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Three Dimensions of Inequality in International Investment Law

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Executive Summary

- This paper puts the system of international investment law into its historical context, examines economic data as well as most recent statements of states on inequalities in international investment law. It examines inequalities between foreign investors and states, between developed and developing states as well as between foreign and domestic investors. It shows that each dimension of inequality has its own *raison d'etre* and proposes ways to tackle them in the context of today's political and economic realities.

- First, this paper asserts that the international investment law's asymmetric model giving the foreign investor only rights and the host state only obligations no longer reflects the new economic and political realities. The equilibrium between corporate and state actors has significantly shifted and international investment law should be reformed accordingly. The existing model furthers the accumulation of wealth and capital in the Global North and the concentration of corporate power.

- Second, the paper shows that in theory, both developing and developed states should be able to equally benefit from international investment agreements. However, in practice, this system disproportionally benefits states in the Global North (capital-exporting states, law firms and arbitrators) while those in in the Global South (primarily developing States) are struggling to find expertise and resources to cope with the influx of investor-state disputes.

- Third, the original idea that host states may discriminate against foreign investors is still valid in many cases. However, states are increasingly concerned about the less favourable treatment of their domestic investors, compared to foreign investors, both on procedural and substantive levels.

- Finally, the paper recommends several measures to reduce inequalities in international investment law. Reform of the system should tackle the lack of accountability of economically powerful corporations, enduring legacies of colonialism in economic development, as well as give states a greater say on their public policies aimed at protecting human rights, environmental standards, strengthen the rule of law and reduce inequalities.

- More specifically, the paper proposes to give greater prominence to the law of host states as applicable law. Further, to widen the inclusion in international investment agreements obligations of the investors related to labour rights, human rights, environmental standards and corruption. It also calls for more effective mechanisms allowing states to assert claims and counterclaims against investors and for measures to reduce the cost and length of investor-state disputes. Finally, it emphasizes the need to strengthen the capacity of states to avoid and better handle investor-state disputes.

1. Introduction

Historically, the system of international investment law was supposed to tackle the inequality between weaker foreign investors and all-powerful states after World War II. However, today foreign investors are often economically more powerful than the states and domestic investors while the system remains largely unreformed. This paper examines and puts into a historical perspective three dimensions (3D) of inequality in international investment law: between investors and host states, developed and developing states as well as between foreign and domestic investors.

Economists are still disputing whether foreign investments have any meaningful effect on inequality,[1] widen[2] or reduce it.[3] In theory, foreign investments may help alleviate inequality, leading to an increase in the pay of low income workers and new tax revenue.[4] Foreign direct investments also constitute the largest source of external finance for developing states.[5] But on the other hand, investors may engage in abusive practices undermining competition,[6] crowding out domestic firms,[7] engage in breaches of labour, human rights and environmental standards,[8] siphon capital avoiding taxation and resources from the host state[9] and in other ways limiting their space for policy decisions aimed at reducing inequality.

What is rarely disputed, however, is that international investment law has become a highly controversial area of international law, both in developed and developing states. In particular, investor-state arbitration has been labelled as an instrument which perpetuates the present inequalities between the rich and the poor through 'an alliance between the States, international capital represented by multinational firms and international legal firms which advise them.'[10]

The author wishes to thank Naina Gupta for her research assistance.

1 K. Sylwester, 'Foreign direct investment, growth and income inequality in less developed countries', International Review of Applied Economics 19 (3) 289-300 (2005).

2 F. Jaumotte, S. Lall & C. Papageorgiou, 'Rising Income Inequality: Technology or Trade and Financial Globalization?' (2008) IMF Working Papers 08/185, available https://www.imf.org/external/pubs/ft/wp/2008/wp08185.pdf.

3 B. Sharma & J. Abekah, 'Foreign Direct Investment, Foreign Aid and Incomes Inequality: Empirical Insights from African and South American Countries', 9 Transnational Corporations Review 1-7 (2017).

4 L. Sachs & L. Johnson, 'Investment Treaties, Investor-State Dispute Settlement and Inequality: How International Rules and Institutions Can Exacerbate Domestic Disparities', CCSI Working Paper 2019 Investment Treaties, Investor-State Dispute, 1–6 (2019).

