

# THE FRICTION BETWEEN INVESTOR PROTECTION AND HUMAN RIGHTS: LESSONS FROM FORESTI V. SOUTH AFRICA

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## I. ABSTRACT

The international investment system is suffering from a legitimacy crisis. Increasingly, states are questioning the benefit to their bargain from offering robust investor protection, and some are even opting out of international investment regimes altogether. In particular, where investment protection conflicts with a state's right to regulate in the realm of human rights or environmental protection, the legitimacy of the investment arbitration system may be called into question by its major constituents. In such cases, arbitrators may introduce what I identify as legitimacy enhancements to ease the friction between international human rights and international investment protection and to promote broader acceptance of the investment law system. In this Article, I first review criticisms of the international investment system particularly with respect to its effect on human rights. Next, I examine the controversial case of *Foresti v. South Africa*, involving South Africa's Black Economic Empowerment policies, which regulated the amount of black ownership in the mining industry. I argue that the tribunal in *Foresti* allowed for further Non-Disputing Party participation and shifted costs to the Claimant as a legitimacy enhancement, due to the friction generated from a case in which an investor's rights directly conflicted with a state's right to enact positive human rights legislation. I conclude that legitimacy enhancements, in contexts like *Foresti*, ought to be pursued, as they can constitute either pareto improvements or Kaldor-Hicks efficient outcomes.

## II. INTRODUCTION

The International investment law system is facing a legitimacy crisis.<sup>1</sup> Criticisms have largely arisen as a function of the increasing number of arbitration claims that have been

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1. Asha Kaushal, *Revisiting History: How the Past Matters for the Present Backlash Against the Foreign Investment Regime*, 50 HARV. INT'L L.J. 491, 492 (2009) (discussing the substantive bias, procedural shortcomings, and political consequences of bilateral investment treaties used in international investment).

brought under bilateral investment treaties (BITs) in recent years,<sup>2</sup> the vast sums in damages that have been claimed by investors against host states that may even exceed the Respondent state's entire budget,<sup>3</sup> and claims by investors against host states that implicate the state's regulatory power to address core human rights and/or environmental concerns.<sup>4</sup> Some critics call for a complete overhaul of the investment arbitration system, suggesting various alternatives, which would significantly alter both the substance and procedure of the status quo. Meanwhile, some states have responded by reigning in investor protection, thus threatening the stability of the very international investment dispute resolution system.<sup>5</sup>

I argue that, consistent with some criticisms, there exists a space in which a state's obligations under the international investment system can conflict with its abilities to regulate in areas of human rights and/or environmental protection. Yet, because many criticisms of the investment system remain under-developed both theoretically and empirically, this conflict between investment protection and a state's regulatory power is often mischaracterized and poorly understood. The first part of

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2. See Susan D. Franck, *Empirically Evaluating Claims About Investment Treaty Arbitration*, 86 N.C. L. REV. 1, 44-45 (2007) (noting that there were approximately 160 known investment arbitration cases in November 2004, 229 known arbitrations in 2005, and 25 new claims filed in the first eleven months of 2006). As one commentator has noted, "Today, there are approximately 2,000 BITs among 170 countries, 1,500 of which have been concluded since the late 1980s." Christopher Borgen, *Transnational Tribunals and the Transmission of Norms: the Hegemony of Process*, 39 GEO. WASH. INT'L L. REV. 685, 693 (2007).

3. Franck, *supra* note 2, at 63-64.

4. Marc Jacob, *International Investment Agreements and Human Rights*, 9, 11, 13-14 (INEF Research Paper Ser. on Human Rights, Corp. Responsibility and Sustainable Dev., Ser. No. 3, 2010), [www.humanrights-business.org/files/international\\_investment\\_agreements\\_and\\_human\\_rights.pdf](http://www.humanrights-business.org/files/international_investment_agreements_and_human_rights.pdf) ("Crucially, not only the actual but also the potential financial and political cost of investor-state arbitration or the threat thereof might suffice to cause a 'chilling effect' on national regulation.").

5. For a discussion on how this can be done by way of fee shifting, see for example, David P. Riesenber, Note, *Fee Shifting in Investor-State Arbitration: Doctrine and Policy Justifying Application of the English Rule*, 60 DUKE L.J. 977, 978-79 (2011). Using the English rule, where the losing party must indemnify the other party, as opposed to the American rule, where each party bears its own costs, could help to curtail the pro-investor bias perceived by some. *Id.*

this paper is dedicated to outlining the many criticisms of the international investment arbitration system and clarifying their theoretical and empirical underpinnings and limitations. My hope is that this will help create a coherent and neutral picture of the claims against the investment arbitration system.

