Special Issue: Critiques of Investment Arbitration Reform

An Introduction

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The last decade has seen escalating criticism of international investment arbitration.[1] Even actors central to the functioning of the investment arbitration regime, and often profiting from it, now accept a need for change.[2] Despite this vital debate, the number of arbitration claims each year is increasing and States continue to sign investment treaties with arbitration clauses. Moreover, in an apparent effort to salvage the treaties, insiders have taken leadership of the 'reform' discourse purportedly aimed at curing the regime's flaws.[3] Various reform initiatives are underway or have been introduced, most notably those of the UNCITRAL Working Group

[1] Gus Van Harten, *The Trouble with Foreign Investor Protection* (OUP 2020); Pia Eberhardt and Cecilia Olivet, 'Profiting From Injustice: How Law Firms, Arbitrators, and Financiers are Fueling an Investment Arbitration Boom' (Corporate Europe Observatory, 2012); Anil Yilmaz Vastardis, 'Investment Treaty Arbitration as Justice Bubbles' in Thomas Schultz and Federico Ortino (eds), *Oxford Handbook of International Arbitration* (OUP 2020) 617; Maria Laura Marceddu and Pietro Ortolani, 'What Is Wrong with Investment Arbitration? Evidence from a Set of Behavioural Experiments' (2020) 31 EJIL 405, 407; Sergio Puig and Gregory Shaffer, 'Imperfect Alternatives: Institutional Choice and the Reform of Investment Law' (2018) 112 AJIL 361; Michael Waibel and others, *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer Law International 2010).

[2] See Malcolm Langford and others, 'Special Issue: UNCITRAL and Investment Arbitration Reform: Matching Concerns and Solutions: An Introduction' (2020) 21 JWIT 167-187.

[3] See Gabrielle Kaufmann-Kohler and Michele Potestà, 'Concept Paper Project: Matching Concerns and Solutions' (Academic Forum on ISDS, 2019) <https://www.cids.ch/images/Documents/Academic-Forum/0_Introduction_to_project_-_Kaufmann-Kohler_Potest.pdf> accessed 25 April 2023; Piero Bernardini, 'Reforming Investor-State Dispute Settlement: The Need to Balance Both Parties' Interests' (2017) 32 ICSID Rev 38.

III,[4] International Centre for the Settlement of Investment Disputes (ICSID),[5] and the European Union, the latter mainly via its proposal for a multilateral investment court (MIC).[6] Under these processes, key areas of proposed reform include the consistency and correctness of legal analysis in awards; independence, impartiality and diversity of arbitrators; multiple proceedings; costs and third party funding; transparency; and assessment of damages. Yet some have criticised this focus on mostly procedural reforms at the exclusion of pressing challenges under the substantive standards and overall scope of investment treaties.[7]

While these initiatives are potential avenues for curbing some egregious failings of the regime, they also lend a veneer of legitimacy to maintaining arbitration as a preferred mode of dispute settlement in the field. That veneer gives cover for the many more claims which continue to be filed under the existing regime. Since the start of UNCITRAL WG III's current mandate on investor-State dispute settlement (ISDS) reform in 2017, at least 376 publicly known arbitrations have been initiated,[8] many of them concerning mineral and fossil fuel extraction disputes and, in some instances, questions of the regulatory capacity of States to safeguard their populations or even humanity.

As the world heads rapidly towards climate catastrophe, investment arbitration poses a major threat to State measures aimed at limiting and ameliorating climate disruption.[9] Besides curbing urgent government action, the regime is simply unfit to accord due consideration to

