INTERNATIONAL INVESTMENT ARBITRATION

Legitimacy challenges and prospects for future reforms

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Abstract

Conflicts that arise between foreign investors and States are regularly adjudicated by a small community of lawyers. This costly process called arbitration seems inherently flawed in the context of investment law, especially from the standpoint of developing and third-world countries which cannot compete with the likes of multinational companies in this legal battle. Investor-State dispute settlement has been subject to abundant criticism in recent years, more particularly for its lack of transparency and the noxious effects it can have on weaker economies. Hence, talks of reforms, whether they are ‘moderate’ or more ‘radical’, are becoming increasingly important in relevant literature.

The following paper aims to provide a different outlook on investment dispute settlement than the traditional, purely legalistic, perspective offered in many law textbooks. This rather unconventional approach, supported by a rich array of data and illustrative examples, draws attention to several striking legitimacy issues that exist in the current context of international investment arbitration. For the purpose of this paper, and for reasons of clarity, a special emphasis is placed on the lack of both input and output legitimacy of investment arbitration. Analyzing the flaws pertaining to one particular legal mechanism is essential in order to provide a roadmap for future reforms.

Résumé

Les différends émanant des relations entre investisseurs et États sont régulièrement tranchés par un groupe restreint de juristes. Il semble que ce processus coûteux, dénommé arbitrage d’investissement, soit foncièrement imparfait. Cela est notamment visible lorsque l’on se place du point de vue des pays en voie de développement et des pays du tiers-monde qui ne peuvent rivaliser avec les firmes multinationales dans de telles batailles judiciaires. Ces dernières années, le processus de règlement des différends entre l’investisseur et l’État a fait l’objet de nombreuses critiques, particulièrement au sujet de son manque de transparence ainsi que sur les effets néfastes qu’il peut avoir sur les économies les plus vulnérables. Ainsi, les discours prônant une réforme du système, qu’elle soit ‘modérée’ ou bien plutôt ‘radicale’, sont de plus en plus fréquents.

Le but de cet article est d’apporter une perspective qui se distingue de celle, plus traditionnelle et purement juridique, que l’on peut trouver dans les manuels portant sur
l’arbitrage d’investissement. L’approche peu conformiste qui est adoptée s’appuie sur des chiffres et des exemples qui mettent l’accent sur certains problèmes de légitimité qui existent dans le contexte actuel de l’arbitrage d’investissement. Dans un souci de clarté juridique et pour des raisons pratiques, le présent article s’intéresse aux principaux problèmes de légitimité qui affectent non seulement la procédure, mais aussi les effets de l’arbitrage d’investissement. Une telle analyse critique d’un système juridique donné est nécessaire avant d’établir un plan d’action pour de futures réformes.
INTRODUCTION

International investment arbitration is largely based on the premise that it allows the resolution of disputes arising between States and foreign investors in an impartial, unbiased and fair context. Yet, this mechanism seems inherently flawed and raises numerous concerns which all point towards the need for change. Whether the reader is a jurist or a person with a non-legal background, my aim through writing this paper is to provide a clear picture of why the current framework of investment arbitration is unsatisfactory. This field involves large numbers and global players, which is why any curious person may find of interest what will be discussed. In order to adopt a different perspective than the traditional purely legalistic discourse that is usually found in law textbooks, turning a critical eye on this topic is a necessity. Hence, this work is not meant to be a purely technical study of arbitration and investment law. Nevertheless, a proper definition of the terms of the subject and providing a frame for this study are required and will be the object of this introduction.

A complex and fertile international investment regime has developed in the past decades with the aim to protect persons who make foreign investments. Those who benefit from this international legal protection are companies integrated and registered in another country and individual investors who are nationals of another State\(^1\). The main instruments used to provide this high level of protection are international investment agreements (IIAs). These treaties exist in two primary forms that ought to be mentioned. IIAs are either concluded at a regional level by groups of States within a particular region, for instance the COMESA investment agreement\(^2\), or at a bilateral scale, for example between Canada and Romania\(^3\). There has been an explosion of the number of investment agreements in the past decades, and particularly regarding Bilateral Investment Treaties (BITs). To date, around 3000 BITs have been signed\(^4\), and more are currently under negotiation, which demonstrates that they are privileged instruments of governance. Many are formed between developed and developing countries, but


\(^2\) The Investment Agreement for the Common Market for Eastern and Southern Africa (COMESA) was signed on the 23 May 2007 and has not yet entered into force.


there seems to be an increasing trend towards BITs and regional agreements among developing economies. This surge, which occurred from the 1990s onwards, can largely be explained by an increase of capital movement across the globe after the end of the Cold War and the fall of communism. The progression of the International Investment Law (IIL) regime through IIAs and domestic liberalization has resulted, over the past decades, in a considerable increase in the rights of multinational companies and their capacity to operate and expand globally. With the prospect of providing foreign investors from the ‘home State’ with special international law rights and remedies aimed at the protection of investments made in the “host State”, IIAs follow a fairly standard design. They incorporate the usual substantive protections such as the requirement for host States to compensate an expropriated investment “promptly” and “according to its full business value”. Also, most treaties will include provisions regarding the “fair and equitable treatment” and the “full and constant protection and security” of investments, as well as clauses which limit the imposition of “performance requirements” by the host State on foreign investments. Parties to IIAs are obligated, according to international law rules on Treaties, to uphold and respect these principles.

One particular feature of IIL is that it lacks a permanent court to settle disputes arising between foreign investors and host States. Instead, it relies on private arbitration, where no appeal is possible. In the context of arbitration, the parties accept to resolve their dispute through a private process with a “disinterested third party”, whereas litigation involves settling disputes through a court with judges (or a jury). The difference between investment arbitration and commercial arbitration must be mentioned as the latter deals with disputes between companies based on contracts. Corollary to the expansion of IIL, the practice of investment arbitration has surged. Well over 600 Investor-State Dispute Settlement (ISDS) cases have been

8 Ibid, p.3.
settled up to date\textsuperscript{13}. One of the main reasons for this seems to be the coming into force of NAFTA in 1994\textsuperscript{14}, which introduced compulsory ISDS. Before that, ISDS provisions were only included in a few IIAs but have now become common\textsuperscript{15}. Just as IIAs play a part in the enforcement of IIL rules and principles, the role of ISDS as a mechanism of governance – in the sense that it possesses a “law-making function” – cannot be denied\textsuperscript{16}. This is even more true when looking at the enforceable character of the arbitrators’ awards\textsuperscript{17}. One should bear in mind, however, that significant variations in regulating ISDS may exist between IIAs\textsuperscript{18}. These include, for instance, the scope of ISDS (relating to which disputes can be submitted to arbitration), the costs of arbitration, waiting periods, or even the arbitral rules and forums that ought to be used (such as ICSID\textsuperscript{19} or UNCITRAL\textsuperscript{20}).

Neutrality and de-politicization of the process were key objectives countries sought upon examining the possibility of creating a system for the settlement of IIL disputes. Furthermore, promptness, flexibility and lower costs for the proceedings were also expected advantages of arbitration\textsuperscript{21}. One of the controversial characteristics of ISDS lies in the fact that only investors enjoy the right to initiate a procedure. In principle, States do not have the ability to file claims against investors which means they can rarely “win”, they can often “not lose”. On the other hand, investors rarely “lose” as they rarely have to pay compensation to the host State. They can, however, end up paying the legal costs owed by the State if the award goes in


\textsuperscript{15} UNCTAD, “Reforming the International Investment Regime: An Action Menu”, \textit{op. cit.}, p. 122.

\textsuperscript{16} H. Mann, “International Investment Agreements”, \textit{op. cit.}, p.6.

\textsuperscript{17} See, for instance, Art. 54(1) of the International Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID), 575 UNTS 159 (concluded 18 March 1965, entered into force 14 October 1966). Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State’.


\textsuperscript{19} The ICSID was concluded 18 March 1965 and entered into force 14 October 1966. It is set in Washington where it is part of, and funded by, the World Bank. It is a common venue for arbitration of investment disputes. As of 2012, approximately 60% of all known ISDS cases were settled in the context of ICSID arbitration (See UNCTAD report, “Investor-State Dispute Settlement: A Sequel”, \textit{op. cit.}, p.65). However, the ICSID is not the only setting for such cases as there are resembling ISDS forums in Paris, London and Hong Kong for example.

