Investor-State Dispute Settlement

AN INDISPENSABLE ELEMENT OF INVESTMENT PROTECTION

KEY MESSAGES:

1. Foreign direct investment (FDI) is of fundamental importance for economic growth, jobs and development worldwide. Open, transparent and non-discriminatory investment policies and agreements, ensuring a predictable and fair treatment of investors and protecting investors against arbitrary behavior of host states or a possible bias of local courts, are essential for business and for countries to stimulate inward investment.

2. Investor-State Dispute Settlement (ISDS) is an indispensable part of a fair, efficient investment protection system. It provides for a neutral, swift and high-quality mechanism of legal dispute resolution in cases of breaches of investment treaties by host states, which make effective the substantive protections offered by investment treaties, particularly in cases of expropriation and discrimination against foreign investors. The ISDS mechanism does not prevent countries from establishing environmental, health or other regulations, but it does prevent countries from discriminating against foreign investors. Therefore, strong ISDS provisions must continue to be part of International Investment Agreements (IIAs) and investment chapters of Free Trade Agreements (FTAs).

3. Business is deeply concerned about the widespread emotional and politicized debate putting the ISDS system as such into question. This discussion needs to be put back in the right perspective, and common misrepresentations need to be effectively addressed. At the same time, any legitimate concerns merit further analysis. Business is willing to engage in future discussion on a state of the art ISDS system.

4. It is a core responsibility of the OECD, as an internationally recognized forum for fact-based and objective analysis, to foster open, transparent and non-discriminatory investment policies, facilitate unbiased policy monitoring, and help shape further understanding about the issues that are at stake.
The importance of FDI, an open international investment climate and investment protection

Investment, whether from domestic or foreign sources, is crucial for prosperity, development and robust economies. It drives economic growth, innovation, trade and job creation in economies around the world. Without investment, economies stagnate, with immediate adverse effects for its citizens. In this sense, foreign investment has contributed to the creation of jobs and wealth in recipient countries. It has improved infrastructure and enabled more and better access to technologies, thus contributing to the sustainable development of these economies.

An open international investment environment enhances the competitiveness of developed, developing and emerging economies by allowing them to serve foreign markets and contribute to the well-being of a country’s economy and its citizens.

FDI is a vital pillar in the overall investment picture, even more so in today’s world of increased interconnectedness and global value chains. Therefore, effective investment protection and promotion is more important than ever. Countries that have pro-investment policies and well-established rule-of-law systems attract more and higher quality FDI.

Companies’ foreign investment decisions often involve significant economic and political risks, such as direct expropriation through nationalization, arbitrary restrictions on remittance of profits and capital, withdrawal of licenses, discriminatory and arbitrary regulatory action by the host state or dependence on national courts which in some cases can be biased against foreign investors. Foreign investors therefore require assurances that they will be treated fairly and equitably before investing significant capital in the host country. In order to remedy uncertainty, international investment agreements have been designed to confirm basic standards of treatment and create safeguards that reduce risks for investors while facilitating the settlement of investment disputes through well-designed neutral and non-political international arbitration proceedings. These safeguards need to be preserved.

Why business needs a well-designed investment protection mechanism

Investment protection treaties are sovereign acts of the states concluding the agreement, by which they commit to apply to foreign investors the same basic principles that apply to their own companies. These basic standards, such as procedural fairness, non-discrimination and proportionality, are nowadays undisputed.

In the absence of a multilateral investment framework, the international investment landscape consists of a vast network of more than 3000 bilateral and other international investment agreements. They serve a standard setting function, laying down important principles of international trade and investment that must be adhered to. BITs and their FTA investment chapter equivalents have been recognized as a key factor in helping countries attract foreign direct investment.

Investors need an effective, swift and independent way to implement and enforce commitments in BITs and IIAs, not least as in many legal regimes the international public law commitments in these agreements cannot be directly enforced in domestic courts. ISDS fulfills

---

1. The fourteen years prior to the promulgation of BITs saw 875 government takings of foreign investor property in 62 countries for which there was no effective remedy.
that role, thus re-establishing a measure of equilibrium to the disadvantaged position that foreign investors may have in comparison to domestic investors. It has thus been included in most investment protection agreements. ISDS was created over 50 years ago and has played a crucial role as an instrument to ensure a fair implementation of investment agreements, to enforce the rule of law, to protect companies against arbitrary behavior of states and to guarantee them a fair process. Thus, it ensures fair and equitable treatment, access to impartial arbitration and free transfer of capital. As such, it is providing a public good, helps states to attract investment and fosters innovative, high-value development and growth.