[4] UNCITRAL, 'Working Group III: Investor-State Dispute Settlement Reform' <https://uncitral.un.org/en/working_groups/3/investor-state> accessed 25 April 2023.
[5] ICSID Arbitration Rules as amended on 1 July 2022.
[6] European Commission Recommendation for a Council Decision Authorising the Opening of Negotiations for a Convention Establishing a Multilateral Court for the Settlement of Investment Disputes (13 September 2017) COM(2017) 493 final.
[7] Ksenia Polonskaya 'Metanarratives as a Trap: Critique of Investor-State Arbitration Reform' (2020) 23 JIEL 949-71; Gus Van Harten, Jane Kelsey and David Schneiderman, 'Phase 2 of the UNCITRAL ISDS Review: Why "Other Matters" Really Matter' (2019) Osgoode Legal Studies Research Paper 2; Alessandri Arcuri and Federica Violi, 'Human Rights and Investor-State Dispute Settlement: Changing (Almost) Everything, so that Everything Stays the Same?' (2019) 3 Diritti umani e diritto internazionale 579.
[8] UNCTAD Investment Dispute Settlement Navigator, updated as of 31 December 2021.
[9] Kyla Tienhaara and others, 'Investor State Disputes Threaten the Global Green Energy Transition' (2022) 376 (6594) Science 701-03.

the rights of those actors, such as local communities or, those who cannot bring claims in investment arbitration.[10] Reforms of investment treaties will not give these actors a status akin to that of foreign investors. Yet the unfairness of this matter, and the underlying urgency for the world, does not appear to affect those driving the reform processes to consider more radical alternatives.

Perhaps the greatest challenge of the current discourse of reform is its apparent assumption that investment arbitration is legitimate and desirable. This assumption avoids or downplays criticisms that are fundamental to the whole regime. On the UNCITRAL process, Polonskaya explains that it is the modus operandi of UNCITRAL reform to avoid most contested issues and to frame debates in narrow and procedural terms.[11] The futility of the limited reforms enacted in the last couple of decades, whether on substance (e.g. exceptions) or procedure (e.g. transparency[12] and third party participation[13]) offer ample evidence that the current reform mentality will not lead to meaningful change. New treaty provisions aiming to preserve the regulatory space of States have largely continued to produce the same outcomes, once they are interpreted by arbitrators.[14] Despite incremental reforms on transparency and third-party participation, investment arbitration remains largely opaque and local communities,

[10] Nicolás M Perrone, 'The International Investment Regime and Local Populations: Are the Weakest Voices Unheard?' (2016) 7 Transnational Legal Theory 383-405; Philipp Wesche, 'Rights of Nature in Practice: A Case Study on the Impacts of the Colombian Atrato River Decision' (2021) 33(3) Journal of Environmental Law 531–55.
[11] Polonskaya (n 7) 964.
[12] United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration (2014, entered in force 18 October 2017) (Mauritius Convention on Transparency); ICSID Arbitration Rule 48(4).
[13] ICSID Arbitration Rule 37(2).
[14] Wolfgang Alschner, *Investment Arbitration and State-Driven Reform: New Treaties, Old Outcomes* (OUP 2021) (argues that arbitrators are partly to be blamed for this outcome. Ultimately the problem is that older investment agreements continue to dominate interpretative reasoning in ISDS); See on environmental exceptions, *Eco Oro Minerals Corp v Colombia*, ICSID Case No ARB/16/41, Decision on Jurisdiction, Liability and Directions on Quantum (9 September 2021); J Benton Heath, 'Eco Oro and the Twilight of Policy Exceptionalism' (*IISD Investment Treaty News*, 20 December 2021) <https://www.iisd.org/itn/en/2021/12/20/eco-oro-and-the-twilight-of-policy-exceptionalism/> accessed 25 April 2023.

for example, at best have a chance to voice concerns in short amicus curiae briefs easily overlooked by tribunals.

Against this background, the contributors to this Special Issue have come together to challenge the existing reform narratives. The contributions collectively do four things. First, they consider the limitations of arbitration as a model for dispute settlement for investment disputes. Second, they examine key issues of 'reform' to draw out deeper flaws of the regime. Third, they identify fundamental considerations that are missing from or are undermined by the reform discussions. Fourth, they elaborate on why some paths for reform are unpromising even where the alternatives are not clear or ideal. Thus, the contributions offer an account of investment arbitration's flaws that goes beyond the frame of current reform in order to shift the focus from fixing a flawed system to understanding its fundamental limitations and challenging any wish to strengthen its legitimacy.