Based on the conclusions that I reach in Part I, I argue that in so far as there is real or perceived conflict between a state's regulatory authority and its investment obligations, there are many areas where legitimacy enhancements will function as efficiency gains. I construct a very simple model with three participants (states, multinational corporations (MNCs), and third parties) in which an investment treaty obligation is at odds with a state's desire to regulate in critical areas such as human rights and/or the environment. The tension introduced by this clash generates criticism and may ultimately threaten the legitimacy of the investment system. Within this context there are institutional changes that can be made, without overhauling the entire system, to make some participants better off without necessarily making others worse off. The result of these changes is an equilibrium result that is either Pareto or Kaldor-Hicks efficient.<sup>6</sup>

The controversial investment dispute *Foresti v. Republic of South Africa* provides a live example of legitimacy enhancements as efficiency gains.<sup>7</sup> The dispute concerned a challenge to South Africa's Black Economic Empowerment (BEE) Policies, affirmative action measures designed to remedy the lingering effects of the apartheid era.<sup>8</sup> There were two

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6. Pareto efficiency requires that at least one person is made better off without making anyone else worse off, while the Kaldor-Hicks standard requires that the winners are better off by an order of magnitude greater than that by which the unsuccessful part is made worse off, i.e. the gain overcompensates for the loss. See Mathew D. Adler & Eric A. Posner, *Rethinking Cost-Benefit Analysis*, 109 YALE L.J. 165, 170, 190 (1999).

7. *Foresti v. Republic of South Africa*, ICSID Case No. ARB(AF)/07/1, Award, ¶ 132 (Aug. 4, 2010).

8. Damon Vis-Dunbar, *South African Court Judgment Bolsters Expropriation Charge Over Black Economic Empowerment Legislation in the Mining Sector*, INV. TREATY NEWS (Mar. 23, 2009), <http://www.iisd.org/itn/2009/03/23/south-african-court-judgment-bolsters-expropriation-charge-over-black-economic-empowerment-legislation/>.

particularly notable developments in the *Foresti* case. First, the Tribunal granted an unprecedented level of participation to non-disputing parties (NDPs).<sup>9</sup> I argue that this represents a type of Pareto improvement, arising in part due to the tension from an investment dispute, which directly implicates a state's regulatory authority in a public rights case. When the investment system is threatened because of this tension, the cost/benefit calculus determining the desirability of introducing transparency-enhancing measures shifts.

The second notable development concerned the Tribunal's decision to shift costs. Claimants ultimately sought discontinuance,<sup>10</sup> and the Tribunal issued a default award on fees and costs requiring the claimants (the corporation) to cover a portion of the respondent's (South Africa) costs.<sup>11</sup> Tribunal cost shifting authority represents another example of a legitimacy enhancing efficiency gain, as illustrated in this case, because it can alleviate the burden on states to defend against unsuccessful and/or non-meritorious claims.<sup>12</sup> Although, as a result of such decisions, individual MNCs face an immediate increase in costs, these costs may be offset by the benefits that arise from maintaining the legitimacy of the system in a climate in which some states are re-considering the level of investment protection offered as a result of the alleged unfairness of the system. I allege that this represents a type of Kaldor-Hicks efficiency gain.

### III. CRITICISMS OF THE INTERNATIONAL LEGAL SYSTEM

#### A. Overview of Critiques

Attacks against the international investment system have been severe and varied. Accompanying such criticism is a growing body of literature that seeks to empirically establish the

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9. Elizabeth Whitsitt, *Innovative Steps are Introduced into Non-Disputing Party ICSID Procedure*, INV. TREATY NEWS (Nov. 3, 2009), <http://www.iisd.org/itn/2009/11/01/innovative-steps-are-introduced-into-non-disputing-party-icsid-procedure-4/>.

10. *Foresti*, ICSID Case No. ARB(AF)/07/1, Award, ¶ 79.

11. *Id.* ¶ 132.