5 According to UNCTAD, foreign direct investment make up 39 per cent of total incoming finance in developing economies as a group, World Investment Report 2019, UNCTAD, 'Key Messages and Overview', Page xi, available at https://unctad.org/en/PublicationsLibrary/wir2019_overview_en.pdf.

6 See, e.g., *EDF v. Hungary*, UNCITRAL, Award, December 4, 2014; *Teco v. Guatemala*, ICSID Case No. ARB/10/23, Award, December 19, 2013.

7 G. Chena, Y. Yaob, J. Malizard, 'Does FDI Crowd In or Crowd Out Private Domestic Investment in China? The Effect of Entry Mode,' 61 Economic Modelling 409 (2017).

8 See, e.g., *Bilcon v. Canada*, PCA Case No. 2009-04, Award on Jurisdiction and Liability, March 17, 2015.

9 See, e.g., *Murphy Exploration and Production Co. v. Ecuador*, Permanent Court of Arbitration, Award, February 10, 2017; Sachs & Johnson, *supra* note 4, 1–6.

10 M. Sornarajah, 'Power and Justice in Foreign Investment Arbitration', Journal of International Arbitration, 14(3), 103–140 (1997).

From the political left, investor-state arbitration is described as 'corporate courts [giving] multi-national companies special treatment while stifling [local] workers'.[11] From the political right, it is criticized for allowing foreign investors to bypass local courts and seek damages from what the current US Trade Representative Robert Lighthizer described as 'three guys in London.'[12] Another argument is that foreign corporations try to get compensation from the taxpayers' pockets rather than from purchasing political risk insurance.[13]

The United Nations Commission on International Trade Law (UNCITRAL) has established a special Working Group III on Investor-State Arbitration while the World Bank's International Centre for Settlement of Investment Disputes (ICSID) is in the process of reforming its Arbitration Rules. As this paper demonstrates, states often raise the issue of inequality in international investment law but this has not yet been systematically addressed in the reform efforts promoted by these institutions.

The paper contributes to the literature by analysing how international investment law could reduce inequalities in wealth and power between investors and host states, developed and developing states as well as between foreign and domestic investors.

Although institutions such as UNCITRAL and ICSID currently try to reform the system of international investment law and dispute resolution, the inequalities have not yet been systematically addressed by these institutions and in academic literature. The main contribution of the paper is that it examines historical reasons of inequality in the light of current economic and political developments and proposes specific solutions to address them.

This study is informed by the author's experience participating in high-level meetings of the UNCITRAL Working Group III on the reform of investor-state disputes. The findings and more detailed recommendations will be communicated to the Working Group III, states and other relevant stakeholders.

11 E. Warren, 'Warren Urges U.S. Trade Rep to Remove ISDS Provisions During Next Round of NAFTA Negotiations', 19 September 2017, available https://www.warren.senate.gov/newsroom/press-releases/warren-urges-us-trade-rep-to-remove-isds-provisions-during-next-round-of-nafta-negotiations.
12 N. Philipps, 'Making NAFTA Nationalist', National Review, 12 March 2019, available https://www.nationalreview.com/2019/03/usmca-investor-state-dispute-settlement-corporate-welfare.
13 Ibid.

2. Inequality between foreign investors and states

International investment law emerged in an age when the corporate power was weaker and the power of states stronger than today. It was the foreign corporation, often operating in environments with a weak rule of law, rather than the host state or its population, which needed special protections.[14] States viewed diplomatic protection as inadequate for safeguarding foreign investors, not least because they were often unwilling to espouse claims of private investors.[15]

Indeed, sovereign states, particularly those with a weak rule of law, can cause serious problems to foreign investors. For example, if a foreign investor is accused of bribery, the state acts both as an investigator (through its prosecutors), as an adjudicator and an enforcer (through its courts and bailiffs) and its officials themselves may be engaged in committing bribery.[16] From this point of view, the idea of balancing the power of states *vis-à-vis* foreign investors and adjudication of disputes by neutral experts is logical.