\textsuperscript{20} The United Nations Commission on International Trade Law (UNCITRAL) was established by United Nations General Assembly Resolution 2205 (XXI), the 17 December 1966. The UNCITRAL Arbitration Rules were adopted on 15 December 1976, initially for the purposes of commercial arbitration between private parties, but regularly serve as the basis for rules governing IIL dispute settlement. As of 2012, approximately 25% of all known ISDS cases were settled in the context of UNCITRAL arbitration (See UNCTAD report, “Investor-State Dispute Settlement: A Sequel”, \textit{op. cit.}, p. 65).

the latter’s favor\textsuperscript{22}. One exception where a State may have the ability to initiate the arbitral process lies in their counterclaim ability\textsuperscript{23}. This ability is, nevertheless, strongly limited by the condition that the claim must be within the scope of the parties’ consent. It follows that this mechanism contains inherent legitimacy issues, which have been subject to abundant criticism in the past few years. These problems entail that many of the presupposed advantages of arbitration appear to be misconceptions in the present context. Two important questions will be tackled in this perspective:

\textit{What are the main legitimacy issues affecting ISDS?}

\textit{How could the current system be improved?}

In order to go further, a definition of legitimacy is required as it is an essential part of the subject matter. For the aim of this paper, I use a broad definition of the concept provided by Mark C. Suchman. He describes legitimacy as “a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions”\textsuperscript{24}. Out of this interpretation, different “faces” of legitimacy may therefore be considered. Andrew Hurrell conceptualized five dimensions of legitimacy\textsuperscript{25}. For practical reasons, this paper will not focus specifically on, but may cover indirectly, “substantive values” legitimacy \textit{vis à vis} a particular legal system, nor will it consider expressly questions of “specialized knowledge” and “persuasion and giving reasons” legitimacy. I will focus on two ‘faces’ of legitimacy in particular as they illustrate well the current issues pertaining to investment arbitration and clearly indicate the need to rethink the current system.

First, ISDS is to be challenged regarding its lack of “input legitimacy”, which entails the study of process and procedure. As a matter of example, I will focus extensively on the alarming observation that a handful of arbitrators exercise a monopoly on the settlement of disputes in IIL. Moreover, the lack of transparency and the risks pertaining to conflicts of interest are considered. Finally, apparent lack of diversity present in the world of investment arbitration, including in academia, are also covered. Second, “output legitimacy”, that is to say

\begin{itemize}
  \item \textsuperscript{23} See, for instance, Art. 46 of the ICSID Convention.
\end{itemize}
effectiveness or result legitimacy, is also examined. As it will be discussed, output legitimacy also has an important democratic dimension. In this perspective, I consider the “overprotection” of private interests over the public good, and the “crippling effect” of arbitral costs especially for developing countries.

The assessment of investor-State arbitration is essential because it has a direct impact on the lives of the citizens of host States. Claims brought by investors relate to sovereign acts taken by the host State which, as it will be examined, often relate to human rights, health and the protection of the environment. The input/output approach seems relevant for the analytical purposes of this paper, with an aim to get a genuine glimpse of the main issues pertaining to this dispute settlement mechanism. With regard to the methodology used throughout this dissertation, focusing on particular “faces” of legitimacy, and the lack thereof, presents a clear description of what is wrong with the system and also provides a roadmap of what ought to be done in order to improve the situation. So as to enrich the content of this paper and back up my thesis, empirical data as well as illustrative examples will regularly be included. Unfortunately, for pragmatic reasons this approach inevitably implies a certain selection of the topics that ought to be covered. This, however, does not affect the final conclusion that ISDS requires a profound process of reform.

With this in mind, investment arbitration’s input legitimacy ought to be questioned first (1), while its output legitimacy is challenged in a second part (2). But no paper assessing the imperfections of a legal system would be complete without addressing the desirability of a reform. Should the approach be ‘moderate’ or more ‘radical? This will be the object of a third part (3).

1. SECRECY, MONOPOLIES, AND CONFLICTS OF INTEREST: A CRITICAL ANALYSIS OF INVESTMENT ARBITRATION’S INPUT LEGITIMACY

Adopting a critical perspective is necessary in order to assess the legitimacy of a dispute settlement mechanism such as ISDS and therefore question the need to reform it. As mentioned in the introduction, this first chapter is solely aimed at tackling the main input legitimacy issues

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26 H. E. Brady, "Causation and Explanation in Social Science", in J. M. Box-Steffensmeier, H. E. Brady, and D. Collier (eds.), The Oxford Handbook of Political Methodology, Oxford University Press, 2008, p. 215. ‘Causal approaches that emphasize mechanisms and capacities provide guidance on how to solve the pairing problem and how to get at the connections between events’.
facing the current system investor-state dispute settlement. This demands a thorough study of procedure and of how “interests, values and ideas” are conveyed in this system\(^\text{27}\).

Several elements are striking when it comes to assessing input legitimacy in the context of investment arbitration. For practical reasons pertaining to the structural requirements of this dissertation, three important issues are considered. First, I will cover some of the main problems arising with regard to the process and procedure of arbitration. In this perspective, the apparent lack of diversity in the industry and the monopoly of a few arbitrators will be subject to scrutiny (1.1). The opaque context of arbitration is then studied as it can potentially lead to issues of conflicts of interest as demonstrated through an interesting example involving Argentina and several multinational corporations (1.2). Finally, many arbitrators wear several hats, including the hat of legal scholar. While this might not seem to be problematic, the possible crowding out of other disciplines such as human rights in the context of IIL discourse could be questioned (1.3).

1.1. Issues With Monopolies and Absence of Diversity

Most treaties do not provide guidance regarding the selection of arbitrators. Therefore, their nomination is governed by the applicable arbitration rules. In general, disputes are decided by a panel of three arbitrators. Each party to the dispute must appoint one and the third panelist is appointed either by both parties (e.g. ICSID Rules) or by the already appointed arbitrators (e.g. UNCITRAL Rules). An appointing authority can be named in the relevant agreement in the event the parties cannot agree\(^\text{28}\). While arbitrators can come from law firms, academia, or have often held a position in government\(^\text{29}\), their experience and qualifications, but also their previous decisions, can influence the choice made by the parties\(^\text{30}\).

However, it seems that only a small group of arbitrators are regularly deciding the world’s biggest investment disputes, and this has been the case for the past two decades\(^\text{31}\). Several reports provide some alarming statistics in this regard\(^\text{32}\). A “small community” of


\(^{28}\) See UNCTAD report, "Investor-State Dispute Settlement: A Sequel", *op. cit.*, p. 91.


\(^{30}\) Ibid.


\(^{32}\) See P. Eberhardt and C. Olivet, "Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom", *op. cit.*
arbitrators, just about fifteen, have decided over 55% of all known investment treaty disputes. For instance, Brigitte Stern had been involved, by 2012, in over 8% of all known IIL disputes. Charles Brower (over 7%), Marc Lalonde (over 6%) or Gabrielle Kaufmann-Kohler (over 6%) are also some of the dominant players in the field. The data provided is equally striking regarding the law firms involved with ISDS. A monopoly exercised by a few firms is clearly visible, among which Freshfields (UK), White & Case (US) and King & Spalding (US) wield a particular influence as they were involved in around 130 IIL cases in 2011 alone, out of the 330-odd cases processed by the twenty most proficient firms in the field until then. These apparent monopolies could be explained by the quality of the legal services provided by these arbitrators and law firms, their wisdom and integrity. Indeed, having acquired a certain measure of expertise and influence in the field over many years of practice, it is only natural that parties frequently solicit these renowned experts to represent them. But the existence of monopolies in the particular context of investment arbitration can be problematic for several reasons.

Elasticity in the composition of the bench is often cited as one of the elements that differentiates arbitration from courts. Nevertheless, it seems that investment arbitration’s ability to provide more flexibility than courts is an illusion. The data provided demonstrates that the current situation in ISDS strangely resembles that of a permanent court with sitting judges, due to the ‘unacceptably low’ pool of qualified arbitrators that are chosen to settle disputes. This situation is problematic because most cases require the ability to determine local facts and apply local law. If arbitrators were picked not only regarding their expertise in the sense of “volume of cases, publications and public speeches”, but also regarding their “familiarity” with the relevant cultures and laws that apply in a particular case or domain, then arbitration

See also Allen & Overy, ‘Who is the most influential arbitrator in the world?’, Global Arbitration Review (14 January 2016). Available at: http://www.allenovery.com/SiteCollectionDocuments/Who_is_the_most_influential_arbitrator_in_the_world_pdf accessed 21 July 2018.


Ibid., p. 115.

Ibid.
adaptability might be put to the test. For now, however, it does not appear to have substantially more flexibility than a standing permanent court.

Along the same line, monopolies in the context of ISDS can lead to a questionable lack of diversity. Some would rather describe this situation as that of “a big family”\(^39\), but a more critical eye would probably portray this more as an “inner mafia”\(^40\). Regardless, the large majority of arbitrators in the context of ISDS are from Western Europe and North America which could be criticized as many disputes in IIL involve developing countries\(^41\). Indeed, these lawyers and firms are mostly from the UK or the US, and leave very little room for Non-Western law firms or lawyers to prove their worth and make use of their competence\(^42\). This absence of cultural diversity and inclusiveness could raise doubts as to the adaptability of ISDS proceedings. Indeed, an arbitrator with a cultural link towards the party to the dispute is “more likely to understand the issues involved”, they could be in a better position to provide “necessary explanations”, and even “make an unfavorable award more acceptable”\(^43\). Emphasizing the perspective of developing States, who are regularly confronted to arbitral procedures, would potentially increase the legitimacy of ISDS. Moreover, men tower above this small “club” of arbitrators. Hence, feminist approaches to international law would likely push towards a greater role for women in this process, as they only accounted for only 4% of the total of arbitrators in 2012. Gabrielle Kaufman-Kohler and Brigitte Stern decided most of the disputes resolved by women\(^44\). In an age where gender equality is considered as central to the functioning of democracy and the respect for the rule of law\(^45\), this apparent imbalance in investment arbitration could be problematic for equally competent women arbitrators.