12. Riesenber, *supra* note 5, at 992-93.

claims. In Part II.A, I will present an overview of the existing criticisms of the international investment legal system and note any concrete empirical evidence supporting or refuting such critiques. Next, in Part II.B, I will attempt to organize the criticisms of the international investment legal system along a conceptual framework in order to inform an understanding of the nature of the criticisms, their merit, and where potential solutions might lie.<sup>13</sup>

#### 1. Human Rights and Environment Provisions within BITs

Critics argue that investment treaties do not adequately account for the consideration of a state's human rights obligations.<sup>14</sup> In fact, very few BITs expressly reference a state's human rights obligations.<sup>15</sup> This implicates the extent to which a state's human rights obligations may inform an interpretation of its obligations under its investment treaties in the event of a dispute. For example, tribunals have disagreed over whether a state's purpose in enacting regulations that qualify as expropriation should be considered in the determination of whether or not the state has breached its treaty obligations and/or whether restitution is owed.<sup>16</sup> It is possible that a state,

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13. As a cautionary preface, the range of criticism of the current international investment dispute procedures is far more complex than can be summarized here. Nevertheless, I have attempted to organize the criticisms and delineate them along a relevant framework in order to provide meaningful evaluation of their origin, merit, and trajectory. In this I hope to enhance the clarity of a topic, which has grown ever more complicated and convoluted.

14. *E.g.*, Jacob, *supra* note 4, at 9 ("Investment agreements could address human rights concerns either by directly imposing obligations on investors or by referring to state duties. In practice very few, if any, investment agreements mention human rights or associated fields."); HOWARD MANN, INT'L INST. FOR SUSTAINABLE DEV., INTERNATIONAL INVESTMENT AGREEMENTS, BUSINESS AND HUMAN RIGHTS 10 (2008), [http://www.iisd.org/pdf/2008/iia\\_business\\_human\\_rights.pdf](http://www.iisd.org/pdf/2008/iia_business_human_rights.pdf) ("There are a very limited number of surveys concerning the inclusion of express provisions on human rights in IIAs [(International Investment Agreements)], and these appear to document just one express inclusion of human rights obligations in an IIA.").

15. *E.g.*, Jacob, *supra* note 4, at 9 ("In practice very few, if any, investment agreements mention human rights or associated fields.").

16. *Id.* at 15-16; *Compare* Técnicas Medioambientales, Tecmed S.A. v. The United Mexican States, ICSID Case No ARB(AF)/00/2, Award, ¶¶ 36-43, 174 (May 29, 2003)

in enacting expropriation type measures, was actually acting with the express purpose of fulfilling its obligations under international human rights law. A clearer expression of a state's human rights obligation in its investment treaties could clarify this standard and ensure that states have a greater freedom to regulate in matters concerning human rights.

Human rights obligations may also be considered by a Tribunal where an explicit provision in the BIT specifies that the Tribunal should decide the case in accordance with principles of international law.<sup>17</sup> Absent such an explicit provision, public international law may be read into a treaty: (1) to interpret the meaning of a BIT, (2) to avoid conflicting with a principle of international law, in particular, a *jus cogens* norm, or (3) through Article 313(c) of the Vienna Convention allowing international law to inform an interpretation of a treaty.<sup>18</sup>

Although such methods allow for some consistency in interpreting and applying the bulwark of public international law, some commentators have argued that such methods are insufficient at protecting human rights in the context of investment disputes.<sup>19</sup> For one, critics argue that specific

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(finding that, because the federal government – through its environmental agency – had granted authorization to operate a landfill to a local agency for an indefinite term, its refusal to renew an investing company's permit to operate the same landfill constituted discriminatory treatment and, therefore, an indirect expropriation on the part of the federal government), *with* Compañía de Aguas de Aconquija, S.A. v. Argentine Republic, ICSID Case No ARB/97/3, Award, ¶¶ 32, 64, 92 (Aug. 20, 2007) (finding that neither the actions of provincial authorities in relation to a contract it had entered into with an investing party nor any inaction on the part of the federal government constituted grounds for finding an indirect expropriation on behalf of the federal government).

17. Jacob, *supra* note 4, at 27.

18. *Id.* at 28-31 (quoting the Vienna Convention on the Law of Treaties, 23 May 1969, 1155 UNTS 331, which holds that “any relevant rules of international law applicable in the relations between the parties should be taken into account together with the particular context in interpreting a treaty” (internal quotes omitted)). *Jus cogens* is customary international law that is so fundamental, that it is seen as that which may not (easily) be overridden by treaty-based law. *Id.* at 29. An example would be a State legislating against slavery, which effectively fulfills a “peremptory norm,” that is, it codifies the *jus cogens*. *Id.*

