Dispute Resolution Guide **2015**

Featuring contributions from

Al Busaidy Mansoor Jamal & Co
Arias Fábrega & Fábrega
ASAR - Al Ruwayeh & Partners
Big Ben Chambers
Covington & Burling
FJ & G de Saram
Freshfields Bruckhaus Deringer
Gün + Partners
Hermawan Juniarto
Hui Zhong
Khan & Associates
Prager Dreifuss
Shardul Amarchand Mangaldas
Tsvetkova Bebov Komarevski
Udo Udoma & Belo-Osagie
Yoon & Yang
Zamfirescu Racoti & Partners

www.iflr.com

IFLR
INTERNATIONAL FINANCIAL LAW REVIEW

COVINGTON

www.cov.com

Maximising investment treaty protection

Marney Cheek and **Catherine Gibson** of **Covington & Burling** examine investor-state dispute settlement, and ask whether it is the key to the TTIP's investment package

Investment treaties have a long history of laying down core principles of fairness and equal treatment for foreign investors, and enforcing these principles through arbitration between investors and states. Although investment treaties were historically used to protect foreign investment in countries with a weak commitment to the rule of law, the use of these treaties has evolved and expanded in the modern era. Today, the investment-treaty framework provides an architecture that ensures fair treatment of foreign investors in countries of any size, in any region, and at any stage of development. Moreover, there is an increasing expectation among governments that protections offered across various investment treaties will involve similar levels of protection by all countries, and that these protections will be enforceable in similar ways. The recently concluded Canada-EU Comprehensive Economic Trade Agreement includes these important protections, as does the North American Free Trade Agreement (NAFTA) between Canada, the United States, and Mexico. And the ongoing Transatlantic Trade and Investment Partnership (TTIP) negotiations will inevitably inform the negotiations that the US and the EU are engaged in with China regarding their respective bilateral investment treaties. Should the US and the EU change course with the TTIP, China may demand that these bilateral treaties follow a similar path.

> Even though arbitration is a last resort, knowing that the commitments in the investment treaty are enforceable is meaningful in itself

In recent years, investor-state arbitration, commonly referred to as investor-state dispute settlement, or ISDS, has attracted increased attention as investors have sought to enforce the protections they are guaranteed in investment treaties. The number of these investor-state arbitration cases filed, however, pales in comparison to foreign investment flows. While there are billions of dollars in cross-border investments in place today, only a few hundred investment disputes have been filed by investors who have sought compensation for breaches of investment protections. Investor-state disputes are the exception rather than the rule. Businesses typically seek to establish long-term relationships when investing abroad, and often have more than one investment in the country. In light of these long-term commitments to their foreign investments, businesses view arbitration as a last resort when disputes arise regarding their investments abroad. Still, even though arbitration is a last resort, knowing that the commitments in the investment treaty are enforceable is meaningful in itself – the obligations to treat foreign investment fairly and provide market access are more likely to be respected if the host government knows that it can be held accountable if it fails to respect its international commitments.

Both the US and the EU have signaled that they will include investment protections in the TTIP, and this treaty is intended to be, as its name states, an investment partnership. Given the TTIP's ambition to create a holistic architecture to promote trade and investment flows across the Atlantic, it is logical that the agreement includes both investment protections and investor-state arbitration to enforce these protections. In this regard, the TTIP would simply expand protections that already exist between many of the countries concerned (albeit to the EU member states with the largest investment flows with the US). The US already has bilateral investment treaties with nine EU member states – Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Romania, and Slovakia. All of these agreements, like the planned TTIP, include typical investment protections, which can be enforced with investor-state arbitration.

Core principles of investment protections

Investment treaties, including those treaties already in existence between potential TTIP parties, typically provide a standard set of protections to foreign investors. The most basic of these is the protection against expropriation by the host government without adequate and effective compensation. By committing to this protection, a host government promises that it will pay foreign investors for their investments, if the government takes that investment after it has been made. This most basic protection assures investors that the amounts they spend developing an asset in a foreign country will not be entirely lost if the local government decides to nationalise the industry in which they have invested. This protection encourages investments by offering a degree of security against the most severe adverse government action.

