International investment courts

Are they next in the evolution of ISDS arbitration?

The recent proliferation of bilateral investment treaties and free trade agreements involving Australia[1] has brought with it the vexed issue of how best to resolve investment disputes between foreign investors and States.

One of the most common mechanisms has been Investor State Dispute Settlement (ISDS) clauses, which to date have been used by Australia in six free trade agreements and 21 investment protection and promotion agreements (bilateral investment treaties). The Gillard Government disavowed the future use of ISDS, however they were re-enlivened by the Abbott Government, and an ISDS clause has been used in the Investment Chapter of the widely-publicised Trans Pacific Partnership (TPP).[2]

In view of the current controversies surrounding the use of ISDS and the many amendments that have been introduced under the TPP in an attempt to 'modernise' the clause, an emerging issue is whether the modernisation of ISDS will ultimately result in the establishment of a permanent international investment court.

While these issues involve inherently difficult and competing political, economic and legal considerations that will likely take years for States to resolve through international trade negotiations, they also provide one of the more fascinating examples of the challenges faced by practitioners engaged in drafting complex dispute resolution clauses.

The problem

ISDS clauses are somewhat unusual in that they are 'one-way' clauses agreed between States that provide the investor of one State with the ability to sue another State in relation to an 'investment'. In this sense they are truly investor ⇨ State dispute settlement clauses. The proceeding is by arbitration, typically under the rules of an international institution,[3] with the appointment of an arbitrator by each party followed by appointment of a chairperson by the parties or their appointed arbitrators.

On the face of many ISDS clauses[4] they appear to provide an innocuous means through which an investor is able to protect or be compensated for an investment made in another State. The benefits of such a mechanism include encouraging foreign investment in that State by discouraging unlawful expropriation and providing a neutral forum for determination of the investment dispute without requiring the investor to resort to the State's domestic courts.

The use of ISDS has, however, come under heavy and widespread criticism because of what are perceived to be the practical realities of modern international arbitration, including high costs, low transparency, a limited pool of arbitrators, the lack of any rights of appeal and the potential for inconsistent and conflicting awards.

Criticism has also been levelled at the ability of foreign investors to bring claims that are not available to domestic investors (through international arbitration that is also not available to domestic investors), and the increasingly novel uses to which ISDS have been put by foreign investors, including to bring very large claims in response to legislative and regulatory changes made by States in areas of public concern such as health and the environment. The threat of such claims by foreign investors is said to affect the way in which States then regulate their domestic affairs, creating what has been described as a 'regulatory chill' on State conduct.

The change

During its participation in TPP negotiations, many of these criticisms were recognised by Australia and addressed as 'ISDS safeguards'.[5] The Australian Department of Foreign Affairs and Trade advises that these safeguards include:

1. explicit recognition that TPP parties have an inherent right to regulate to protect public welfare, including in the areas of health and the environment
2. a requirement that hearings will be open to the public, and that documents filed in the arbitration, as well as the tribunal's decision, will be made public
3. a right for any TPP party that is not involved in an ISDS case to make oral and written submissions
4. the ability to permit submissions from interested individuals, including from civil society and non-governmental organisations
5. rules preventing a claimant pursuing a claim in parallel proceedings, such as before an Australian court
6. expedited review of claims that are baseless, or manifestly without legal merit
7. interim review and award challenges
8. a requirement for arbitrators to comply with rules on independence and impartiality, including on conflicts of interests.

These amendments form part of the 'modernisation' of ISDS clauses, which has been gradual but extensive. This has seen the incorporation of a single ISDS clause in early free trade agreements and bilateral investment treaties evolve to become what are now many clauses, sub-clauses and annexures that together comprise a highly complex and lengthy ISDS mechanism. Paradoxically, these amendments bring with them the potential for new disputes regarding their interpretation.

At a procedural level, many of these amendments will result in a shift away from traditional international arbitration conducted on a confidential basis between only those parties directly involved in the dispute. Indeed many of these changes point more towards the proceedings of a court, and the prospect that States might agree to establish an international investment court is now a live issue in countries such as Canada and the members of the European Union.

On 16 September 2015,[6] the European Union announced its approval of a proposal to establish the 'Investment Court System' to replace existing ISDS mechanisms in all ongoing and future EU investment negotiations. On 12 November 2015, the EU formally presented to the United States its proposal for such an Investment Court System as part of the current EU-US talks on a Transatlantic Trade and Investment Partnership (TTIP).[7]

Will international investment courts replace ISDS arbitration to resolve disputes between foreign investors and States? Report by **Liam Prescott** and **Arndt Herrmann**.

The Investment Court System is said to be "built around the same key elements as domestic and international courts, it enshrines governments' right to regulate and ensures transparency and accountability". The system will involve a first instance tribunal and an appeal tribunal composed of fully qualified judges. The EU has indicated that, in addition to establishing this system, it will start work, together with other countries, on setting up a permanent International Investment Court to replace ISDS mechanisms in trade and investment treaties, including between non-EU countries.

Change for the better or change for change's sake?

The problems faced by States in designing a regime that encourages and protects foreign investors but does not go so far as to elevate their rights above State interests and domestic investors has seen States continually amend ISDS clauses to such an extent that they are virtually unrecognisable from their predecessors and are arguably now so complex as to inhibit their intended purpose and use.

This has led to some States rethinking the design of the mechanism itself and, in considering all options, proposing the creation of a specialist investment court as a preferred forum through which many of the current challenges might be overcome.

The irony of a public international court evolving from treaty arbitration will not be lost on those engaged in the drafting lifecycle of ISDS clauses, but if the result is an improvement and extension of present options then it should be seriously considered by States including Australia as a welcome addition to the existing body of alternative dispute resolution vehicles.

This article appears courtesy of the Queensland Law Society Alternative Dispute Resolution Committee.
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Notes

1 Trans Pacific Partnership (announced 5 October 2015), China-Australia Free Trade Agreement (announced 17 November 2014), Japan-Australia Free Trade Agreement (announced 8 July 2014), Korean-Australia Free Trade Agreement (announced 8 April 2014).

2 See 'Trans-Pacific Partnership Agreement' – Chapter 9 (Investment), Section B: Investor-State Dispute Settlement (dfat.gov.au).

3 Such as the ICSID (International Centre for Settlement of Investment Disputes) Convention and the ICSID Rules of Procedure for Arbitration Proceedings.

4 See for example Article 10 (Settlement of Investment Disputes) of the 1993 'Agreement between the Government of Australia and the Government of Hong Kong for the Promotion and Protection of Investments'.

5 Ibid 2 – FTA outcomes and background documents > Outcomes: Investment.

6 See 'Commission proposes new Investment Court System for TTIP and other EU trade and investment negotiations' (europa.eu/rapid/press-release_IP-15-5651.en.html).

7 See 'EU finalises proposal for investment protection and Court System for TTIP', europa.eu/rapid/press-release_IP-15-6059_en.htm.