Finally, the fact that one arbitrator can be solicited for so many cases raises questions of practicality. Could one arbitrator be fully committed to handle personally all of these situations for their clients (States or investors)? Just like judges in regular courts, delegation of work to clerks seems inevitable in the context of arbitration, especially for the most proficient

\(^39\) Quote from B. Stern in M. D. Goldhaber, “Deciding the world’s biggest disputes”, Focus Europe: Arbitration Scorecard, 2015.
\(^40\) Y. Dezalay & B. G. Garth (eds.), Dealing in virtue: international commercial arbitration and the construction of a transnational legal order, University of Chicago Press, 1996, p. 50. An arbitrator is reported to have described the world of arbitration as a ‘mafia’ because ‘people appoint one another’. Sometimes they act as counsel and sometimes as arbitrators, but they always appoint their ‘friends’ – people they know.
\(^41\) Ibid.
\(^42\) Ibid, p.22.
\(^43\) W. L. Kidane (ed.), The Culture of International Arbitration, op. cit., p.154.
\(^44\) P. Eberhardt, C. Olivet, "Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom", op. cit., p.36.
\(^45\) Council of Europe, Gender Equality and Women’s Rights: Council of Europe Standards, 2015, p.1. Available at: https://rm.coe.int/168058feef accessed 8 August 2018.
However, for the latter it seems to be more problematic. Indeed, parties choose arbitration in order to make use of a panel specially constituted for their needs and consisting of members who are going to consider the relevant case as their primary concern. This is all the more true as judges do not benefit directly from payments by the parties, but arbitrators do. Moreover, as it will be covered in the second chapter of this paper, the costs of arbitration are often exorbitant. Arbitrators who possess the required skills and have sufficient time could thus be chosen to handle these disputes instead. But more than these apparent monopolies and serious lack of diversity in the context of arbitration, the discourse of arbitrators seems to be predominant in academia.

1.2. The Dominance of Investment Arbitration Discourse in Academia

Arbitrators hold a “firm grip on academic discourse”\(^47\). This dominance of arbitrators’ voices is expressed both in international investment law literature and in academia.

First, journals and reviews pertinent to the field are greatly influenced by arbitrators who often publish articles and hold positions on their boards. On average, as of 2012, approximately three quarters of the editorial boards of relevant journals are either arbitrators or have a “background” in the arbitrator industry\(^48\). For example, the ICSID Review, the Journal of International Arbitration, or the Journal of World Trade and Investment all have an incredibly high percentage of arbitrators among their board members (between 67% and 100%). Arbitrators such as Gabrielle Kaufmann-Kohler, James Crawford or Emmanuel Gaillard are right in the middle of this closed circle of publishing arbitrators\(^49\).

Second, arbitrators often occupy a position of strength in the field of academia. Some of the most influential arbitrators are present in several notorious law schools, either as permanent or guest lecturers. As a matter of example, Professor Brigitte Stern holds a position at the University of Paris I Panthéon-Sorbonne\(^50\), Professor Jan Paulsson holds a chair at the


\(^{47}\) P. Eberhardt, C. Olivet, “Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom”, op. cit., p. 65.


\(^{49}\) Ibid.

University of Miami School of Law\textsuperscript{51}, Professor Emmanuel Gaillard is a professor in the Transnational Arbitration & Dispute Settlement Masters at the University of Sciences Po Law School\textsuperscript{52}. Professor Bernard Hanotiau teaches at the Catholic University of Louvain\textsuperscript{53}, and this list could go on.

The issue does not reside, \textit{per se}, in the fact that arbitrators regularly get published and hold positions either in universities or on the boards of investment journals. It is only natural that renowned specialists regularly address specific issues and nourish investment law literature. Undeniably, readers and future investment lawyers have much to learn from the insight and contributions of practicing arbitrators such as Brigitte Stern or James Crawford who have had a long career in the field and who have many ideas to share on IIL and its intricacies.

The issue lies in the fact that the current dominance of arbitrators’ discourse could crowd out the perspectives and insight coming from other fields which are inherently tied to IIL, such as human rights, environmental law or other extralegal disciplines (social economics, demographics, etc.). Setting aside these discourses is probably not done purposefully, but it ought to be called into question. One meaningful example of this apparent crowding out in academia could be found in the University of Geneva’s International Dispute Settlement LL.M. curriculum\textsuperscript{54}. It is quasi-exclusively composed of “star” arbitrators, among which we can find in the 2018 roster Professor Gabrielle Kaufmann-Kohler as the programme director\textsuperscript{55}, as well as Professor Albert Jan van den Berg, Professor Emmanuel Gaillard, and Professor Brigitte Stern as a visiting professor\textsuperscript{56}.

One could contend that human rights and investment law perspectives do not belong together. However, this assumption is flawed. As the examples regarding Togo and Romania will illustrate in the second chapter, IIL can have considerable impacts on the daily lives of the citizens of host States, their rights, their health, and with regard to the environment they live in.

\textsuperscript{51} See University of Miami School of Law website, 2018, \textit{Professor J. Paulsson}. Available at: https://www.law.miami.edu/faculty/jan-paulsson accessed 22 July 2018.
\textsuperscript{54} P. Eberhardt, C. Olivet, "Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom", \textit{op. cit.}, p.68.
Increasing awareness regarding these impacts is of the essence. Other discipline’s contributions necessarily need to be included and heard in the context of IIL discourse. In light of Dezalay and Garth’s analysis on international commercial arbitration, one could argue that academia is a space that provides ‘strategic opportunities for competitive struggles’\textsuperscript{57}. From this angle, the relevant “struggles” could be whether arbitration should be more reflective of third-world perspectives, or the place given to human rights and environmental concerns. Yet, for these struggles to be heard, a more multidisciplinary and inclusive approach would be required in IIL literature and academia.

1.3. Lack of Transparency and Conflicts of Interest

The opaque process of arbitration can lead to disconcerting consequences. The absence of public access to information as well as the lack of involvement by non-parties to adjudication have been widely criticized in the field of investment arbitration\textsuperscript{58}. Participation in this “behind closed doors” process is indeed problematic from a legitimacy standpoint. Transparency, public participation and accountability are often described as the necessary conditions for good governance\textsuperscript{59}. Indeed, when all the protagonists (arbitrators, parties, representatives…) know that what they are doing is subject to scrutiny by the public, they are more likely to proceed with caution so as to avoid any negative criticism.

In this view, relatively recent regulations have been made in an effort to enhance and popularize values of openness and transparency in the industry. In 2006, ICSID Arbitration Rules were amended to provide for a more transparent procedure\textsuperscript{60}. The ISDS case law confirmed this ‘move to transparency’\textsuperscript{61} and the trend continued with the 2014 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration. Even so, there are still signs showing that more should be done.

\textsuperscript{57} Y. Dezalay & B. G. Garth (eds.), \textit{Dealing in virtue}, op. cit., p. 3-4.
\textsuperscript{59} See UN General Assembly, \textit{United Nations Convention Against Corruption} (UNCAC), A/58/422 (concluded 31 October 2003, entered into force 14 December 2005). Article 5 of the UNCAC establishes ‘fairness, equality, transparency, accountability and public participation’ as the foundational principles to avoid corruption. \textit{Also see} Council of Europe, \textit{European Convention for the Protection of Human Rights and Fundamental Freedoms}, as amended by Protocols Nos. 11 and 14, ETS 5 (concluded 4 November 1950, entered into force 3 September 1953). Article 40 of the Convention provides that the Court’s hearings ‘shall be held in public’ and that documents ‘shall be accessible to the public’.
\textsuperscript{60} ICSID website, 2018, \textit{About ICSID Amendments}. Available at: https://icsid.worldbank.org/en/amendments/Pages/About/about.aspx accessed 21 July 18.
\textsuperscript{61} See for instance ICSID, \textit{Biwater Gauff (Tanzania) Ltd. v. United Republic of Tanzania}, Case n° ARB/05/22 (Award, 24 July 2008). It is one of the first cases in which the ICSID tribunal accepted \textit{amicus curiae} briefs from Non-Governmental Organizations (NGOs) with regard to the environment, human rights and sustainable development.
Indeed, in a context of secrecy and opacity, conflicts of interests could potentially prosper. This situation arises when the interest of a person tends to interfere with their objectivity in the “exercise of their judgement on another’s behalf”\textsuperscript{62}. The study of Gabrielle Kaufmann-Kohler’s role as an arbitrator in several cases involving French multinational companies and Argentina will serve as a good illustrative example of this issue.