According to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), in the absence of an agreement on applicable law, investor-state tribunals should apply the law of the host state and such rules of international law as may be applicable.[17] In practice, however, states increasingly view the system of international investment law as based on vague standards and lacking legal certainty which results in long and costly proceedings.[18] Host states often argue that they are struggling with finding the expertise to deal with investment claims

14 ICSID, Convention on the Settlement of Investment Disputes between States and Nationals of Other States: Documents Concerning the Origin and the Formulation of the Convention, Volume II-1 Part 1 240 (1968); Y. Kryvoi, 'The Path of Investor-State Disputes: From Compensation Commissions to Arbitral Institutions', ICSID Review, Foreign Investment Law Journal, Volume 33, Issue 3, 743, 749-150 (2018).

15 C. Schreuer, L. Malintoppi, A. Reinisch & A. Sinclair, *The ICSID Convention: A Commentary* 6 (2009); S. Franck, 'Empirically Evaluating Claims about Investment Treaty Arbitration' 86 North Carolina Law Review 1, 10-11 (2007); ICSID, *supra* note 14, 242; UNCTAD Series of International Investment Agreements II, 2014, 23, available https://unctad.org/en/PublicationsLibrary/diaeia2013d2_en.pdf.

16 Y. Kryvoi, 'Economic Crimes in International Investment Law', International & Comparative Law Quarterly 67.3 (2018): 577-605.

17 Article 42 of the ICSID Convention.

18 A. Roberts & Z. Bouraoui, UNCITRAL and ISDS Reforms: Concerns about Costs, Transparency, Third Party Funding and Counterclaims, 6 June 2018, https://www.ejiltalk.org/uncitral-and-isds-reforms-concerns-about-costs-transparency-third-party-funding-and-counterclaims/ (discussing statements of various states on the lack of legal certainty and the link between lack of consistency and cost of proceedings).

and have to rely on expensive Western law firms.[19] This shortage of expertise and resources particularly affects less economically developed states.[20]

Today, over 3,000 international investment agreements impose obligations on states to protect certain standards of treatment of foreign investors, usually without imposing on them any obligations. Foreign investors benefit not only from special international norms favouring them but also from the lack of regulations imposing obligations on them in areas such as taxation, human rights, labour and environmental obligations.[21]

Since the 1960s, when the modern system of international investment law has emerged,[22] the equilibrium between private investors and states has shifted. Critics argue that it was the ideology of neoliberalism, which has led to the domination of large oligopolistic transnational corporations in the world economy and the demise of small, entrepreneurial firms, which undermined competitive markets.[23] Between 1960 and 2019, the nominal revenues of the US 500 largest companies have grown 70 times.[24] By contrast, the GDP of low-income states have only increased six-fold during the same period.[25] In other words, the concertation of corporate power has greatly exceeded the pace of development of many states.

Foreign investors have significantly expanded the scope of their activities, crossing the boundaries of what was traditionally considered the domain of the state. International and domestic law shielded them from intervention allowing them to grow to sizes previously considered anti-competitive.[26] Developing

19 See, e.g., Possible reform of Investor-State dispute settlement (ISDS), Comments by the Government of Thailand A/CN.9/WG.III/WP.147, 11 April 2018 available https://undocs.org/en/A/CN.9/WG.III/WP.147 paras 15-17 ('Developing countries often lack experience in ISDS cases and do not have in-house lawyers specialized in ISDS. They consequently have to rely heavily on legal services provided by external counsel… international law firms specializing in ISDS [which] are not necessarily familiar with developing countries' procedures, mindset and methodology of work…')

20 See, e.g., Possible reform of investor-State dispute settlement (ISDS), Submission from the Government of Mali, 17 September 2019 available http://undocs.org/en/A/CN.9/WG.III/WP.181 ('African States find themselves involved in arbitral proceedings, often without being sufficiently prepared, given the lack of a strategy document for negotiations, with only limited expertise in complex legal issues.')

21 See, e.g., Possible reform of Investor-State dispute settlement (ISDS), Submission from the Government of South Africa, A/CN.9/WG.III/WP.176, 17 July 2019, available at http://undocs.org/en/A/CN.9/WG.III/WP.176 ('There are no binding international obligations for multinationals on human and labour rights as well as environmental protection and affected individuals and communities have no recourse to international justice when multinationals violate their rights.')