The Special Issue opens with Juan Carlos Boué's article on valuation of damages in investment arbitration. Academic scholarship, policymakers, and parties to investment disputes have dedicated a great deal of time and energy to assessing questions of jurisdiction and substantive standards, leaving compensation mostly as an afterthought. Boué reminds us how compensation is the essential aim and final culmination of investment arbitration, such that the flaws in valuation of damages are perhaps the most dangerous among all of its defects. He argues that the sheer magnitude of problems with valuation of damages is apparent from '[t]he ease with which investors craft "billion dollar claims created out of thin air"'[15] and from the frequency of tribunals endorsing calculations that would never hold true in real world business. The article traces the abusive usage of the discounted cash flow (DCF) method since investment arbitration's early days, abuse that has been exacerbated by subsequent methods,

[15] Juan Carlos Boué, 'The Investor-State Dispute Settlement Damages Playbook: To Infinity and Beyond' (2023) 24(3) JWIT XXX.

such as requests for certain types of pre-award interest. To demonstrate the severity of the challenge of valuation, Boué points to two cases, *Tethyan v Pakistan* and *P&ID v Nigeria*. These cases show how claimants and their experts have been allowed to exploit structural defects of investment arbitration to inflate compensation radically. The situation is so out of control, he argues, that it is unlikely to be fixed by reform. The only reasonable reaction is to exit the system.

Recently, Pakistan has suffered the devastating impacts of the worst floods in a decade, trigged by climate disruption and the putting of a third of the country under water.[16] In the meantime, Tethyan has been given a green light in US courts to enforce the USD 5.84 billion arbitration award against Pakistan.[17] The disjuncture between the urgent reality and a bent law is stark. Boué's analysis make the case for radical change to support Pakistan and its population. No country should be forced to pay billions to investors in a project that never came to be, when faced with the costs of an ongoing catastrophe of national and global dimensions.

The second article, by Deva and Van Ho, focuses on the relationship between investment arbitration and international human rights law. A notable criticism of investment arbitration is its incompatibility with human rights and, more recently, with climate action goals.[18] Yet, it remains for this overarching issue to be acknowledged in reform processes, which focus narrowly on improving 'features' of the system at the expense of the wider picture. Deva and Van Ho describe the responses to this criticism, in scholarship and awards, which focus on fitting human rights into the existing investment arbitration structure. Some of these responses have claimed a common heritage of international investment law and international

[16] Rahmat Tunio, '"We Are Drowning": Pakistan Floods Push Toxic Lake over the Edge' (*The Guardian*, 13 September 2022) <https://www.theguardian.com/world/2022/sep/13/pakistan-floods-lake-manchar-environmental-catastrophe> accessed 25 April 2023.
[17] *Tethyan Copper Company Pty Limited v Islamic Republic of Pakistan*, US District Court for the District of Columbia, Case no 1:19-cv-02424(TNM), Memorandum Opinion (10 March 2022).
[18] Tienhaara and others (n 9).

human rights law, arguing that that they are reconcilable. Others have proposed integrating human rights standards into investment treaties, arbitral interpretations, and processes for third-party participation. Deva and Van Ho flip this traditional approach by examining 'what it would entail to adopt instead a human-rights centred approach into which ISDS must fit.'[19] They begin by analysing the compatibility of investment arbitration with the human rights to equality, non-discrimination, and an effective remedy. The analysis shows an inherent tension between these core human rights and investment arbitration, which none of the existing reform proposals would overcome. According to Deva and Van Ho, international human rights law should be viewed as *primus inter pares* vis-à-vis international investment law, even if there is no formal hierarchy between the two regimes; the latter must integrate itself into the former, not vice versa. To achieve this, Deva and Van Ho argue that the current model of investment arbitration must be abolished so that a new system of dispute settlement, compatible with international human rights law, can be developed. They conclude by elaborating on the elements of a human rights-compatible model of dispute settlement for investment disputes.