ISDS constitutes an independent, high-quality legal instrument, which is generally used as an instrument of last resort in rare cases where no other effective remedy is available. But in these cases, it is crucial. This makes it an essential element of the system. With ISDS, the state-parties concluding an IIA consent in advance that the companies of the other party may bring a claim against them as host states directly to international arbitral tribunals in cases where the international agreement has allegedly been breached. ISDS provides investors with a fair and unbiased instrument to invoke international public law commitments, which states have made to each other with a view to protecting investors, outside the potential political control of the host government.

Given that host states may be deferred to in domestic proceedings, the risk of biased or arbitrary decisions by national courts cannot be excluded. ISDS has therefore been designed to avoid arbitrary treatment of investors by host states. Without ISDS, investors have very limited and unreliable means to protect their investment and business activities, or to invoke treaty commitments which are not directly enforceable in domestic courts. An additional benefit of ISDS is that it can de-politicize disputes. It is important to underline that investment protection is a key component in every investment regime or agreement, not only in agreements with developing countries; indeed, OECD members are parties to well over 1500 such treaties (many of which are between two OECD members) and thus have committed themselves to ISDS arbitration of disputes by investors of the other parties.

---

**A worrying debate**

The international business community is extremely concerned about the current emotional debate about investment protection and particularly ISDS. Many of the arguments put forward are totally out of proportion, disregarding the benefits the system has provided for over five decades by promoting much needed investments, and inflating potential and theoretical risks. It is therefore indispensable to get the debate on IIAs and ISDS back onto a rational level with objective and fact-based analysis and arguments. Business stands ready to actively contribute to these discussions.

---

**Putting the numbers into perspective**

It is often claimed that the inclusion of ISDS in new international investment agreements, such as TTIP, will unleash a flood of claims by investors. This claim lacks substance. According to a report by UNCTAD covering all known ISDS cases through the end of 2013, in over fifty years of investment protection, there have been 568 documented cases of arbitral proceedings, of which 274 have been decided upon. 43% were decided in favor of the government, and 26% were settled. Just 31%, i.e. a total of 85 cases, were decided upon in favor of the company. According to a CSIS paper, about a third of ISDS cases filed with the International Centre for Settlement of Investment Disputes (ICSID) are settled in advance of a ruling. For disputes which end in arbitral decisions, states win about twice as often as investors.

The total number of 85 cases should be put in perspective with the total world stock of FDI of $26 trillion in 2013, even if in recent years there has been an increase in the number of cases, which also corresponded with a further increase in the stock of FDI. Most of the 85 cases did not give rise to any substantial public criticism on their merits. According
to the ISDS experience of Canada in 20 years of NAFTA, 34 ISDS cases have led to close to $157 million of indemnities. In the same period, investments in Canada rose by over $300 billion. A trade diplomat of a large emerging economy recently said that when one compares the total number of ISDS cases which his country lost to the total number of FDI in the country, it was a very good bargain.

Considering these unambiguous numbers and facts and the undeniable importance of ISDS, business is deeply concerned about the widespread debate putting into question the whole system of ISDS. Many countries are actually developing proposals for regional or national arbitration provisions. But precisely in a situation where countries are inclined to cede to the temptation of applying arbitrary treatment, the disciplining effect of an international instrument is indispensable. We call upon governments to clearly consider the advantages of the total stock of FDI that has been facilitated in part thanks to an effective system of investment protection and arbitration.

Addressing criticism in an objective and fact-based manner

BIAC believes that it is crucial to de-escalate the debate on ISDS, make it rational and fact-based, and put it in the broader context of the fundamental importance and benefits of investment protection. Objective analysis is important to address concerns that are brought forward in the public debate.

A number of issues have been raised, such as transparency of procedures, the compatibility of investment protection and governments’ ability to regulate, introducing an appeal mechanism, a new code of conduct for arbitrators, early discharge of frivolous claims, improvement of timing and enforcement, or alternative dispute resolution.