22 The first ever bilateral investment treaty (between Germany and Pakistan) was concluded in 1959 and the ICSID Convention, the basis for the majority of investor-state disputes entered into force in 1966.

23 T. Hathaway, 'Neoliberalism as Corporate Power', Competition & Change 4-6 (2020).

24 To be more specific, it has grown from US$197.4 billion to US$ 13.7 trillion. Fortune 500, 1960, available https://archive.fortune.com/magazines/fortune/fortune500_archive/full/1960; Fortune 500, 2019, available https://fortune.com/fortune500.

25 It has grown from US$ 97.228 billion to US$ 588.23 billion. The World Bank, GDP (current US$) - Low income, available https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&locations=XM&start=1988.

26 Hathaway, *supra* note 23.

states acknowledge the lack of the necessary expertise to effectively regulate foreign investors lead to inefficient coordination among relevant national agencies and reliance on Western law firms in investor-state disputes.[27]

Moreover, the ability of states to assert claims or counterclaims against investors remains limited[28] as tribunals focus on issues directly related to foreign investments in the absence of explicit consent from the investors.[29] Asserting claims or counterclaims against foreign investors is particularly difficult because investment treaties usually impose no obligations on investors.[30] Moreover, the principle of limited liability can effectively insulate the ultimate owner from having to pay as tribunals and courts remain reluctant to pierce the corporate veil.[31] Even if a state wins a case, it still has to pay significant amounts of money for the services of representing them.[32]

In this context, a number of states have limited or completely moved away from the system of investor-state disputes explaining it by the unfair asymmetry between corporations and host states. For example, South Africa moved away from the system allowing investors to assert claims directly against states to a state-to-state dispute settlement system.[33] Bolivia, Venezuela and Ecuador explained their decisions to denounce the ICSID Convention and move away from investor-state arbitration by the rhetoric of standing up to the pressure of big multinational companies.[34]

27 Thailand's submissions to UNCITRAL, *supra* note 19, paras 15-17.

28 Submission from the Government of South Africa to UNCITRAL, *supra* note 21.

29 See, e.g., Y. Kryvoi, 'Counterclaims in investor-state arbitration', 21 Minnesota Journal of International Law 216 (2012); T. Ishikawa, 'Counterclaims and the Rule of Law in Investment Arbitration', 113 AJIL Unbound 33 (2019).

30 Submission from the Government of South Africa to UNCITRAL, *supra* note 21 ('people and communities harmed by foreign investments do not have clear mechanisms to claim justice and reparation. Their rights are subject to a system driven by purely private commercial reasoning prompted to award cases exclusively focused towards serving the private economic interest of investors.')

31 Kryvoi, *supra* note 29.

32 See, e.g., Submission from the Government of South Africa to UNCITRAL, *supra* note 21 ('dispute settlement clauses carry significant financial costs for governments particularly the developing countries whose fiscal position can be seriously affected even when cases have been discontinued or when the outcome is said to be in favor of the state.')

33 Ibid.

34 Reuters, 'Latin Leftists Mull Quitting World Bank Arbitrator', 30 April 2007 (quoting the President of Bolivia Evo Morales '[We] emphatically reject the legal, media and diplomatic pressure of some multinationals that ... resist the sovereign rulings of countries, making threats and initiating suits in international arbitration'); Delcy Rodríguez, Vice President of Venezuela, 1 August 2019, https://twitter.com/ActualidadRT/status/1156747878431256576 ('We denounce to the world that this is a transnational organized crime operation to steal Venezuela's resources.'); Rafael Correa, Informe Semanal, May 2009, available at https://www.lostiempos.com/actualidad/economia/20090531/correa-anuncia-demanda-contra-ciadi (explaining that denouncing the ICSID Convention 'must be faced for the liberation of our countries, because this means colony, slavery vis-à-vis transnational corporations, vis-à-vis Washington, vis-à-vis the World Bank, and we cannot continue to tolerate that.')

3. Inequality between developing states and developed states

As a matter of law, investors from any state can equally benefit from protections offered by international investment agreements. However, in practice investors from developed capital-exporting states are much less likely to use from the system than poor capital-importing states.