Next, the Special Issue turns to the relationship of investment arbitration to local communities that have been harmed by investment projects. Investment arbitration has long been criticized for protecting foreign investors while treating local communities as invisible actors in investor-State disputes. Thus, it ignores harmful impacts of investment projects on the rights of local communities and the environment just as it rewards investors with compensation in spite of the harm they have caused.[20] The relationship between investment arbitration and local communities is on the radar of reform processes. Yet, the solutions proposed, primarily greater participation through amicus curiae,[21] fall well short of accounting

[19] Surya Deva and Tara Van Ho, 'Addressing (In)equality in Redress: Human Rights-Led Reform of the Investor-State Dispute Settlement Mechanism' (2023) 24(3) JWIT XXX.
[20] Federico Suárez Ricaurte, 'Two Tiers and Double Standards: Foreign Investors and the Local Community of La Guajira, Colombia' (2022) 19 Globalizations 854-64.
[21] EU Proposal for MIC (n 8).

for local community interests. As Nicolás Perrone explains in his contribution on this theme, local community opposition to large scale projects – harmful to livelihoods and the environment – often lead to modification, delay or cancellation of the projects and, in turn, to investor claims for compensation.[22] Perrone argues that the role of local communities is not merely a procedural matter that can be fixed by allowing amicus curiae submissions or greater community participation in dispute resolution. He argues that ISDS processes do not merely resolve investment disputes, but also shape the conditions and knowledge-making processes which influence the livelihoods of communities. Perrone introduces claims of recognition into the relationship between investment arbitration and local communities. Besides questions of material distribution of resources, he explains, investment arbitration also displaces local culture, tradition and ways of life. This impact amounts to an ontological occupation of territories. Using *Bear Creek v Peru* and *Gabriel Mining v Romania* as case studies, Perrone argues that investment arbitration is inherently unsuitable as a forum to resolve local claims of recognition due to its adversarial nature and adherence to a proportionality standard. Instead of reforming investment arbitration and maintaining the existing one-way adversarial regime, a new model of investment governance should be developed to ensure local participation before, during and after investment projects. According to Perrone, the only way forward is to embed local values and organisation into investment projects themselves.

Focusing on more specific issues of potential reform, Garcia and Güven's contribution tests the EU's MIC proposal against well-established principles of procedural justice.[23] To its credit, the EU has emerged with a more substantial institutional alternative than the UNCITRAL and ICSID reform processes, which focus primarily on improving aspects of the

[22] Nicolás M Perrone, 'Investment Treaty Law and Matters of Recongnition: Locating the Concerns of Local Communities' (2023) 24(3) JWIT XXX.
[23] Frank J Garcia and Brooke S Güven, 'Designing a Multilateral Investment Court for Procedural Justice' (2023) 24(3) JWIT XXX.

existing arbitration model. The MIC would be a permanent dispute settlement body with a first instance and an appeal tribunal, and with tenured judges.[24] It is meant to adhere to full transparency, allow third party interventions, improve independence and impartiality of adjudicators, and improve cost effectiveness. Yet this more wholesome reform has also been criticized as falling short of addressing the most problematic aspects of investment arbitration and further entrenching the logic of privileging foreign investors in international and national venues for governance.[25] Garcia and Güven acknowledge that procedural reform solutions fall short of addressing the systemic problems of investment arbitration for sustainable development. However, the reforms that are under way, even if procedural or institutional, may still achieve fundamental shifts Garcia and Güven argue that empirical insights from procedural justice research can help States in determining the acceptable limits of negotiation and compromise toward a MIC. While, from this perspective, the EU's proposal fares well on independence, impartiality, and transparency, it falls short on participation and error correction. A key reform that could improve the proposed reforms on these issues is the introduction of a requirement to exhaust local remedies. Such a requirement would allow opportunities for third parties, such as local communities, to participate in the proceedings directly and from the outset. On error correction, Garcia and Güven propose to complement the local remedies requirement with a single tier international court system instead of the MIC's two-tier model. On participation, they recommend further that the MIC needs to go beyond amicus participation since a heightened level of participation may be warranted where disputed issues impact third parties directly.

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[24] EU Proposal for MIC (n 8).

[25] CCSI, 'Position Paper in Support of Opinions Expressed in Response to the European Commission's "Public Consultation on a Multilateral Reform of Investment Dispute Resolution"' (15 March 2017) <https://ccsi.columbia.edu/sites/default/files/content/docs/publications/CCSI-EU-Court-public-consultation-submission-15-Mar-17-FINAL.pdf> accessed 25 April 2023; Anil Yilmaz Vastardis, Justice Bubbles for the Privileged: A Critique of the Investor-State Dispute Settlement Proposals for the EU's Investment Agreements (2018) 6(2) London Review of International Law 279-97.