19. *E.g. id.* at 29-30 (noting that outside of *jus cogens* norms, the parties to a BIT are free to insert whatever mutually agreeable provisions they like, which do not violate (as flagrantly) human rights or which do not violate the more fundamental international

reference to a state's human rights obligation in the BIT would help prevent some of the "regulatory chill" effects, discussed *infra*.<sup>20</sup> Additionally, without a specific contractual mandate to look to human rights obligations, the BIT, as a *lex specialis* instrument could be allowed to trump non-fundamental human rights norms—though such a reading is doubtful.<sup>21</sup>

## 2. BIT- Contractual Procedural Unconscionability

Critics also allege that negotiations of BITs and other investment treaties are procedurally unfair.<sup>22</sup> In theory, BITs

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human rights); LUKE E. PETERSON & KEVIN R. GRAY, INT'L INST. FOR SUSTAINABLE DEV., INTERNATIONAL HUMAN RIGHTS IN BILATERAL INVESTMENT TREATIES AND INVESTMENT TREATY ARBITRATION 3 (2003), [https://www.iisd.org/pdf/2003/investment\\_int\\_human\\_rights\\_bits.pdf](https://www.iisd.org/pdf/2003/investment_int_human_rights_bits.pdf) ("The ability [of arbitral tribunals] to monitor the full human rights impacts of emerging investment treaty arbitration is hindered by various shortcomings of this process.").

20. See *infra* Part II.A.7 (explaining "regulatory chill" and why it is criticized). *But cf.* Christoph Schreuer & Ursula Kriebaum, *From Individual to Community Interest in International Investment Law*, in FROM BILATERALISM TO COMMUNITY INTEREST 1079, 1088 (Ulrich Fastenrath et al. eds., 2011) (noting the trend among investment arbitrations against deciding issues of human rights violations brought under a BIT, finding that the arbitral tribunal has a limited competence, which extends only to commercial disputes); Jacob, *supra* note 4, at 23 (arguing that countries have little incentive to include provisions protecting human rights in BITs as the added restrictions make trade less attractive); Nicolas Klein, *Human Rights and International Investment Law: Investment Protection as Human Right?*, 4 GOETTINGEN J. INT'L L. 200, 204-07 (2012) (providing an overview of how international human rights law is typically viewed in relation to the field of international investment law).

21. As one commentator has noted:

At the outset, it is almost trite to note that, like every other treaty, BITs are an attempt to create special legal relations between the parties and that these can in theory 'contract out' of general public international law other than *jus cogens*. But the observation that BITs constitute *lex specialis* between pairs of states dealing with investment promotion and protection is not tantamount to arguing that they reject all other potentially relevant norms of international law. Indeed, BITs are silent on most matters of international law. At a more fundamental level, it is highly doubtful whether special treaty-based regimes (i.e. BITs) could even have legal effect without reference to another system of law that could provide them with such validity (i.e. public international law).

Jacob, *supra* note 4, at 30.

22. E.g., James D. Fry, *International Human Rights Law in Investment Arbitration: Evidence of International Law's Unity*, 18 DUKE J. COMP. & INT'L L. 77, 78

are agreements based on the free will of two sovereign governments.<sup>23</sup> Critics point out that this premise is undermined by the significant resource differentials that systematically disadvantage developing countries.<sup>24</sup> The United States, for example,

has bargained with dozens of countries. It is familiar with provisions that may have large effects, either in terms of benefits or costs. The United States has a large staff that can write, review, and analyze such agreements clause by clause. As if these advantages were not sufficient, the United States is assisted by well-paid corporate lobbyists and lawyers, who are even more sensitive to the consequences of each provision.<sup>25</sup>

Developing countries, on the other hand, lack the legal capacity to negotiate investment treaties to their strategic advantage.<sup>26</sup> Moreover, because of international power differentials, even if developing countries identify an area of strategic concern, they often lack the ability in negotiations with powerful Western countries to change model BITs.<sup>27</sup> And “[e]ven if renegotiations

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(2007) (“[T]he ability [of arbitral tribunals] to monitor the full human rights impacts of emerging investment treaty arbitration is hindered by various shortcomings of this process.”); PETERSON & GRAY, *supra* note 19.

23. Fry, *supra* note 22, at 104.

24. *E.g.*, Joseph E. Stiglitz, *Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights with Responsibilities*, 23 AM. U. INT’L L. REV. 451, 476-79 (2008) (“[T]he economic powers of MNCs are huge – often far larger than that of the countries with which they are dealing.”); Evaristus Oshionebo, *The U.N. Global Compact and Accountability of Transnational Corporations: Separating Myth from Realities*, 19 FLA. J. INT’L L. 1, 31 (2007) (noting that many MNC have larger economies than the developing nations in which they do business).