Investment treaties also protect businesses more generally against arbitrary or discriminatory treatment by host governments. These protections guarantee equal treatment and ensure that investors from abroad are permitted to compete on an even playing field with domestic businesses and third-country competitors. These protections are particularly important in sectors that were previously dominated by large domestic businesses, as they ensure that these sectors will truly be open to foreign investment after the host government has concluded an investment treaty with the foreign investor's home government.

In addition, these treaties typically eliminate government-imposed restrictions on access to foreign markets. These restrictions frequently take the form of export quotas, local-content requirements, or technology localisation requirements, and such restrictions – unless prohibited by treaty – can discourage businesses from even attempting to enter a foreign market. Finally, these treaties permit foreign investors to freely transfer investment-related funds in and out of the host state. These investment-related funds may include royalties, profits, or contract payments, and permitting foreign investors to freely transfer these funds allows businesses to structure their global operations in a manner that maximizes efficiency.

The protections offered in investment treaties are guaranteed through the enforcement mechanism of investor-state arbitration. In investor-state arbitration, disputes are typically resolved by panels of three arbitrators who

are chosen for each particular dispute. After an arbitration has been filed, the investor and the government will each appoint one arbitrator, and a third arbitrator is selected to serve as chair. (The chair might be selected by agreement of the parties, by agreement of the two party-appointed arbitrators, or by the arbitral institution.) Those frequently chosen as arbitrators in these disputes include international human rights scholars as well as former government officials, and arbitrators deciding cases at one leading arbitral institution, the World Bank International Centre for the Settlement of Investment Disputes, have hailed from more than 40 different countries. Some arbitral institutions maintain standing rosters of qualified arbitrators, although neither investors nor governments are required to appoint from any particular list. Some recent investment treaties – including recent US treaties as well as the recent agreement between Canada and the EU – require arbitrators to have expertise in international law or international economic law, in certain cases, and all arbitrators are encouraged to follow ethical guidelines developed particularly for the investor-state arbitration context.

Investor-state arbitration offers a non-political method of resolving disputes

Decisions of investor-state arbitral tribunals have long been publicly available for free, and in recent years, there has been a significant trend towards promotion of transparency in investor-state arbitration. In 2014, the United Nations Commission on International Trade Law adopted transparency rules for international arbitration, and both the US and the EU have bolstered the transparency provisions of their recent investment treaties. As a result of this transparency movement, third parties such as non-governmental organisations may participate in investor-state arbitrations by filing amicus briefs on issues of particular interest or expertise. In addition, tribunals now increasingly require parties to make their legal briefs, expert opinions, and other filings available for public scrutiny. Finally, tribunals increasingly publish the transcripts of proceedings held before them. This transparency movement has directly responded to earlier criticisms that the system operated behind closed doors.

Recent cases demonstrate the effectiveness of protections offered in investment treaties, when combined with these treaties' enforcement mechanism of investor-state arbitration. In the NAFTA case of *AbitibiBowater v Canada*, for example, a US investor filed an arbitral claim against Canada after a Canadian provincial government effectively cancelled all the leases, licences, and grants that it had previously granted to that investor, and the provincial government nationalised the investor's assets. The cancellation was described by provincial authorities at the time as a decision to 'repatriate' rights related to Canada's national resources in response to AbitibiBowater announcing the need to close the last of several facilities in that province. Before the case had progressed to a substantive phase, however, the parties reached a settlement and the investor received about a quarter of the damages it had initially sought in the arbitral case. This case demonstrates that the mere filing of an investor-state arbitration claim can help resolve a dispute between an investor and a host government, without a decision by the tribunal or even substantive written arguments by the parties. Sometimes the mere existence of the enforcement mechanism helps move the parties towards an amicable resolution.

Not all cases settle, however, and arbitral tribunals have shown courage in addressing wrongful conduct of host states when called upon to do so. A number of arbitral proceedings were filed after the Russian Federation essentially nationalised Yukos Oil Company through a series of tax measures, asset freezes, refusals to provide payment plans for amounts allegedly owed, and eventual bankruptcy. In all of the cases decided to date, arbitral tribunals have ordered the Russian Federation to pay foreign investors in Yukos for the amounts that they lost as a result of the Russian Federation's wrongful conduct. A guarantee of this type of protection, and the ability to enforce it with a claim before a neutral panel of arbitrators, serves to facilitate investment in environments that might otherwise be seen as too risky. It also provides a neutral forum in circumstances when the local courts may be viewed as less than objective, particularly if a dispute has been highly politicised.