\textbf{An Illustration of the Conflict of Interest Issue: The Vivendi v. Argentina Case}

In 2001, Argentina was in the midst of a serious economic crisis, largely due to the devaluation of the dollar-pegged peso and extensive borrowing done by the government of Carlos Menem. Poverty rates were around 50% by 2002. With the aim to reform the country, however, Argentina’s decisions affected foreign investments\textsuperscript{63}. In response, investors brought multiple claims against the host State under ISDS, calling for reparation. By 2006, 30 claims were pending for an estimated total of $17 billion in compensation\textsuperscript{64}.

At that time, Vivendi controlled part of the water supplies of the country. After a disagreement on the price and quality of water, and in this context of economic turmoil, Argentinian authorities terminated the contract that bound them to the company. In response, Vivendi took the case to an arbitration panel in 2004 and chose Gabrielle Kaufmann-Kohler as their arbitrator. Gabrielle Kaufmann-Kohler is a prolific arbitrator and had decided over 26 cases up until July 2015, mostly representing investors. She has also been described as “the most influential arbitrator” in the field of IIL based on the impact of her decisions, as well as the number of cited decisions and appointments she was involved in\textsuperscript{65}.

But to what extent is this choice an issue? Gabrielle Kaufmann-Kohler had “two hats” during the time she was supposed to arbitrate this dispute. She was appointed to sit on the board of directors of the Swiss bank UBS in 2006 which is, surprisingly, the single largest shareholder in Vivendi\textsuperscript{66}. Gabrielle Kaufmann-Kohler did not deem necessary to mention this to any other panelists, which seems controversial given the dubious nature of this situation. Argentina challenged Gabrielle Kaufmann-Kohler’s impartiality in this case. However, the committee in

\textsuperscript{63} G. V. Harten (ed.), \textit{Investment treaty arbitration and public law}, op. cit., p. 2.
\textsuperscript{64} \textit{Ibid.}, p.2.
\textsuperscript{65} See Allen & Overy, "Who is the most influential arbitrator in the world?", \textit{op. cit.}
\textsuperscript{66} P. Eberhardt, C. Olivet, "Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom", \textit{op. cit.}, p. 40.
charge of deciding on this matter responded negatively to the country’s claim. Still, she resigned from the UBS board in 2009 after several critics. However, this is only one example. UBS was also a shareholder in Suez, another company also represented, at that time, by Gabrielle Kaufmann-Kohler against Argentina. In fine, the panel decided that the total losses sustained by Suez to be of approximately $223 million, and Vivendi’s losses were evaluated to be around $37 million, all this at the expense of Argentina.

Confidentiality from public scrutiny in investment arbitration is often justified by the will of the parties and arbitrators to avoid “trial by press release”. But are judicial independence and procedural fairness worth risking over secrecy? Confidentiality could shield questionable practices from the public eye. It is not the aim of this paper to assert that the entire investment arbitration system is corrupt. However, there is a growing case law on arbitrator challenges. It can definitely be argued that the requirements of judicial independence and impartiality are undermined in these situations. Indeed, the whole dispute settlement process could be compromised. *Nemo iudex in causa sua* (“No one should be judge in their own cause”). Under ICSID, it is the peers of the challenged arbitrator that have to decide on the latter’s apparent lack of independence, which could explain the rare success of such challenges. Perhaps making these choices public more frequently would help ensure that the “proper administration of justice” is complied with.

Hence, between secrecy, monopolies and the apparent lack of diversity, the input legitimacy of ISDS can be called into question. The same could be argued regarding the coercive effects of investment arbitration on States.

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70 See ICSID, Suez, Sociedad General de Aguas de Barcelona S.A. & Vivendi Universal S.A. v. Argentina, Case No ARB/03/19 (Award, 9 April 2015), para. 105.

71 W. L. Kidane (ed.), *The Culture of International Arbitration*, op. cit., p.105.


73 Ibid. p.123.
2. ECONOMIC COERCION AND LACK OF PUBLIC INTEREST ORIENTATION: A CRITICAL ANALYSIS OF INVESTMENT ARBITRATION’S OUTPUT LEGITIMACY

Companies can use arbitration as a means to coerce governments and get them to reconsider measures that potentially could have negative effects on investments. Before getting to the heart of this debate, a definition of the term ‘economic coercion’ is necessary. Broadly speaking, this term can be defined as the use, or threat to use, “measures of an economic – as contrasted with diplomatic or military – character taken to induce [a target State] to change some policy or practices or even its governmental structure”74. This coercion should be seen more as a form of “background constraint on available choices” than a “direct” form of coercion75.

Investment arbitration’s role as a dispute settlement mechanism has often been criticized for the economic pressure it could impose on States, especially with regard to developing and third world countries. This is even more blatant when studying the high costs of arbitration and their ‘chilling effect’ over sovereigns, as illustrated by the situation in Togo regarding its plain cigarette packaging policy (2.1). Furthermore, the apparent overprotection of investors through the current system of ISDS, often happens to the detriment of the public interest. States who wish to protect legitimate interests, such as health or the environment, are often impeded by the threat or use of arbitration. The Philip Morris v. Australia case will serve as an example (2.2).

But tackling these particular issues first requires a proper definition of “output legitimacy”. One dimension of this term is the study of the “effectiveness” of a particular mechanism of governance76. However, one must not omit the “democratic” element inherent to output legitimacy, which often seems to be the case in the dominant literature on International Organizations77. Therefore, this chapter will develop more on this ‘democratic’ side to output legitimacy, which entails an in-depth focus on the “substantial rationality” and “public interest” orientation, or lack thereof, of the investment arbitration system78.

2.1. **The “Chilling Effect” of International Investment Arbitration**

Investor-State arbitration is a costly process (2.1.1). These expenses are problematic from a legitimacy standpoint, particularly from a developing country’s point of view. Indeed, ISDS can sometimes discourage governments from taking public policy measures, as illustrated by the recent situation in Togo (2.1.2).

2.1.1. **The “Large Numbers” Involved in Investor-State Arbitration**

Getting familiar with the sums at stake in the context of ISDS can help understand the “economic coercion” argument sustained in this paper. The costs incurred by both the claimant and the respondent are often substantial. With regard to legal fees and tribunal expenses, the Organization for Economic Co-operation and Development (OECD) concluded in 2012 that, on average, an ISDS case would cost over $8 million per party per case. These costs can sometimes exceed $30 million\(^79\). Costs and fees in *Philip Morris v. Australia* are said to have stacked up to $37 million for the Australian government\(^80\). An overwhelming majority of these sums are incurred for legal counsel and experts (82% of the total amount). Arbitrator fees (16%) and institutional costs (2%) make up the rest\(^81\).

With regard to monetary claims and compensations awarded, a complete overview is difficult to obtain as this information is not always disclosed, even in cases that are made public\(^82\). In a 2017 note\(^83\), UNCTAD reveals that a successful claimant was awarded some $522 million on average per case, which is approximately 40% of what the original claims amounted to. But how frequently does an investor win? Approximately 25% of all ISDS cases were ruled in favor of the investor with monetary compensation involved, and in these cases, only a small part of the original claim is usually granted. In 2% of the cases recorded investors won the case without any compensation awarded. For other cases, 28% were settled, 37% decided in favor of States, and 8% were discontinued\(^84\). Based on these official numbers, one

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\(^82\) Ibid. p.7.


could argue that the system is fair as States win more than investors do. However, a distinction is to be made between decisions on jurisdiction (does the matter fall within the competence of the panel?) and on merits (is the investor entitled to have the claim?). Win rates for investors regarding former are generally closer to 70%. Taking away the jurisdictional decisions that ended the arbitration (i.e. the 30% decided in favor of States), approximately 60% of the panels’ decisions regarding merits went in favor of investors.

2.1.2. The Crippling Result of Investment Arbitration on the State’s Economy

The combination of both high win rates for investors and the amounts of money involved with ISDS are sufficient to scare risk-averse governments from lawsuits, especially weaker economies. This is where the “crippling effect” of arbitration comes in. Indeed, the sums associated with this procedure (fees and potential compensation) would be a burden for any government in crisis or with insufficient funds to start a legal battle with a multinational company. This is even more true when many corporations’ net revenue can often come close, or even surpass, a State’s total gross domestic product (GDP), in particular that of third world countries. In order to get an idea of the economic edge these corporations possess over “weaker” States, the relationship between Togo and Philip Morris International (PMI) is an example that will be covered with more consideration below.

The economic pressure exercised on States as a result of the astronomical amounts involved with international investment arbitration thus greatly undermines the legitimacy of the system. The ‘chilling effects’ of this mechanism should be a matter of concern. This term entails a “discouraging effect” as a consequence of the “potential or threatened prosecution under, or application of, a law or sanction”86. The probable liabilities resulting from the ISDS process can indeed be crippling for any developing country, thus creating a system where access to justice is a privilege of those who possess capital. Furthermore, all the money that would go into investment lawsuits could be used by these countries for domestic, public-oriented, purposes. For instance, the $37 million paid in fees by Australia for the proceedings against PMI could have gone into the refurbishment of the Royal Perth hospital estimated at around 20 million AUD in 2018 (approximately $14.8 million USD)87. Consequently, the result is that many States would rather bend the knee to corporations and reconsider their policies knowing

that they cannot rival with the latter in this legal battle. The economic pressure is big enough to coerce States, who are often left with no choice but to cave in to investor demands whenever a threat of litigation arises. The example of Togo is striking.

