying the English rule, the avenue for ‘legalized blackmail’ would be reduced because a rational claimant will be encouraged to bring a strong, small claim rather a non-meritorious large claim. A pro-claimant rule will further harm the legitimacy of investor state arbitration as it tilts the balance in the favor of claimants.

Thus, adopting the English rule of shifting costs in investor state arbitration can solve the two most hotly debated issues of investment arbitration: alleged pro-investor bias and the shrinking domestic policy of the State due to the effect of regulatory chill.

vi. OTHER MEASURES

To enhance the legitimacy of the system, investor-state arbitration can borrow the practice of World Trade Organization (“WTO”) panels, in which the disputants are given access to the panel’s proposed award. It allows both the parties, to submit their comments and re-argue matters which they think have been misunderstood or have escaped the panel’s attention.

Additionally, it might be advantageous to encourage conciliation as a mode of dispute resolution. Once the arbitral tribunal has been appointed, the focus of arbitration shifts to payment of compensation and not to the preservation of working relationship between parties. To discourage costly and time consuming arbitration, there should be clear procedural rules to facilitate negotiation and conciliation between the parties prior to the filing of arbitration claim. Such a requirement will also reduce the number of nuisance suits- a chief complaint by host states.

There have also been suggestions to replace the current system with international investment courts with tenured full time judges. However, the plan is too ambitious to be politically feasible, especially when the current system is built to last. Additionally, under the short and medium term, investor-state arbitration is here to stay. Further, getting an arbitrator appointed in the tribunal gives some semblance of control to the parties on the final outcome of the proceedings. Establishing a

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permanent court where parties do not have any control over who decide their disputes will further increase the perception of bias in the system.

VI. **CONCLUDING REMARKS**

Protection for foreign investors may not be the horror critics claim, but they could be improved. To assert that the system and the current regime itself is in danger, would tantamount to over exaggeration of its problems. Nevertheless, the perception of bias and the crisis of confidence are too real to be ignored now. The strains have started to show. Unless changes are made to the existing regime of international investment law, host countries will try to ease their burden of complying with what they perceive as ‘lopsided investment agreement’ and ‘wide protection clauses’ threatening the very legitimacy of this mode of dispute resolution.

Investor treaties aim to protect foreign investment. However it would not be able to protect anyone unless states are willing to participate in it. An interpretation which exaggerates the protection to be accorded to foreign investments will undermine the overall purpose of investor state arbitration. Cost, efficiency and finality aside, investment law would never have become a significant field of international law unless all the participants viewed the system as unbiased, neutral and reliable.

In conclusion, we must understand that the success of investor-state arbitration as a mode of dispute resolution will mostly depend upon the ease of negotiations between the countries and the recognition of genuine demands of all the participants in the process. It is imperative that investor treaties should not only stress the concerns of the foreign investors but also the domestic policy, regulatory authority and sovereignty of the host state.