25. Stiglitz, *supra* note 24, at 479.

26. *See, e.g.*, Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, 50 HARV. INT’L L.J. 435, 484 (2009) (discussing concerns that poor developing countries lack the legal capacity to defend investment treaty claims and select arbitrators).

27. Stiglitz, *supra* note 24, at 479; *see also* Leon E. Trakman, *Foreign Direct Investment: Hazard or Opportunity?*, 41 GEO. WASH. INT’L L. REV. 1, 22 (2009) (“Some BITs are also dictated by the dominant party. In effect, developed states present them to developing states as a *fait accompli* for formal endorsement, and the BITs are concluded in the absence of extensive bargaining over the terms, including over investor-state

and other later corrections are not impossible, such initial misalignment is likely to produce unfavourable results.”<sup>28</sup>

Andrew Guzman presents a related thesis, positing that the system of BIT negotiations for developing countries constitutes a prisoners’ dilemma.<sup>29</sup> According to Guzman’s argument, developing countries negotiate investment protection in an effort to attract Foreign Direct Investment (“FDI”), to foster economic growth.<sup>30</sup> In Guzman’s theory, all developing countries would be better off by mutually agreeing to offer lower levels of investment protection – which would better preserve their own sovereign authority and lower the cost of certain state regulatory actions – however, in the natural equilibrium each individual country has an incentive to defect.<sup>31</sup> Defection, in which a country offers greater investment protection than other developing countries, draws investment to the defecting state away from other cooperating states.<sup>32</sup> Although developing countries could seemingly overcome this problem by negotiating a multilateral investment treaty, this fails due to coordination problems.<sup>33</sup> Therefore, according to this theory, a BIT negotiation by a developing country does not represent a sovereign’s strategic choice, but the default equilibrium result of a coordination failure.

Finally, some argue that developing countries are coerced, either subtly or openly, by International Financial Institutions (IFIs) into offering investment protection.<sup>34</sup> Because loan

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mechanisms governing dispute resolution.”).

28. Jacob, *supra* note 4, at 23.

29. Andrew T. Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT’L L. 639, 666-67 (1998).

30. *Id.* at 642.

31. *Id.* at 688.

32. *Id.* at 666-67.

33. Riesenberger, *supra* note 5, at 989.

34. Stiglitz, *supra* note 24, at 491; Guy Brucculeri, *A Need to Refocus the Mandate of the International Monetary Fund and the World Bank*, 17 WINDSOR REV. LEGAL & SOC. ISSUES 53, 70-71 (2004) (noting the World Bank conditioned release of funds in the mining sector to the Democratic Republic of Congo by requiring the restructuring of the government controlled mining company); Risa L. Lieberwitz, *Linking Trade and Labor Standards: Prioritizing the Right of Association*, 39 CORNELL INT’L L.J. 641, 645 (2006)

conditions imposed by the International Monetary Fund (IMF) and the World Bank (Bank) required a degree of openness to investment and trade, some allege that developing countries were pressured to “sign the charter of a new era” in their acceptance of BITs and investment protection.<sup>35</sup> Under this view, BITs, negotiated under duress and incorporating the imposed will of non-parties, cannot rightly be considered a contract between treaty parties.

### 3. Participation/Transparency Deficit

A related concern is that investment treaty negotiations do not allow for adequate participation by citizens and NGOs.<sup>36</sup> In theory, citizens’ views are represented by their respective governments,<sup>37</sup> however, that simplistic assumption may not hold in non-democratic contexts. This is particularly problematic because investment treaties have been applied even when they were negotiated under a corrupt regime and followed by a violent regime change.<sup>38</sup>

Additionally, critics argue that the BIT negotiation process and the investment dispute resolution process suffer from a lack of transparency, to be discussed in more detail *infra*.<sup>39</sup> Because

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(“The World Bank, the International Monetary Fund (IMF), and the World Trade Organization (WTO) foster a favorable investment climate for TNCs in the global south by conditioning loans and preferential trade status to developing nations on their implementation of economic ‘liberalization,’ through policies such as privatization of public services and legal protection of intellectual property.”).