➢ *An Example of Investment Arbitration’s ‘Chilling Effect’: the Philip Morris v. Togo situation*

The tobacco industry knows how ISDS can be used to inflict a “chilling effect” on States. In an effort to tackle the problem of tobacco smoking, Togo adopted legislation with the objective to only allow plain cigarette packaging, the branding being replaced with upsetting graphic health-related warning labels and pictures. Since the law was passed in December 2010, however, not much change has resulted from this particular measure. Indeed, through rather intimidating letters sent to the Togolese government, PMI disregarded the adopted legislation and threatened to sue in front of an arbitral tribunal on the ground of a fifty-year-old BIT between Togo and Switzerland, home of Philip Morris S.A. and PMI’s worldwide operations center. The agreement does not even contain a dispute settlement provision, but the threat was enough to induce a “chilling effect” on the government. The coercive effect of the simple threat of an ISDS process is clearly visible through this example. Philip Morris International has a revenue of approximately $80 billion. In comparison, Togo is one of the smallest States in Africa and one of the poorest countries in the world, with a GDP of approximately $5 billion. Many States do not have the necessary funds to pay the fees required for such a procedure. As a consequence of these threats to engage in a legal battle, States could abandon the pursuit of legitimate goals such as public health, just as Togo did. ISDS could, in fine, also lead to a certain “regulatory chill” where governments avoid introducing new public policy measures out of fear...

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from foreign investors who could challenge them⁹³. As it will be further discussed in the next section of this chapter, one can wonder if, in this context, corporate interests are not overprotected in comparison to public interests.

2.2. ISDS: A System Protecting Investors Over the Public Interest?

It seems that the community of investors benefits from a high level of protection from State action. In this perspective, a parallel could be made between constitutional law and ISDS, as well as IIL in general (2.2.1). While such a degree of protection is essential, it can also be argued that it affects the pursuit of legitimate goals and policies by countries. Indeed, the effects of investment arbitration in this regard ought to be discussed (2.2.2).

2.2.1. Foreign Investors: A Privileged Community in a Global Constitutional Order?

Most IIAs allow for investors to sue governments for compensation of alleged expropriation of property (land and factories for instance)⁹⁴. Initially, this mechanism was destined to “boost” the confidence of investors and help promote foreign investments so as to bring “jobs, revenue or technology” to countries, which would also allow them to develop their economy. If investors have a feeling that their activities are backed up by a “fair and impartial” dispute settlement mechanism, then foreign investments are likely to prosper⁹⁵. Furthermore, regulatory risks involved with host States can be high for investors (for instance with a sudden change of government policy). Therefore, IIAs help ensure that a certain level of political stability is maintained for investors to proceed in their enterprise.

From a domestic legal standpoint, a comparison could be made between IIL and constitutional law⁹⁶. The global network of IIAs seems to serve a role similar to that of constitutions in that it provides “limits” to “governmental capacity”. In this perspective, several elements, play an essential role in the protection of investors against illegitimate coercion from States. For example, the law on expropriation and nationalization, as well as the “fair and equitable treatment” (FET) requirement vis à vis investors, have a restrictive impact on the


⁹⁴ S. E. Wild (ed.), Webster’s New World Law Dictionary, op. cit., p. 139. Expropriation is defined as ‘the action of forcibly divesting another of a property interest’, i.e. whenever the government takes possession of private property by means of ‘eminent domain’, for public use.

⁹⁵ Ibid.

regulatory sovereignty of States. The FET standard, more particularly, is the “treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment”\textsuperscript{97}. Also, stabilization clauses have a “freezing effect” on business relationships’ terms and conditions for a certain amount of time. The law that applies between the parties is thus “frozen”, regardless of any future legislative or regulatory developments. If IIAs act as a “constitution”, then ISDS can be compared to a “supreme” domestic jurisdiction, with a binding enforcement mechanism. It provides non-State actors with a direct means of international action to defend themselves against arbitrary decisions of the host State and enables them to avoid relying on diplomatic protection from their home country.

How did this extensive protection of investors develop? One could link this situation to Duncan Kennedy’s argument on the centrality of the identity/rights discourse in contemporary legal thought\textsuperscript{98}. Behind Kennedy’s reasoning lies the assumption that because of their identity (because of who they are), certain groups of legal subjects are entitled to a particular set of rights. This legal thinking developed first in the field of human rights (with minority rights, women’s rights, or indigenous rights for instance), and then spread to IIL as well. The premise that the investor community deserved specific rights and protections, just as there exists minority rights and protections, caught on. Thus, leading to the current IIL system with its numerous agreements and a prolific dispute settlement mechanism, providing investors with a context favorable to their activities.

From a more general perspective, it can be argued that liberal interests dominate the global legal order and the judicialization (through international courts and tribunals) that has been associated with it until now\textsuperscript{99}. IIL is only an example of this perceptible phenomenon, through its extensive protection of investor property rights as well as its aim to increase flows of private funds. Altogether, these protection mechanisms and safeguards are particularly important for investments made in unstable political or economic systems, where the rate of expropriations and the risk of corruption are high\textsuperscript{100}. Hence, protecting foreign businesses from

\textsuperscript{97} ICSID, Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States (TECMED Case), Case N° ARB (AF)/00/2 (Award, 29 May 2003), para. 154.
“unfair regulatory excess” can, on the one hand, be considered a legitimate aim\textsuperscript{101}. However, the present ISDS mechanism appears to suffer from a severe lack of public interest orientation, thus affecting its output legitimacy.

2.2.2. The Lack of Public Interest Orientation of the Investment Arbitration System

The same mechanism that protects investors from illegitimate government action can also limit the latter’s capacity when it is most necessary, that is when there is an urge to take measures for human rights, health or environmental protection purposes. The \textit{PMI v. Togo} example presented above, and the focus on the \textit{Gabriel Resources v. Romania} case below, both illustrate the extent to which ISDS can affect States’ regulatory sovereignty regarding public policy.

By developing such a level of reliance interest for investors, the relation between the latter and the host State strongly resembles that of a private contract which clearly defines the business relationship between both parties. However, the fact that States are considered to be parties to a contract is problematic, particularly when one becomes aware of the “weight” of responsibilities incumbent upon countries (maintaining public order or taking health measures for its citizens to serve as examples). These responsibilities entail that the situation is considerably different to the usual private contract. When States go back on their policies in favor of corporate interests, because of legal threats or challenges in front of a tribunal, it is often a measure with a legitimate aim of public interest that is abandoned.

Investment arbitration, in its own way, could hinder State capacity to tackle domestic issues relating to health, energy, climate change, or human rights for instance\textsuperscript{102}. It seems ISDS is more receptive to the protection of investors’ interests through the enforcement of IIAs which create a “bill of rights” specifically for investors\textsuperscript{103}. The “sole effects” doctrine is a revealing example of the extent of the protection provided by this system to investors. According to this concept, the tribunals ground their decisions regarding the violation of particular protections “solely” on the effects of the measure at issue on investors\textsuperscript{104}. As a result, it appears that all

\textsuperscript{103} D. Schneiderman, \textit{Constitutionalizing Economic Globalization}, op. cit., p.69.
\textsuperscript{104} \textit{Ibid.} p. 72.
matters other than the investor’s condition do not benefit from such consideration from the tribunal, including human rights or environmental considerations.

In recent decades, some agreements have included a list of exceptions that the State can bring forward in order to protect some of its interests on the basis, for instance, of the preservation of natural resources, the protection of national security or the protection of human life or health\(^\text{105}\). The latter can do so by incorporating the rules of Articles XX and XXI of the General Agreement on Tariffs and Trade (GATT 1994) into the act. Still, this does not concern most agreements.

IIAs allow investors to sue governments over a multitude of legitimate policies which, they argue, infringe their property rights. In this perspective, multinationals often sue to claim the money they already invested as well as “lost profits” and “expected future profits”. This can be problematic as monetary claims can often seem disproportionate compared to the initial investment made and can reach enormous numbers. But if such a system is at the companies’ disposal, why would they refrain from using it?

The role of investment arbitration can be criticized for the imbalance that it creates between the protection of investors and the protection of public interests. Indeed, the current ISDS regime can hinder the possibility for States to take regulatory measures aimed at the protection and promotion of human rights, health or environmental law and compel them to pay compensation to those that have harmed these values. This means that arbitration can potentially impede States from addressing corporate impunity when violations of environmental law or human rights take place. In retrospect, after having gathered all the elements covered in this section (the constitutional character of IIL, the Bill of Rights for investors, and ISDS as a supreme court to enforce this system), it appears that the investment law regime is advancing towards a harmonized “global law market”\(^\text{106}\), to which ISDS is contributing through its case law. In this market, through the adaptation of their regulatory systems, States battle to seduce investors and attract capital. But is this desirable for States and their populations? Be that as it may, the output legitimacy of ISDS regarding public interest can be questioned and governments like Romania are becoming aware of this often the hard way.