Allowing foreign investors to assert claims against states was historically justified by the lack of adequate domestic laws to protect foreign investors, which required a better standard of protection.[35] In the absence of well-developed domestic law, general principles of law were supposed to apply to fill the *lacunae*.[36] Most of the time, developing states still simply follow the model treaty of the developed state because they lack legal expertise or political power to insist on provisions favourable for them.[37]

Economic data suggests that most foreign direct investments come from developed states, which are often labelled as the Global North. For example, in 2019, 75 of the world's top 100 companies by market capitalisation are based in Western Europe and North America, with the rest mostly based in middle-income states such as South Africa and China.[38] In addition, a significant part of investments between developing states is ultimately owned by transnational companies from developed states.[39]

It is therefore not surprising, that investors from developed, capital-exporting states of Western Europe and North America bring the vast majority of investor-state claims[40] while the largest share of respondents in cases administered by the ICSID comprises of states from Eastern Europe and Central Asia and South America.[41] At the same time, the vast majority of those appointed as arbitrators are

35 See a discussion of this Sornarajah, *supra* note 10, 110-115.

36 Lord NcNair, General Principles Recognized by Civilized Nations (1957) 33 BYIL p. 1 (citing The Aramco Arbitration (1958) 27 ILR 117; The Qatar Arbitration (1953) 20 ILR 534; The Abu Dhabi Arbitration (1958) 27 ILR 117. In the latter case, Lord Asquith said: 'This is a contract made in Abu Dhabi and wholly to be performed in that country. If any municipal system of law were applicable, it would prima facie be that of Abu Dhabi. But no such law can reasonably be said to exist.' All these awards contain similar dicta.)

37 Developed countries-are almost always the drafters of BIT agreements; the wealthier the country, the more likely it is to share the outcome of the treaty negotiations. W. Alschner & D. Skougarevskiy, 'Mapping the universe of international investment agreements', 19 Journal of International Economic Law 561-588 (2016).

38 PwC, Global Top 100 Companies by Market capitalisation, available https://www.pwc.com/gx/en/audit-services/publications/assets/global-top-100-companies-2019.pdf.

39 World Investment Report 2019, UNCTAD, 'Key Messages and Overview', Page xi, available https://unctad.org/en/PublicationsLibrary/wir2019_overview_en.pdf.

40 According to UNCTAD, all twelve most frequent home States of claimants between 1987–2018 were in Europe or North America, responsible for the lion's share of all investor-state disputes. UNCTAD, Fact Sheet on Investor-State Dispute Settlement Cases in 2018, May 2019, Issue 2, available https://unctad.org/en/PublicationsLibrary/diaepcbinf2019d4_en.pdf.

41 ICSID, ICSID Annual Report 2019, available https://icsid.worldbank.org/en/Documents/ICSID_AR19_EN.pdf.

either nationals of or practitioners based in Western Europe and North America.[42] They are often perceived as lacking enough expertise related to the law and practices of host developing states.[43]

Arbitrators from the Global North are not the only group, which benefits from the system. Regardless of who wins in an investor-state dispute, parties to an investment arbitration usually run up legal costs in millions,[44] which usually go to law firms in the Global North, often imposing a disproportionately heavy burden on developing states.[45] Elite western law firms dominate the field of investment arbitration because of their expertise – according to one estimate, all top 30 law firms representing investors and states in arbitration were headquartered in the United States or the United Kingdom.[46] A charge of £1,000 per hour is not unusual for a partner of such a law firm, while, for example, the average salary in Kyrgyzstan, which is currently involved in at least four investor-state disputes, is less than £200 per month.[47]

The UNCITRAL Working Group III confirms that developing states with scarce financial and human resources are particularly affected by the high cost of proceedings often leading to significant reputational harm and the risk of regulatory chill.[48] The system of investor-state arbitration provides no legal aid for developing states further increasing the gap between economically powerful and weak states.[49]

42 Ibid. The majority of arbitrators come from Western Europe (47%) and North America (20%).

43 Although there is no conclusive evidence, many states perceive that homogeneity in the background of the arbitrators results in an insufficient understanding of the host States and the local laws. See, e.g., UNCITRAL Report of Working Group III on the work of its thirty-sixth session (Vienna, 29 October – 2 November 2018).