The Special Issue closes with a shorter article focusing on third-party funding by Davitti and Vargiu. The role of third-party funding in investment arbitration has attracted much debate in recent years.[26] The role of these ostensibly silent actors in investment arbitration has been criticized primarily as encouraging frivolous claims and creating an imbalance among participants, for giving rise to conflicts of interests and influencing claimant strategy and settlement outcomes. Third-party funding has been identified as an area of concern by the UNCITRAL WG III. Reform options outlined include prohibition or regulation of third-party funding. The latter include disclosure of third-party funding and conditions on its provision. Davitti and Vargiu's article provides a fresh perspective to this debate. Taking a step back from the cosmetic reform options, they mount a fundamental critique against uses of third-party funding in investment arbitration by analysing its metamorphosis into an investable asset class as part of a broader pattern of assetization of access to justice. Behind the access-to-justice rhetoric often used by third-party funders, Davitti and Vargiu argue, is opportunity for profit not dissimilar from any other speculative investment. They explain that unlike more traditional modes of third-party funding, the introduction of private equity and hedge funds through financing of claims 'expands the spectrum of speculation'.[27] While access to justice has long been commodified, the modern models of third-party funding have consolidated it into an asset class in its own right, with investment arbitration promising the largest returns on investment and biggest stakes for speculation. This process, they argue, is part of a broader pattern of assetization of global public goods and of the emerging Wall Street Consensus. According to Davitti and Vargiu, the reform agenda has ignored these substantial issues at the core of third-

[26] Brooke Guven and Lise Johnson, 'The Policy Implications of Third-Party Funding in Investor-State Dispute Settlement' (May 2019) <https://ccsi.columbia.edu/sites/default/files/content/docs/our%20focus/extractive%20industries/The-Policy-Implications-of-Third-Party-Funding-in-Investor-State-Disptue-Settlement-FINAL.pdf> accessed 25 April 2023.

[27] Daria Davitti and Paolo Vargiu, 'Litigation Finance and the Assetization of International Investment Arbitration' (2023) 24(3) JWIT XXX.

party funding that allow large amounts of capital flowing to third-party funding 'from institutional investors who do not even know what claim their money supports, but who will have far more rights in the proceedings than the affected local communities.' According to Davitti and Vargiu, reform is not a panacea to the legitimacy concerns posed by third-party funding in investment arbitration.

Concluding remarks

The articles in this volume have not reviewed and assessed every investment arbitration reform effort. It is acknowledged that some reforms may make positive contributions, or display weaknesses, beyond the themes and case studies of this volume. However, the contributions together support a message that 'reform' of investment arbitration misses many important considerations.

Even the more ambitious proposals, led by the EU's MIC proposal, have difficulty satisfying principles by which they must be evaluated to deliver on promises of procedural justice. Wider efforts to develop exceptions to the thrust of foreign investor protection and privilege have wide-ranging gaps and uncertainties. A comparison to international human rights law, assuming the primacy of this corpus of human legal achievement over that of asset and wealth protection, sees little future for investment arbitration in its current form and forum. The latter regime affords disturbing opportunities for litigation speculators, not to say parasites, of the financial system to undermine and bankrupt the State as a forward-looking regulator and arbiter of risk which accounts, at least partially, for the needs of most people. Arbitral awards are clearly out of control, most obviously for their size and fanciful notions of investor compensation, but also for their disregard of principles of judicial prudence in relation to budgeting and the need to balance individualist wealth protection against priorities for collective wellbeing and survival. Where the treaties and arbitrators have lost sight of the inter-

connections between business, on the one hand, and the communities and societies in which it exists, on the other, they are themselves little more than a doomed, if dangerous and harmful, investment project.

When the regime fails, so too will timid and gradualist reforms. As forecast by the contributors here, investment arbitration should be retired so the manner of resolution of investment disputes can be redesigned, initially at the national or regional levels, in ways that are freed from a 25-year legacy of investor-centred imbalances.