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ALTERNATIVE DISPUTE RESOLUTION SYMPOSIUM

Investor-State Arbitration as Part of the International Rule of Law

CHRISTIAN TIETJE — 4 July, 2016

Investor-state arbitration is not only the most heated topic discussed in international economic law, but it also has become an important political issue more generally. Indeed, it is amazing to see how a topic that, some years ago,

omic lawyers and very few academics has emerged today as an issue on which everybody has an opinion. Moreover, there seems to be only one direction that all participants of the debate follow: investor-state arbitration or, as it is usually called, investor-state dispute settlement (ISDS) is an evil, is in violation of principles of constitutional law and democracy, is an instrument exclusively for profit-seeking companies and

lawyers without social commitments, is “private” in nature as opposed to public court proceedings, and, because of all this, needs to be abolished as soon as possible.

Much has already been written and said about ISDS and investment protection, unfortunately not always on a very objective basis. This is not the place to reconstruct the entire debate. Instead, only a very limited number of arguments shall be presented in order to explain the rationale and legitimacy of investment protection and ISDS in a broader constitutional and public international law context.

The overall rationale of international investment agreements (IIAs) is well known: the legal and economic relationship between the foreign investor and the host state of the investment is usually not protected by public international law. Thus, in many cases, there are no restrictions on the host state to change its domestic laws to the detriment of the foreign investor. Moreover, due to the lack of international rules, the home state of the investor usually has no or very limited avenues for diplomatic protection (for a classical example, see the Anglo-Iranian Oil Company case). This corresponds to a situation in constitutional law visible in many jurisdictions: reflecting public international law, domestic constitutions often fall short of extending constitutional rights to foreign investors. They differentiate between the protection of citizens and foreigners. This is even more frequently true with regard to judicial/legal persons. If legal persons are granted constitutional rights, the rights are usually restricted to domestic legal persons. Art. 19 (3) of the German Constitution is a good example in this regard. It reads as follows: “The basic rights shall also apply to domestic artificial persons to the extent that the nature of such rights permits.” Moreover, the legal person is usually

not subject to any international human rights protection. With the notable exception of the European Convention on Human Rights, international human rights instruments do not apply to legal persons. As the Inter-American Human Rights Commission in a report from 1999 stated: "[t]he Convention grants its protection to physical or natural persons. However, it excludes from its scope legal or artificial persons, since they represent a legal fiction." (Report Nº 106/99, para. 17).

It is thus obvious that there is a gap in international and domestic constitutional law with respect to the legal protection of foreign investors in comparison to domestic investors. Granting investment protection by IIA is thus not per se providing "better rights" to foreign investors, but first of all only filling a legal gap in international and domestic constitutional law, i.e., leveling the playing field between foreign and domestic investors. By the same token, this gap is the rationale for investment arbitration.

Investment arbitration is usually not an "alternative" dispute resolution mechanism, but the only enforceable legal means for the foreign investor to protect his or her investment. International law is, in many cases, not applicable in domestic courts. This might be the result of the lex posterior rule as to "later" domestic law affecting foreign investors' interests, or of a general exclusion of the applicability of international law. A good example in this regard is the regular practice of the European Union (EU) regarding the conclusion of free-trade agreements (FTAs). All FTAs with or without investment chapters the EU has concluded during the last 10 years or so and also the currently discussed drafts of CETA, EU-Vietnam etc. contain an explicit provision specifying that the respective agreement is not directly

applicable before domestic courts (for details see Semertzi, CMLR 2014, pp. 1125–1158).

Moreover, there is no monopoly of the state to organize dispute settlement procedures in domestic courts. To the contrary, as the ECtHR just recently underlined again, arbitration is an exercise of individual freedom as a human right (see ECtHR, Tabbane v. Switzerland (application no. 41069/12), Judgment of 24 March 2016). This applies equally to commercial arbitration and ISDS. The involvement of the state as a party to arbitration and thus of public interests as the subject of the arbitral proceeding, does not change this, as demonstrated by the recognition of arbitration as a means of dispute settlement in domestic administrative law and by the many cases in which the state is suing private economic entities before domestic or international arbitral tribunals (for examples see here and here).

One of the biggest myths in this regard is the idea that investment arbitration is conducted by "private" tribunals. Investment arbitration is usually based on an arbitration clause which is part of an investment treaty between two or more states. Investment arbitration is therefore per definitionem public arbitration or at least some kind of sui generis arbitration (for details see here). With respect to public interests in this kind of arbitration, it is not arbitration that is the problem; problems that might occur in this context are an issue of substantive, applicable law. It is the respective applicable law that needs to reflect public interests.

Even though the general idea of not only commercial, but also investment arbitration is the exercise of party autonomy in areas in which there is no monopoly of domestic courts,

specific rules are necessary to reflect the importance of public interests at stake. Most important in this regard is transparency. To this end, the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration of 1 April 2014 and the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration are important reform developments, even though the Convention on Transparency has so far only been ratified by one state (Mauritius).

Next to transparency, an essential element of the legitimacy of arbitration is the insurance of equal rights for both disputing parties. The possibility for both parties to autonomously appoint an arbitrator is an important aspect of this. This also applies to a court system of arbitration. German Courts currently question the legality and legitimacy of the Court of Arbitration for Sport (Lausanne) because athletes have less influence on appointing potential arbitrators than sports associations (see the decision of the OLG Munich in the Pechstein case). If one applies this rationale to the Court system of investment arbitration as proposed by the EU and already implemented in the FTAs of the EU with Canada and Vietnam, it is obvious that respective arbitral awards under the new system will face legal challenges.

In sum, any discussion on ISDS must be framed within the broader picture of international investment protection in general. Even though investment arbitration as we know it today is comprehensively accessible to the public (see here for a comprehensive database) and subject to very strict scrutiny regarding the independence of the arbitrators, there is no doubt that the system – just as any legal system – is in periodical need of reform. The EU has recently tabled

convincing reform proposals, namely with regard to substantive investment protection, even though the proposed investment court system, which remains a system of arbitration, raises legal questions. While discussing these and other reform proposals, one should not forget that arbitration is essentially, and must remain, an exercise of individual freedom and be based on an equal footing of the parties involved.

A response to this post can be found here.

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