\(^{105}\) See, for instance, Article 11 of the Comprehensive Economic Partnership Agreement between Japan and the Republic of India (concluded 15 February 2011, entered into force 1\textsuperscript{st} August 2011).

The Apparent Dominance of Private Interests in ISDS: The Gabriel Resources v. Romania Case

In the Apuseni Mountains of Transylvania, a remote community of villages has become in just a couple of years a symbol of the conflict between private and public interests in arbitration. In the early 2000s, a Canadian mining company, Gabriel Resources, saw a huge investment opportunity in the large-scale open-pit mining of gold and silver in the region, which is considered as “one of Europe's most prolific mining districts”\(^{107}\). Its plan was to reopen the old State mine that had been closed since the cessation of mining in 2006 and to expand the site. A huge advertising campaign promised a bright future perspective to the inhabitants of the region, new schools, plenty of jobs, and claimed that it would boost Romania’s economy.

In order to carry out this enterprise, however, the company would have had to level a large part of the region to the ground. This process would have meant the disfigurement of a historic part of Transylvania, its landscape, its mountains, and Roman ruins. More than this, the extraction process was supposed to include the use of “thousands of tons” of cyanide and would have likely created huge amounts of toxic wastes in the region\(^{108}\). Afraid, and rightly so\(^{109}\), of the possible destruction of their ecosystem and probable negative impacts on their health, the Romanian population clearly did not see matters in this light and chose to take their destiny into their own hands. This regional issue quickly became a major nationwide cause and demonstrations brought in the streets of Bucharest tens of thousands of people outraged by this project and by the fact that the Romanian government had accepted it. Under such a level of public pressure, the Parliament suddenly changed its position in 2013. After a wave of unprecedented protests since the fall of communism in Romania, it voted to reject the draft bill that authorized the project.

This domestic political battle was won, but a legal battle was about to begin. Gabriel Resources decided to file a complaint and took the case up to the ICSID. Having failed to exploit the mines of Rosia Montana, the company has maybe found in investment arbitration another gold mine. $4.4 billion is the amount sought by the investor as compensation for the alleged damages caused by “Romania’s failure to accord a fair and equitable treatment” to the

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enterprise, as well as the “unlawful expropriation” of the project, among other legal groundings. In this perspective, the legal bases used by the claimant, counseled by White & Case LLP, are provisions included in the UK-Romania BIT, as well as the Canada-Romania BIT.

Gabriel Resources has invested some $700 million in Romania and has put into this project time, money and effort. Hence, some form of compensation ought to happen. From a business standpoint, on the one hand, particularly after the Romanian authorities’ sudden change of policy, the situation shows a lack of political stability which is exactly what IIL tries to prevent for investors.

On the other hand, a company suing a country through an international tribunal over a public health and environmental measure could be questioned. This example illustrates that States are not just any “normal” commercial players, largely due to their responsibilities vis à vis their citizens. Also, the claims are over four times the initial amount invested by the company due to its demands to be compensated for lost profits and expected future profits. This could also seem unfair considering that Romania is one of the poorest countries in the EU. The company’s claims amount to approximately 2% of Romania’s 2016 GDP. Adding to that amount the fees and other procedural costs incurred in this legal process which could last at least three years (the first hearing will not be held before September 2019), this case could have a considerable impact on Romania’s economy. Both for Romania and its people could potentially pay a hefty price if the panel rules in favor of Gabriel Resources.

This apparent lack of public interest orientation of investment arbitration and IIL could result in a lack of ‘persuasion’ or “giving reasons” legitimacy. In particular, the idea that governments have to compensate these foreign corporations with taxpayer money can, unsurprisingly, scandalize citizens of the host State. In this sense, the legitimacy of ISDS in its

110 ICSID, Gabriel Resources Ltd. and Gabriel Resources (Jersey) v. Romania, Case No. ARB/15/31 (Claimant’s Memorial, 30 June 2017).
115 S. Taylor, "Canada's Gabriel Resources to seek $4.4 bln", op. cit.
sociological sense (is it widely believed to have the right to rule?) also seems to be challenged, especially because it is public pressure that induced a change of government policy. Thus, all the elements seem to indicate that ISDS needs some sort of reform in order to remedy these problems.

3. THE NEED FOR A REFORM OF INVESTMENT ARBITRATION?

Discussions on the legitimacy issues pertaining to the system appear to be gathering momentum. Hence, it is necessary to think about what could make this dispute settlement system work more efficiently and fairly for the sake of both investors and States. An increasing number of IIL reports and textbooks now include sections about, or are entirely dedicated to, the reform of ISDS. Seemingly, two routes for reform seem possible.

The first route is the more “moderate” one. It entails, through technical readjustments, a rectification of several issues pertaining to ISDS such as transparency, policy space for countries, investor duties and costs. The question remains as to whether these arrangements are sufficient to address these problems (3.1). One could argue instead that a profound systemic reform is needed. This second possible route is more “radical” and pushes for a major reform of the entire IIL dispute settlement mechanism. With that in mind, the question of an appellate process to ensure that fairness and impartiality are complied with is considered first. Finally, the perspective of a permanent court to settle investor-State disputes is studied and appears to be a desirable option. But is it feasible? (3.2)

3.1. The ‘Moderate’ Route: Potential Adjustments to Improve ISDS

Three ‘moderate’ reforms are considered in this section. The increase in transparency seems like a good starting point to improve the current ISDS mechanism (3.1.1). Nevertheless, it appears that it cannot be achieved with tackling the important issue of arbitration costs (3.1.2). Finally, a push towards more binding obligations for investors relating to human rights or the environment seems necessary (3.1.3).

3.1.1. Increased Transparency for Increased Legitimacy?

As mentioned in the first chapter, the opaque context in which the whole system operates is one of the main challenges facing investment arbitration. It creates an environment favorable to questionable situations such as conflicts of interest. There exists a trend towards more transparency, through the adoption of the previously stated 2014 UNCITRAL Rules on Transparency for instance. Still, there is a call for a more accessible process. Working towards
this prospect is one medium through which the currently fragile legitimacy of investment arbitration could be addressed, or at least partly\textsuperscript{117}. Nevertheless, as it stands today, it is difficult to decide whether the pros of a more transparent mechanism outweigh the potential downsides of such a reform.

On the one hand, several arguments play in favor of this move towards transparency. Developing a process that regularly informs the public about the existence of disputes\textsuperscript{118}, discloses documents, and facilitates public access to hearings and participation would contribute to remedying the lack of input legitimacy that currently exists. Especially with regard to the public has a particular interest at stake like in the \textit{Gabriel Resources v. Romania} case previously covered, civil society should be entitled to have access to information (through public hearings and \textit{amicus curiae}). As a result, any arbitral decision would presumably be easier to implement because it would be more accepted\textsuperscript{119}. Also, an enhanced place for third party participation, such as NGOs, is likely to result in a limitation of any improper behavior from arbitrators and would therefore create a “culture” of accountability in ISDS\textsuperscript{120}. One could also contend that the multiple investor-state tribunals would be aware of each other’s previous decisions and would thus be able to construct a coherent regime through consistent interpretations.

On the other hand, however, transparency could increase the overall costs of arbitration\textsuperscript{121}. This consequence is often missed out and is not desirable as costs are already immense, especially for developing and third-world countries\textsuperscript{122}. This would risk furthering even more the inequalities that already exist with regard to the “chilling effect” of arbitration fees and accessibility of ISDS to poorer nations. Hence, without tackling the economic issue, any attempt at reform towards a more transparent procedure would appear to be fruitless. Delays to resolve disputes will be more important as increased transparency will likely entail a longer

\textsuperscript{117} See UNCTAD report, "Investor-State Dispute Settlement: A Sequel", \textit{op. cit.}, p.121.
\textsuperscript{120} Ibid.
\textsuperscript{121} Ibid., p. 1287.
\textsuperscript{122} Ad Hoc Tribunal (NAFTA/UNCITRAL), \textit{Methanex Corporation v. United States of America (Decision on 'amici curiae', 15 January 2001)}, para 50, p. 22. The tribunal noted that ‘there is a possible risk of imposing an extra burden on one or both the Disputing Parties’. As a result, strict page limitations must be respected.
procedure\textsuperscript{123}, added to the fact that the duration of a case is already considerable (approximately 4 years)\textsuperscript{124}.

The issue of transparency would therefore have to be tackled jointly with the burden of costs if one wishes for a more accessible IIL justice.