35. Stiglitz, *supra* note 24, at 491; Jose E. Alvarez, Remark, *The Development and Expansion of Bilateral Investment Treaties*, 86 AM. SOC’Y INT’L L. 532, 552 (1992) (“For many, a BIT relationship is hardly a voluntary, un-coerced transaction. They feel that they must enter into the arrangement, or that they would be foolish not to, since they have already made the internal adjustments required for BIT participation in order to comply with demands made by, for example, the IMF.”); Brucculeri, *supra* note 34, at 70-71; Kaushal, *supra* note 1, at 503-06.

36. See, e.g., Jacob, *supra* note 4, at 22 (noting that the BITs providing the basic legal framework for large-scale projects have traditionally been negotiated and concluded outside the public sphere).

37. Fry, *supra* note 22, at 104.

38. Kaushal, *supra* note 1, at 513; Alvarez, *supra* note 35, at 553-54 (discussing how U.S. model BITs protect sanctity of contract above all else, even with respect old contracts negotiated with corrupt regimes).

39. See *infra* Part IV.D (discussing how the closed door policy of BIT dispute

international investment law contains a private dispute resolution system, which operates in lieu of an official judicial forum, transparent procedures are generally not mandatory and usually depend instead on the consent of the parties. This dearth of transparency generates controversy because investment disputes necessarily involve a public actor – the state. Therefore, in contrast to commercial arbitration – involving only private parties – investment arbitration carries the public expectation that dispute proceedings should be accomplished in an open and transparent manner.<sup>40</sup>

#### 4. Inherent Pro-investor Bias

Some claim that the system of arbitration is skewed in favor of investors at the expense of capital importing states.<sup>41</sup> Some of the specific justifications for this argument mirror the alternative critiques discussed here (e.g. BIT procedural unconscionability and biased arbitrators).<sup>42</sup> In addition to these claims, some have made general allegations of systemic bias.<sup>43</sup> The President of Bolivia, for example, claimed that “[g]overnments in Latin America and I think all over the world never win the cases. The transnationals always win.”<sup>44</sup> Critics have also targeted the North American Free Trade Agreement (NAFTA) Chapter 11, claiming it is biased in favor of the United

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arbitrators is antithetical to modern democratic ideals).

40. Jack J. Coe, Jr., *Transparency in the Resolution of Investor-State Disputes – Adoption, Adaptation, and NAFTA Leadership*, 54 KAN. L. REV. 1339, 1353 (2006).

41. See Steven Donziger et al., *The Clash of Human Rights and BIT Investor Claims: Chevron’s Abusive Litigation in Ecuador’s Amazon*, 17 HUM. RTS. BRIEF 8, 12 (2010); Riesenber, *supra* note 5, at 988-89; Kate Miles, *International Investment Law: Origins, Imperialism and Conceptualizing the Environment*, 21 COLO. J. INT’L ENVTL. L. & POLY 1, 2-3 (2010) (“Structurally, the panels seem to favor well-resourced private investors who can afford the best legal talent and disfavor the government lawyers running litigation for developing nations. Under the inchoate standards that govern these proceedings, some arbitrators have ruled in favor of investors repeatedly across numerous cases.”).

42. Miles, *supra* note 41, at 2-3; Riesenber, *supra* note 5, at 988-89.

43. See, e.g., Donziger *supra* note 41, at 12; Riesenber, *supra* note 5, at 988-89.

44. Leslie Mazoch, *Chavez Takes Cool View Toward OAS, Says Latin America Better Off Without World Bank*, HUFFINGTON POST (Apr. 30, 2007), <http://www.huffingtonpost.com/huff-wires/20070430/la-gen-venezuela-leftist-alternative/>.

States and Canada (capital exporting states) at the expense of Mexico (a capital importing state).<sup>45</sup>

The claim of pro-investor bias was tested empirically in 2006 by Franck who examined all available published investment arbitration awards at that time. She found that “[t]he percentage of ultimate winners does not appear to be meaningfully different for investors and governments.”<sup>46</sup> Although this limited empirical work helps to disprove the notion of the existence of an inherent pro-investor bias in investment dispute resolution, it does not necessarily address whether the system itself is designed in a way that favors investors at the expense of capital importing states. The relatively even distribution of investor winners versus government winners does not necessarily disprove a pro-investor bias if more than fifty percent of the cases brought by investors are non-meritorious.