44 For example, in *Abaclat v Argentina*, Argentina's cost during the jurisdictional phase amounted to US$12 million, while the claimants' costs added up to US$28 million. *Abaclat and Others v. Argentine Republic* (ICSID Case No. ARB/07/5), Decision on Jurisdiction and Admissibility of 4 August 2011; By the end of 2017, in cases decided in favour of the investor, the average amount awarded is US$504 million and the median amount is US$20 million. UNCTAD IIA Issues Note, Investor-State Dispute Settlement: Review of Developments in 2017, Issue 2, 5 (2018).

45 One study shows that in 2017 the costs awarded to claimants reached $110 million and this amount increases annually. Matthew Hodgson and Alastair Campbell, Damages and costs in investment treaty arbitration revisited, Global Arbitration Review (14 December 2017) *available at* http://www.allenovery.com/SiteCollectionDocuments/14-12-17_Damages_and_costs_in_investment_treaty_arbitration_revisited_.pdf. See also, United Nations Commission on International Trade Law Working Group III (Investor-State Dispute Settlement Reform), Possible Reform Of Investor-State Dispute Settlement (ISDS) - Cost And Duration, 31 August 2018, A/CN.9/WG.III/WP.153, *available at* https://documents-dds-ny.un.org/doc/UNDOC/LTD/V18/057/51/PDF/V1805751.pdf, paras. 8-9.

46 The value of current portfolio as arbitration counsel for these firms is between US$6.1 billion and US$202 billion. The GAR 30, 2019 edition, 05 April 2019, https://globalarbitrationreview.com/benchmarking/gar-100-12th-edition/1189626/the-gar-30.

47 National Statistical Committee of the Kyrgyz Republic, Average monthly salary (soms), available http://www.stat.kg/en/opendata/category/112.

48 Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-sixth session
(Vienna, 29 October–2 November 2018), available https://undocs.org/en/A/CN.9/964.

49 South Africa and Italy argued that the high costs of ISDS makes it a system for powerful. See A. Roberts, UNCITRAL and ISDS Reforms: Concerns about Costs, Transparency, Third Party Funding and

Counterclaims, 6 Jun 2018, available https://www.ejiltalk.org/uncitral-and-isds-reforms-concerns-about-costs-transparency-third-party-funding-and-counterclaims.

4. Inequality between foreign and domestic investors

Historically, international investment law was based on the assumption that host states may treat domestic investors better than foreign investors. Therefore, international investment agreements contain provisions prohibiting discrimination of foreign investors compared to domestic investors, guaranteeing them fair and equitable treatment or most favoured nation treatment. In practice, international investment law allows investors to challenge domestic decisions related to extractive industry operations,[50] land rights,[51] environmental damage,[52] intellectual property protections[53] and otherwise limit their right to regulate and to pursue public policy objectives.[54]

However, already when the system of investor-state disputes was designed in the 1960s, developing states expressed concerns that the new system of investor-state arbitration conferred a privilege on the foreign investors even allowing them to violate domestic laws[55] and placing the nationals of the host state in a position of inferiority.[56]

50 See, e.g., *Infinito Gold v. Costa Rica*, ICSID Case No. ARB/14/5, Request for Arbitration, February 6, 2014, and Petition for Amicus Curiae Status, September 15, 2014.

51 See, e.g., *Awdi v. Romania*, ICSID Case No. ARB/10/13, Award, March 2, 2015.

52 See, e.g., *Chevron Corp. v. Ecuador*, Permanent Court of Arbitration (PCA) Case No. 2009-23. Submission from the Government of South Africa to UNCITRAL, *supra* note 21 ('Local communities are being displaced from their traditional areas in order to clear up the space for investment projects and yet are not provided with new jobs or opportunities and there is little or no consideration for their cultural, social and political attachments to their land.')

53 See, e.g., *Eli Lilly v. Canada*, ICSID Case No. ARB/14/2.

54 Submission from the Government of South Africa to UNCITRAL, *supra* note 21 ('objectives of investment treaties … may lead governments to thread more cautiously – and hence potentially insufficiently from a public-interest perspective – when planning and designing regulation'); See, for example, Mauritius' submissions to UNCITRAL on investor–state dispute settlement (ISDS), reported in Anthea Roberts and Zeineb Bouraoui, UNCITRAL and ISDS Reforms: What are States' Concerns? 5 June 2018, available https://www.ejiltalk.org/uncitral-and-isds-reforms-what-are-states-concerns ('countries run scared of the legal risks and financial exposures that have come to be associated with the [ISDS] system calling to rebalance it.')