Investor-state dispute settlement is not without critics, however. Some critics argue that this enforcement mechanism might discourage governments from passing public health or environmental regulations that would affect foreign investors because such regulations might be seen as violations of investment-treaty protections. Other critics argue that investment treaties may create a race to the bottom that encourages governments to decrease environmental and labour protections in order to attract foreign investment.

These concerns are not new, however, and despite the alarmist rhetoric are not borne out by the cases. Further, modern investment treaties – and one would expect TTIP to follow this model – include explicit provisions that protect governments' ability to enact environmental regulations and other public health regulations. The most recent US investment treaties also expressly forbid governments from reducing environmental or labour protections in order to attract foreign investment.

Finally, one important note about investor-state arbitration: investor-state arbitration does not force a country to change its laws. Arbitral tribunals do not have that power and investment treaties do not even purport to grant it to them. An arbitral tribunal may decide only the arbitral case before it, and in that individual case, the tribunal is limited to determining whether the host government has violated the protections guaranteed in the investment agreement, and if so, what amount of monetary compensation the host government should pay the investor because of that violation. Host governments maintain full control of domestic legislative, executive, and judicial functions.

Benefits of the system

Investment treaties with investor-state dispute settlement offer a number of benefits to both investors and host states, beyond the investment protections themselves. First, these treaties promote openness to investment and facilitate new investments, particularly in sectors that have been previously closed to foreign investment or dominated by large local players. After investments are made, these treaties offer a stable environment for investments so that businesses may confidently make long-term commitments when investing abroad without fear of expropriation or discriminatory treatment.

Investor-state arbitration also offers a non-political method of resolving disputes. Although using investor-state dispute resolution will remain a last resort, disputes will inevitably arise, and without investor-state arbitration, an investor who was unable to negotiate a solution with a host government would be required to rely on its home government to resolve its dispute through political channels, or subject itself to the local courts. Attempts to resolve investment disputes at the government level has proven complicated, time-consuming, and often fruitless because the investor's home government will balance an investor's interests with all other issues on the political agenda that it may have with the host government. Investor-state arbitration benefits investors by permitting a direct and efficient route to resolving disputes with host states, should the usual efforts at negotiating a solution or settlement fail.

Investor-state arbitration also benefits host governments. Host governments may likewise avoid addressing an individual investor's dispute with the complicated backdrop of a broader diplomatic agenda. Investor-state arbitration permits host states to present their arguments to a neutral panel of arbitrators, who will decide whether a violation of the treaty has occurred.

Twofold enforcement

Investment treaties provide important protection to foreign investors, but these protections are meaningful only if accompanied by an enforcement mechanism of investor-state arbitration. For a comprehensive agreement like TTIP, investor-state dispute settlement is an essential part of achieving the type of stability that investors from all countries are seeking. The typical investment-treaty protections, when coupled with investor-state dispute settlement, provide core principles of law plus a non-political method of resolving disputes. As both the US and the EU negotiate bilateral treaties with China, it is important for both countries to demonstrate that they are willing to live up to the same standard that they expect China to use.

Marney Cheek
Partner, Covington & Burling

Washington, DC, US
T: +1 202 662 5267
F: +1 202 778 5267
E: mcheek@cov.com
W: www.cov.com

About the author

Marney Cheek is co-chair of the firm's international arbitration practice. She arbitrates international disputes before tribunals in complex commercial and investment treaty cases and litigates international disputes in US courts. Her practice spans a range of jurisdictions and industries, including oil and gas, mining, and life sciences.

Marney also advises clients on international trade and investment matters in foreign markets around the world. Her advisory practice draws upon her trade, investment, and public international law expertise, as well as her experience as associate general counsel at the Office of the US Trade Representative. Marney routinely counsels clients on a range of World Trade Organization dispute resolution and trade policy issues, including intellectual property, financial services, standards, trade preferences, non-tariff trade barriers, and environment. She is vice-chair of the firm's trade and international policy practice.

Catherine Gibson
Associate, Covington & Burling

Washington, DC, US
T: +1 202 662 5191
F: +1 202 778 5191
E: cgibson@cov.com
W: www.cov.com

About the author

Catherine Gibson is an associate in Covington's global dispute resolution and trade practices. Before joining the firm, Kate was a legal adviser in the Iran-United States Claims Tribunal in The Hague.