Some argue that the entire system of international investment law was evolved from and maintains the interests of capital exporting states at the expense of capital importing states.<sup>47</sup> Kate Miles argues that the current international investment legal system emerged from a previous system of law and order that was very much based on power and domination; whereas, Ibironke Odumosu adds that “[c]olonial domination and gunboat diplomacy as the primary choices for investment protection reflect the power asymmetry that prevailed in the colonial era, and, which continued to influence the reaction of Third World states to foreign investment even after the end of direct colonial domination.”<sup>48</sup> Miles further observes that the

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45. See, e.g., Trakman, *supra* note 27, at 58 (“Chapter 11 decisions are also criticized for providing greater benefits to investors from capital-exporting NAFTA states than capital-importing ones, in effect, protecting U.S. and Canadian investment interests above Mexican interests.”); Ari Afilalo, *Meaning, Ambiguity and Legitimacy: Judicial (Re-) Construction of NAFTA Chapter 11*, 25 NW. J. INT’L L. & BUS. 279 (2005) (describing NAFTA Chapter 11 as “theater”).

46. Franck, *supra* note 2, at 50.

47. Miles, *supra* note 41, at 1-2.

48. *Id.* at 3, 20; Ibironke T. Odumosu, *The Antinomies of the (Continued) Relevance of ICSID to the Third World*, 8 SAN DIEGO INT’L L.J. 352, 358-59 (2007).

international investment system “emerged from an international legal system established amongst European nations and evolved through the ‘colonial encounter’ as a tool to protect the interests of capital-exporting states.<sup>49</sup> By the mid-nineteenth century, international investment principles had materialized, claiming universality and neutrality, but largely consisting of protection for investors and obligations for capital-importing states to facilitate trade and investment.”<sup>50</sup> For example, Miles points to the fact that many of the creators of international law, such as Hugo Grotius, developed their theories as agents for powerful corporate interests.<sup>51</sup>

Many allege that the current system of international investment law has maintained its “pro-investor” bias, which is but one symptom of gross global power differentials.<sup>52</sup> For example, corporations, usually incorporated in developed, Western countries, are given rights without being assigned any corresponding responsibilities.<sup>53</sup> Additionally, indirect expropriation claims grant investors enforceable rights without regard to the host state’s domestic need to regulate, which reinforces the concept of the host state as a passive commodity for exploitation.<sup>54</sup> Moreover, these rights have altered the rhetoric and frame of investment disputes. Instead of framing

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49. Miles, *supra* note 41, at 1-2.

50. *Id.* at 2.

51. *Id.* at 13-14 (“Indeed, Hugo Grotius, regarded as an objective legal theorist and described as ‘the father of international law,’ was in fact engaged as a legal advisor to the VOC. Far from embodying a disinterested representation of the law, a number of his most significant theories were developed to provide a legal basis for the activities of the VOC.”).

52. Stiglitz, *supra* note 24, at 468; Miles, *supra* note 41, at 45, Kaushal, *supra* note 1, at 503-06.

53. Stiglitz, *supra* note 24, at 468 (“One of the problems of BITs is that they are one-sided and unbalanced: They give corporations rights without responsibilities, compensation for adverse treatment, but not recovery of capital gains from positive treatment.”); *see also* Miles, *supra* note 41, at 45 (“The colonial encounter created ‘otherness’ in the concept of the host state, [excluding it] from the protective principles of international investment law. The host state was, and remains, unable to call upon the rules of international investment law to address damage suffered at the hands of foreign investors.”).

54. Miles, *supra* note 41, at 20.

the issue as one of whether or not the host state has the sovereign authority to regulate on important matters within its borders, the issue is re-framed in terms of the rights of corporations to their property, protected under international agreements, against arbitrary or unfair measures by the state. Miles observes that

[t]he investor response in using protections designed as a ‘shield’ instead as a ‘sword’ is a continuation of the imperialist pattern of manipulation of legal doctrine. It is an attempt to re-frame the use of a legal mechanism so as to support the commercial interests of foreign investors at the expense of the interests of the host state.<sup>55</sup>

It seems at least plausible that in a competitive global economy, the wealthier and more powerful nations are able to squeeze more out of developing countries in terms of getting what they want out of investment protection. And in such a relationship, what is stopping a country from acting in its own rational best interest, which at times will involve the exploitation of another country?

Yet there is a danger that the rhetoric of states versus corporations is overly simplistic. States are not always the champion of human rights, with corporations as the enemy. In many cases, states themselves are the perpetrators of human rights abuses. Within these contexts, tribunals may act as a check on state abuses of power, where the tribunal’s decision is well grounded in the law.

##### 5. BIT Protection and FDI Flows: The Benefit to the Bargain

The strategic gains that capital exporting countries receive from negotiating BITs are quite obvious – substantial protection for their investors who locate operations abroad.<sup>56</sup> For countries that function primarily as capital importers, it is not so obvious that offering private corporations a host of internationally

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55. *Id.* at 42 (footnote and citation omitted).