55 ICSID, *supra* note 14 Volume II-2 ('In Ecuador, as in other countries, the Constitution embodied the principle of equality of nationals and foreigners before the law. To make a different jurisdiction available to foreigners would place them in a privileged position.'); see also Indonesia's Submission to UNCITRAL on investor-state-dispute settlement (ISDS) 1-5 April 2019, available https://uncitral.un.org/en/working_groups/3/investor-state.

56 Statement of Felix Ruiz, Governor of Chile, 9 September 1964, Tokyo, in ICSID, *supra* note 14, 606 ('by virtue of the fact that he is a foreigner, the right to sue a sovereign state outside its national territory, dispensing with the courts of law').

Today, investors may use a threat of an investment claim as a bargaining tool in their negotiations with the host state.[57] States have argued that the mere possibility of liability results in the regulatory chill, deterring host states from implementing riskier regulatory measures that might incur liability under an investment treaty.[58] For example, Indonesia appeared to have reversed a previous ban on open-pit mining due to the threat of arbitration.[59] Awards in investor-state arbitration often reach hundreds of millions or billions of US$, and result in a substantial transfer of resources, usually from taxpayers in developing states to private investors in developed states.[60]

Developing states are not alone in having concerns about the privileged position of foreign investors. For example, inequality between foreign and domestic investors is a reason why the 2018 United States–Mexico–Canada Agreement, the successor of the North American Free Trade Agreement (NAFTA), contains a more restrictive version of investor-state dispute settlement compared to NAFTA.[61] The European Union decided to adopt a single policy on the protection of foreign direct investments because, among other reasons, diverse policies of EU member states created inequality among European investors, and could distort the European single market.[62]

57 Submission from the Government of South Africa to UNCITRAL, *supra* note 21 ('large claims may serve to sustain threats of arbitration, increasing the bargaining power of investors in informal discussions with governments to water down regulatory measures or to settle a dispute').
58 See, e.g., Submission of Indonesia to UNCITRAL, *supra* note 55 ('the threat of ISDS can lead to a 'regulatory chill', where governments become hesitant to undertake legitimate regulatory measures within the public's interest for fear of claims, thus hindering the government's right to regulate') Possible reform of investor-State dispute settlement (ISDS), Submission from the Government of Brazil, A/CN.9/WG.III/WP.171, 11 June 2019 available at http://undocs.org/en/A/CN.9/WG.III/WP.171 ('excessive litigation resulting from BITs harms the business environment and the effort to attract investments to developing countries, as well as the regulatory capacity of the State to pursue legitimate policy interests in areas such as health, environment, and public safety').
59 S. Gross, 'Inordinate Chill: BITs Non-NAFTA MITs and Host State Regulatory Freedom – An Indonesian Case Study', 24 Michigan Journal of International Law 894 (2003).
60 For example, in the *Occidental v Ecuador* case the US$1.77 billion award was equivalent to 10.2% of Ecuador's US$17.37 billion tax revenue in 2012, the year of the award; when the claim in Philip Morris v Uruguay was brought, Uruguay's GDP is half the size of Philip Morris's US$66 billion in annual sales. https://stats.oecd.org/Index.aspx?DataSetCode=REVECU; D. Rosert, The Stakes Are High: A review of the financial costs of investment treaty arbitration, International Institute for Sustainable Development (2014).
61 See Philipps, *supra* note 12.
62 S. Woolcock & J. Kleinheisterkamp, *The EU approach to international investment policy after the Lisbon Treaty.' European Parliament* 10 (2010) ('Member State investment policies and BITs have created inequality among European investors. … The uneven distribution of BITs among EU member states could therefore distort investment flows within the Single Market.')

5. Tackling the inequalities

As demonstrated above, the system of international investment law is based on a mixture of assumptions, some of which no longer reflect the reality. It does not mean, however, that the system of international investment law should be scrapped altogether. States still need to attract investments to strengthen their economies, while the problems of the weak rule of law, corruption and denial of justice will never disappear.