It should be underlined that steps have already been taken to address a number of these points. With regard to transparency, for example, it should be noted that as of April 2014, the new UNCITRAL transparency rules are in place. This transparent legal process gives the public the right to access records without though undermining the competitive position of firms or revealing sensitive information.

Also, the language used in new investment agreements has become more precise to define the scope and include provisions in this respect. The recently concluded free-trade agreement of the EU with Canada, for example, recognizes the right of the state to protect legitimate public welfare objectives, such as health, safety and the environment, when undertaken in a manner consistent with the basic obligations for the treatment of investors of the other party. The long history of investment agreements demonstrates that they do not prevent governments from regulating in the public interest. The right of the state to regulate is recognized by ISDS tribunals and is incorporated in many investment protection agreements.

Furthermore, it should be underlined that ISDS rulings only deal with the question of monetary compensation, but do not require changes to a state’s laws or regulations. ISDS simply guarantees that fair compensation will be awarded to investors in case the latter are treated unfairly, e.g. are unlawfully expropriated or discriminated against, in violation of the treaty. BIAC considers that exempting certain sectors from the scope of the provision is not a right answer to address criticism. Business is willing to engage further in these debates.

---

An enhanced role for the OECD

The OECD has for many years played an important role in developing guidance for open, transparent and non-discriminatory investment policies and has facilitated unbiased policy monitoring to support accountability and frank and open exchange of views. In light of the current debate about investment protection, we believe that this work needs to be stepped up. Work on core investment issues should also include analysis as well as a clear policy statement on why investment and open markets matter. The 2015 Ministerial Council Meeting would present an excellent opportunity for the OECD to clearly highlight the fundamental importance of an enabling policy framework for investment and the importance of FDI for economic growth and development.

More detailed work on ISDS should be embedded in broader work on the international investment architecture, highlighting the importance of sound national policies, rule of law as well as high quality international investment treaties for attracting FDI and reaping the full benefits of FDI for development. We therefore encourage the OECD Investment Committee to further step up work on key investment issues.

We strongly recommend reviving the OECD Global Forum on Investment, which last took place in 2011, as a regular forum to illustrate the importance of fostering investment as an overarching objective for the OECD and provide a forum where governments, key stakeholders and policy experts can have a constructive and objective discussion on core investment issues.

Taking into account work carried out by other international organizations, the OECD should also help inform the discussion through empirical research, addressing specific questions related to the outcome of ISDS cases, such as the proportion of amounts actually awarded compared to the amounts that had been claimed, how they relate to overall FDI flows, specific grounds for various cases, and the profile of companies filing cases (large/small, which sectors, major international investors or not).

Furthermore, we would welcome detailed research and analysis on the similarities and differences of the many IIAs that are in force around the world, including on the question of what changes some nations have made in BITs over the last 20 years and an evaluation of the effects of these changes. By conducting such empirical research and analysis, the OECD could contribute to developing a set of globally relevant investment rules.

The OECD could also consider organizing a dialogue involving firms that have filed ISDS cases to determine the reasons for filing the case and whether they seriously considered other options (mediation, local courts, etc.). In addition to such a discussion with companies, another panel discussion with ISDS arbitrators could be organized to facilitate direct discussion with members of the OECD Investment Committee to give them insight on practical aspects and motivations.

When looking into specific issues that have been raised, such as appellate mechanisms (e.g. multilateral versus bilateral level), umbrella clause, third-party funding, SME access to ISDS, code of conduct for arbitrators, avoiding frivolous claims, length of procedure and associated costs, analysis must be done in an objective, careful and fact-based manner. In view of the very challenging and delicate context of current discussions in the investment policy arena, we call upon the OECD and all other relevant players in the international economic field, including national governments, to communicate in an objective manner with a view to help get this policy debate back into rational realms.

We urge the OECD to confirm its leading role to foster investment and shape further understanding about the issues that are at stake. BIAC and its member companies, large and small, stand ready to participate constructively in such an effort. We would very much welcome the opportunity for an in-depth brainstorming session with the leadership of the OECD Investment Committee and the Secretariat in the margins of the next Committee meeting. Business is willing to actively engage in this debate.