3.1.2. Tackling the Burden of Investment Arbitration Costs

‘Exorbitant’ legal costs and arbitrator fees, as well as the billions of dollars of compensation often claimed by investors, are a matter of concern\textsuperscript{125}. In response to the large amounts involved with documentation, ICSID works towards “going greener”. This also aims at modernizing and simplifying the process, focusing particularly on reducing the time and costs of arbitration through the increasing use of electronic documents in the stead of hard copies\textsuperscript{126}. Is this sufficient?

Another possible reform is also gaining importance in IIL literature. Unlike judges, arbitrators have no cap on financial remuneration, meaning their fees can vary from around $375 to $700 per hour, and how much one can earn in total will depend on the case’s length and complexity. On average, an arbitrator could earn up to $350,000 per case, but in some cases this number was much closer to $1 million\textsuperscript{127}. It seems logical for arbitrators to be well remunerated as these cases are often very complex and demand a lot of time, work and expertise. Nonetheless, it has been argued that a cap should be imposed on the costs of lawyers and arbitrators so as to mitigate the current disparity between those who can and those who cannot afford such fees\textsuperscript{128}. As previously discussed, these costs can have a “chilling effect”, especially on weaker economies, and are therefore an issue that needs to be addressed. For

\textsuperscript{123} Ibid.


\textsuperscript{127} P. Eberhardt and C. Olivet, "Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom", op. cit., p.35.

\textsuperscript{128} A. Roberts, Z. Bouraoui, “UNCITRAL and ISDS Reforms”. South Africa denounces the fact that there is “no limit as to the costs” of a case and goes as far as to describe ISDS as “first and foremost the system for the most powerful”, op. cit.
example, a Center for legal advice including a fee cap has been subject to discussion within the Union of South American Nations (UNASUR), in an effort to limit the parties’ expenses\textsuperscript{129}.

In addition, many corporations claim compensation for “lost profits”. Such claims could often be seen as excessive regarding the initial investment made. For instance, Libya was ordered to pay $935 million for “lost profits” to a company from Kuwait for a cancelled investment project. In comparison, the company had only invested $5 million in the project and construction never began\textsuperscript{130}. This could also be subject to reform. Limiting the potential compensation of foreign investors to expropriation of property and loss of previous investment value would be more justifiable\textsuperscript{131}. The legitimacy of the arbitration system would surely increase if lawsuits were more ‘affordable’ and thus more “accessible”.

Nevertheless, focusing solely on financial and procedural matters is not enough. From a substantive point of view, ISDS could also be more equitable by aiming reforms at what investors can or cannot do.

3.1.3. Health, Human Rights and Environmental law: More Binding Obligations for Investors?

IIL was founded on the idea of creating rules and procedures to promote and protect foreign investments (both from individuals and multinational corporations)\textsuperscript{132}. In this system the State is perceived negatively, as a possible obstacle to businesses, which is understandable in a post-colonial context marked by independence struggles vis à vis foreign domination. By introducing BITs, western States provided a way to protect their investors’ interests from, for instance, ‘unfair’ nationalization and expropriation of land or property\textsuperscript{133}. Nevertheless, in today’s globalized world, businesses impact the societies of the host States too, whenever and however they operate, whether it is in a good way (e.g. employment and development) or in a bad way (e.g. pollution, corruption, or child labor). Currently, however, many instruments

\begin{itemize}
\item \textsuperscript{132} P. Muchlinski, "Corporate Social Responsibility", in P. Muchlinski, F. Ortino & C. Schreuer, The Oxford Handbook of International Investment Law, p. 1108-1109.
\item \textsuperscript{133} Ibid.
\end{itemize}
providing for human rights, health or environmental requirements in IIL are non-binding. The United Nations Guiding Principles on Business and Human Rights, for instance, do not create legal obligations. Also, IIAs rarely contain such provisions.\(^{134}\)

The development of binding obligations for investors regarding impacts of businesses on these matters would likely result in a more legitimate dispute settlement system. Indeed, as a result of these inclusions in IIAs, arbitrators would therefore have to take such issues into consideration when deciding cases. Consequently, the host States’ policy-space to regulate would presumably be enhanced, and arbitrators would have to follow through and apply what the law is to the particular case. This could hopefully reduce the number of situations similar to the *Gabriel Resources v. Romania* example, where a State has to compensate a company whose activities were abandoned because they threatened the environment and the citizens’ health.

Investment treaties ought to include certain obligations in this perspective, so as to clarify what investors can or cannot do. It could be conceived that future IIAs increasingly refer to these issues as a source of “important standards”\(^{135}\). Binding or not, these standards could be placed on the balance with the rights and obligations of investors that ought to be interpreted through the ISDS process. Combined with the increased transparency of arbitration, particularly with the popularization of *amicus curiae* briefs from the civil society, these standards would probably be subject to more consideration from arbitrators and lead to more legitimate outcomes. One step in this direction was made with the revised COMESA Agreement on a Common Investment Area. It is one of the first IIAs to include commitments aimed at investors regarding the respect of human rights as well as a provision on environmental impact, along with other social issues.\(^{136}\)

However, it is unlikely that the aforementioned reforms, on their own, can fully address the inherent flaws of IIL arbitration. To provide for a more balanced and just system, another route, although more radical, could also be envisaged.


\(^{135}\) P. Muchlinski, "Corporate Social Responsibility", *op. cit.*, p.1148.

\(^{136}\) See Art. 7.2.d. of the Investment Agreement for the COMESA Common Investment Area (signed 23 May 2007, not yet ratified).
3.2. The ‘Radical’ Route: Towards a Systemic Reform of Investment Arbitration?

The creation of an appeal mechanism has been subject to discussion and could potentially help correct some legitimacy issues, but it is not without its own disadvantages (3.2.1). Finally, the idea of an independent and permanent Investment Court as an alternative to private arbitration needs to be discussed (3.2.2).

3.2.1. The Pros and Cons of an Appellate Mechanism

The new model agreement presented by Ecuador in March 2018, and which will serve as the basis for future negotiations with other countries, includes an appellate stage\(^ {137}\). Therefore, the idea of an appellate mechanism for investment disputes seems to be expanding. But the desirability of such a mechanism needs to be considered with some degree of prudence. Indeed, what seems like a good option towards an impartial and equitable process might also have unwanted consequences.

On the one hand, the “consistency argument” is often presented as one of the main reasons for the creation of an appellate system in IIL dispute settlement. Such a reform would possibly enhance the coherence and also the quality of decisions taken by the present investment tribunals\(^ {138}\). In this perspective, the legitimacy of the system could find itself enhanced if the appellate body in question can verify the respect of ‘due process’, the impartiality and the independence of arbitrators, thus potentially limiting the likelihood of conflicts of interest\(^ {139}\). One could contend that, in the long run, the perceived “pro-investor bias” that seems inherent to the system would be weakened in favor of increased public interest orientation\(^ {140}\). Nevertheless, these are only expectations and are nothing close to being certain.

On the other hand, these potential advantages of an appeal would have to be balanced with the possible drawbacks pertaining to the creation of such a mechanism in the context of IIL. Many complications can arise from this reform. Indeed, one of the main drawbacks of an appellate mechanism is the increased time and costs of procedure. Adding another step in the

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\(^{140}\) C. J. Tams, "An Appealing Option?", op. cit., p.34.
process will not only risk undermining first instance decisions, it will most likely have an important impact on the amount of time required to resolve disputes. Necessarily, this will affect the total costs incurred, in particular the amount of legal fees that ought to be paid by both the investor and the host State. Hence, this sort of reform does not seem to resolve the “chilling effect” of ISDS, and the long proceedings that already exist\(^\text{141}\). One particular example of a prolific appeal mechanism, by international law standards, is the WTO’s Appellate Body, where panel reports are appealed around 68% of the time\(^\text{142}\). This is a prospect to consider in the context of investment arbitration if such a reform comes to fruition.

Many specific questions remain as to which type of appeal mechanism could be set up. Will this appellate body be permanent? How will the members be chosen? Will they be able to base their decisions upon the facts of the case, or will they just scrutinize the respect of “due process”\(^\text{143}\)? Could this reform increase the risk of investors bias to the detriment of weaker host States by furthering the ability of companies to appeal? Eventually, could this lead to a discouragement of States and investors to providing or looking for investment opportunities\(^\text{144}\)?

Notwithstanding, from a general perspective, it seems that through the creation of an appeal procedure the status quo in ISDS would likely remain. Instead, for a meaningful reform of the system, the option of a standing permanent court to settle investment disputes could be the way forward.