Although investor-state arbitration gets a lion's share of criticism, it appears that reforming procedural elements without reforming substantive provisions will only have a limited effect. The subsequent sections will outline several proposals on how to better reflect the new geopolitical realities and help decrease the undesirable inequalities. These proposals will be further considered and elaborated in the final version of the paper.

Today, investor-state tribunals resolve disputes largely on the basis of broad treaty standards, such as fair and equitable treatment. International investment agreements and tribunals need to give a greater role to the substantive law of the host state. Unlike in the middle of the 20th century, there is no such need to rely on vague principles and standards resulting in long and expensive proceedings.

A. Allow a greater role for domestic substantive law

A greater role of domestic law of host states will reflect the fact that today many developing states have their own sophisticated legal systems. A greater reliance on domestic law should not mean a departure from the primacy of international law. International law should have a complimentary and gap-filling function role rather than almost entirely replace domestic law. A greater role of domestic law will make applicable law more predictable, and result in the need to appoint arbitrators and counsel who are familiar with the law and practice of the host state. This may potentially make the process less expensive and facilitate greater respect of the sovereign right of states to regulate.

B. Articulate obligations of investors in investment treaties

Because of the new equilibrium between foreign investors and states, investment agreements need to focus not only on protecting the rights of investors but also integrating broader obligations of the investors such as respect of fundamental human rights and labour rights, environmental standards and combating corrupting. Although modern international investment agreements increasingly include obligations of investors in these areas, the vast majority of such treaties still provide no obligations of investors.

C. Strengthen the ability of states to assert claims and counterclaims

To balance the procedural inequality between investors and states, it should be easier for states to assert claims and counterclaims against investors. Not only should investment agreements provide for obligations of investors, but the requirement of consent to counterclaims with regard to related obligations should be reconsidered. Finally, working mechanisms of enforcing awards against multinational corporate groups through which investors often operate, in which each entity is shielded by limited liability should be reconsidered.

D. Balance the Global North and the Global South in appointments

Mechanisms need to be put in place to balance the position of the Global North and the Global South in appointments of arbitrators. The appointments system should reflect the various regions the parties come from and also require familiarity of the appointees with the laws and practices prevalent in that region. It could be useful to look at the efforts made by the World Trade Organization, the International Court of Justice and other international dispute resolution bodies to balance the inequality between developing and developed states in their appointments.

E. Lower the costs and enable access to funding

Several measures can help tackle high costs in investor-state disputes. A greater reliance on domestic law, firms and arbitrators from the respective regions can help bring in more legal certainty and make proceedings cheaper as hourly rates of lawyers from developing countries tend to be lower. It is also important to a greater extent to stick to the rule that costs follow the event to deter frivolous claims and balance the inequality between investors and states. Finally, it is important to establish a mechanism enabling developing states to access legal aid, which could be inspired by the experience of other dispute resolution bodies.

F. Strengthen capacity building in developing states

To address inequality between developed and developing states, the latter not only need help with defending themselves in investor-state disputes but also with effectively negotiating international investment agreements and improving domestic regulation of foreign investments. It is also important to help states, both developing and developed, to better coordinate between agencies in charge of these tasks and learn from experiences of other states. Such agencies should also be better financed and have greater international cooperation to exchange experience. In fact, the money saved on payments of arbitral awards and counsel fees would be more than enough to increase their budgets and therefore their quality of work.

About the Author

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Yarik is the Director of the Investment Treaty Forum and the Senior Research Fellow in International Investment Law at the British Institute of International and Comparative law.

Professor Kryvoi specialises in international and comparative law, with a particular focus on dispute resolution and foreign investment law. He was admitted to the New York Bar and was in private practice with Morgan Lewis & Bockius in Washington, DC and Freshfields Bruckhaus Deringer in London. He represented investors and states under various arbitration rules. Prior to that he worked as an Extern Law Clerk at the US Court of Appeals for the District of Columbia Circuit and taught law in Belarus. He holds law degrees from Harvard, Moscow, Nottingham, Utrecht and St Petersburg universities.

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