### 3.2.2. The Call for a Permanent Court

Many technical questions are relevant in order to craft a viable and fair permanent court solution for the settlement of investor-State disputes. Should this court be an institution of its own or set up as part of a chamber in the International Court of Justice? The latter option could be interesting as it is often considered as one of the main judicial organs of the international economic order\(^\text{145}\). Also, by what standards and through which process should the judges be nominated? For instance, judges could be appointed or elected by States on a permanent basis

\[^{141}\text{C. J. Tams, "An Appealing Option?", op. cit., p.15.}\]

\[^{142}\text{See WTO website, 2018, Statistical Information on Appeals in the WTO. Available at: https://www.wto.org/english/tratop_e/dispu_e/stats_e.htm accessed 1 August 2018. Data between 1996 and 2014.}\]

\[^{143}\text{Ibid., p. 6, for a general overview of the questions that could arise for the creation of an appellate body in the context of ISDS.}\]

\[^{144}\text{Ibid, p.15.}\]

\[^{145}\text{A. H. Qureshi, "An Appellate System in International Investment Arbitration?", op. cit., p. 1947-1950. For example, States have resorted to the International Court of Justice for the resolution of economic-related disputes before, and it has also been central in confirming several international economic law principles (the right to development, the right to environmental protection, the principle of sustainable development…).}\]
for a fixed term, which is essential to guarantee their independence. Furthermore, in order for the process to be more “inclusive”, the roster of judges would have to comprise non-Western and female professionals as well. The aim of this paper, however, is not to provide definitive answers to these numerous technical points, but rather to adopt a global approach on the desirability of an independent investment court in the stead of private arbitration.

The issues covered in this paper demonstrate that ISDS, as a whole, seems to lack openness and accountability. One could also perceive it as not operating in the fairest of ways regarding developing and third-world countries. The legitimacy issues facing this system are inherent structural problems. Consequently, it appears that only a more “radical” reform could overcome the current legitimacy crisis. Many of the presupposed advantages of arbitration previously mentioned are illusory in the context of ISDS. The presumed “promptness” of the arbitral process, the greater “flexibility” and control by the parties in the proceedings, and the “lesser costs” of arbitration are misconceptions. The fact that a private mechanism of adjudication is competent regarding claims by individuals against “the legality of the use of sovereign authority”, that is for public law matters, is often seen as inappropriate.

With the creation of a standing investment court, parties could gain an independent and more transparent dispute settlement mechanism. The creation of an appellate body could also be an additional safeguard in this perspective. As a result, both conflicts of interests and perceived bias would likely pose a lesser risk. If the roster of judges is more representative of the diversity of States and actors which are relevant in the context of IIL, then perhaps this system will consider more the local specificities of each case. Also, delegation to clerks in the context of a permanent court would seem less problematic than with arbitration as judges do not benefit directly from payments by the parties. Hopefully, the “chilling effect” of arbitration

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146 UNCTAD report, "Investor-State Dispute Settlement: A Sequel", op. cit., p.194. Also see, G. V. Harten, *Investment Treaty Arbitration and Public Law*, op. cit., p.181-182. This could be done by nomination from an entity through a list of judges submitted by States, much like the International Court of Justice. Another possibility, similar to the process applied in the International Criminal Court, through an election of the judges by an assembly of State parties for instance.


151 Ibid.
on States will not be repeated in the case of a major reform, thus allowing States more space for policy-making, particularly regarding human rights, health and environmental matters.

However, any dispute settlement procedure is costly for a developing economy\textsuperscript{152}. By replacing arbitration with a permanent body composed of judges one cannot hope to remedy all of the legitimacy issues inherent to ISDS. For instance, the duration of proceedings will probably remain close to the average 4 year-long process required to settle investment disputes. The creation of an ‘independent’ and “permanent” institution does not totally negate the risks of bias either. Depending on how the judges are nominated (e.g. if States have a monopoly on this matter) there could still be critiques on how much the court is conditioned by Member State preferences\textsuperscript{153}. Hence, some “illegitimacy” seems inevitable in any given legal system, regardless of the extent of reforms\textsuperscript{154}. There are no “perfect” dispute settlement mechanisms.

Moreover, enhancing the legitimacy of ISDS is not only about changing the institutional model that is used. For the system, as a whole, to be more “equitable”, both parties have to be considered for what they represent. This entails the inclusion of the relevant obligations owed by investors (particularly regarding human rights and environmental protection) in IIAs, as mentioned previously in the first section of this chapter, as well as a transparent process allowing for public participation. These problems ought to be tackled simultaneously if the future ISDS mechanism is to be more legitimate.

Joseph E. Stiglitz suggests that the judicial standards of ISDS fall ‘far below twenty-first century standards’ and that the problems could “easily” be remedied\textsuperscript{155}. While he may be right about the deceit of international investment arbitration, a major reform of the system in the near future seems unlikely to happen. Indeed, many reasons can be pointed out to explain the relatively slow progress of reforms in the context of IIL. States worry that their “attractiveness” to foreign investors may be reduced if the current system is ‘disrupted’ by a

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\item \textsuperscript{154} P. G. Stillman, "The Concept of Legitimacy", \textit{Polity}, vol. 7, n. 1, 1974, p. 43. Available online at: https://www.jstor.org.ezproxy.lib.gla.ac.uk/stable/3234268?pq-origsite= summons&seq=1#page_scan_tab_contents accessed 2 August 2018. Providing an analysis of the concept of legitimacy and applying to governments, Stillman argues that “in almost all societies some illegitimacy exists” but that “legitimacy is nonetheless a desirable property”. A parallel could be made with ISDS and the idea that some legitimacy issues may remain, but reform is nonetheless desirable for the sake of both States and investors.
\item \textsuperscript{155} J. E. Stiglitz, "Towards a Twenty-first Century Investment Agreement", \textit{op. cit.}, p. xxiv.
\end{itemize}
\end{footnotesize}
substantial reform\textsuperscript{156}. Moreover, if a permanent court is to be conceived, consensus would be required among the States concerned, as such an institution will not be created unilaterally\textsuperscript{157}. Nevertheless, ISDS has probably more to gain from the creation of a permanent court composed of independent judges, for fixed terms, than from maintaining the current private arbitration system and occasionally correcting some of its flaws with “modest” adjustments. Anyone who is satisfied with the current state of affairs might still prefer a permanent investment court rather than the total loss of the ability of investors to bring claims in front of a tribunal\textsuperscript{158}.

**CONCLUSION**

It seems clear that for investor-State dispute settlement to be a more just and fair process, a major reform is needed. The system suffers from several important legitimacy issues, as demonstrated by the “input/output legitimacy” perspective of this paper. The multiple examples covered provide a clear picture of the several lacunas of this system.

Only a handful of arbitrators and a few global law firms, handle most of the world’s biggest disputes, to the detriment of inclusiveness and diversity. This calls into question the presupposed flexibility of arbitration as most cases require the ability to determine local facts and apply local law. This “family” of lawyers are very present in academia and research, through extensive publishing as well as teaching in several notorious law universities. Hence, perspectives from other disciplines risk being crowded out. This is problematic as foreign investments impact human rights, the environment of host States and the health of their citizens. Therefore, these elements need to be included in IIL discourse. Perceptible monopolies are coupled with a serious lack of transparency in the arbitral process and little to no room for public participation which could facilitate abuses such as conflicts of interest.

More than these input legitimacy issues, the output legitimacy of the system is also challenged. ISDS creates an uneven balance of interests. The enormous costs related to the legal fees and the tribunal expenses, along with the huge monetary claims and compensations at stake, are crippling for weaker economies. This has a “chilling effect” on States meaning that the latter are compelled to recede from their policies whenever there is a risk or threat of prosecution. This situation could be qualified as some sort of economic coercion inflicted upon

\textsuperscript{156} UNCTAD, "Recent Developments in the International Investment Regime", op. cit., p.10.
\textsuperscript{157} Ibid., p. 7.
countries who would prefer complying with investors’ demands than be engaged in expensive legal battles. In this system, one could suggest that investors are “privileged” actors. The existing network of IIAs creates a constitutional-like protection system for them. Their “Bill of Rights” includes provisions like the FET requirement or the law on expropriation to limit the risk of unfair regulatory excess from governments. Investment arbitration works as a supreme court to protect investors’ interests through its binding awards and the application of the “sole effects” doctrine.

Nevertheless, as demonstrated in the examples relative to the situations in Togo with the tobacco industry, and Romania with a mining firm, the apparent overprotective nature of this system vis à vis investors often happens to the detriment of legitimate public policy measures. A country cannot be treated like just any normal commercial player as it is responsible for the health and safety of its citizens, as well as human rights and environmental matters.

As a result of the current legitimacy crisis in the ISDS mechanism, the debate on a reform of investment arbitration seems to be nourishing an interest in recent international investment law literature. In this prospect, how can ISDS be improved? A more transparent investment arbitration process could, on the one hand, create a culture of accountability regarding arbitrators. As a result, through an increase in public participation in proceedings the system’s input legitimacy would be enhanced. On the other hand, this is likely to create more costs and longer procedures. This burden, however, can be diminished if a cap is imposed on fees and if investors’ claims are not disproportionate regarding their initial investment. Also, the integration of standards relating to the environment and human rights in IIAs could lead to more public interest-oriented system. Finally, in a more “radical” perspective for reform, the creation of an appeal mechanism or even a standing investment court have to be debated. There is no miracle solution for all of the legitimacy issues of investment arbitration. However, depending on what modalities they are built on, these options could possibly be the way forward for a more equitable dispute settlement mechanism for both States and investors.