56. Fry, *supra* note 22, at 106.

enforceable rights outside of the state's normal judicial process is beneficial. The traditional argument offered in support of BITs for capital importing countries was the supposed positive relationship between investment protection and FDI.<sup>57</sup> In fact, promoting investment flows to developing countries was one of the original institutional missions of the International Centre for Settlement of Investment Disputes (ICSID).<sup>58</sup> Recent evidence seriously undermines the assumed empirical relationship between investment protection and FDI. Two United Nations (UN) studies found no direct link between BIT protection and FDI, and a World Bank study concluded that BIT protection does not seem to increase flows of FDI.<sup>59</sup> Moreover, the consensus in the research community has not even confirmed that FDI is beneficial for the host country's economic growth.<sup>60</sup> States may, in fact, have legitimate economic motivations for placing limited restrictions on FDI.<sup>61</sup> Such evidence calls into question the "benefit of the bargain" that capital importing countries are receiving in exchange for the significant protections offered to private investors. Of course, insofar as the current international legal system acts as a direct substitute for gunboat diplomacy, it is a preferable, albeit still

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57. *Id.*; see, e.g., Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?*, 46 HARV. INT'L L.J. 67, 77 (2005) (arguing that developing countries sign BITs to promote foreign investment); Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?*, LSE RESEARCH ONLINE (Feb. 2006), <http://eprints.lse.ac.uk/archive/00000627>.

58. Odumosu, *supra* note 48, at 358-59.

59. Kaushal, *supra* note 1, at 509 (citing THE WORLD BANK, GLOBAL ECONOMIC PROSPECTS OF DEVELOPING COUNTRIES 129 (2003)).

60. Trakman, *supra* note 27, at 5 ("Actually, economic studies suggest that, as far as developing states are concerned, FDI has not accounted for accelerated economic growth."); Maria Carkovic & Ross Levine, *Does Foreign Direct Investment Accelerate Economic Growth?*, in DOES FOREIGN DIRECT INVESTMENT PROMOTE DEVELOPMENT? 195, 196 (Theodore H. Moran et al. eds., 2002) ("Firm-level studies of particular countries often find that FDI does *not* find positive spillovers running between foreign-owned and domestically owned firms.").

61. Trakman, *supra* note 27, at 9-10; Stiglitz, *supra* note 24, at 512 ("Standard infant industry and infant economy arguments provide a strong rationale for why the protection of particular industries, including the financial sector, may be desirable as part of a developmental strategy.").

unequal, system for capital importing countries.<sup>62</sup> This does not mean, however, that there is no room for improvement, as in room for developing countries to better represent their interests in negotiations and investment decisions. Part of that involves, however, an investment on the front end in terms of hiring the right legal assistance, which is often a pricy endeavor that some governments may not quite grasp the importance of.

Another recent empirical study concluded that some countries use BITs symmetrically.<sup>63</sup> Symmetric use of BIT protection means that a state acts both as the respondent and the claimant (via its nationals) in different investment disputes.<sup>64</sup> Yet symmetric use of BIT protection is still relatively uncommon, representing only twenty percent of the total parties to investment disputes.<sup>65</sup> This suggests that, at present, BITs are still most commonly used asymmetrically – offering a country either investment protection for its nationals or offering the promise of increased FDI if a country offers investment protection to foreigners.

#### 6. Arbitrator Bias

Another criticism alleges systemic bias across the community of arbitrators.<sup>66</sup> In particular, one complaint addresses demographic trends in the arbitrators' nationalities.<sup>67</sup> Most arbitrators do not share the nationality of the respondent state, a fact which some feel undermines the arbitrator's ability to adequately consider issues of critical importance to a state.<sup>68</sup> There is no evidence to support the fact that it is actually the case, and I find it unlikely that an individual from the host state itself would serve as the best neutral arbitrator. Another complaint is that most arbitrators come from developed

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62. Odumosu, *supra* note 48, at 352-53.

63. Franck, *supra* note 2, at 34.

64. *Id.*

65. *Id.*

66. Donziger, *supra* note 41, at 12.

67. Coe, *supra* note 40, at 1351.

68. *Id.*

countries, which is confirmed by empirical analysis.<sup>69</sup> One study estimates that some seventy-five percent of arbitrators are from countries that are members of the Organisation for Economic Co-operation and Development (OECD).<sup>70</sup> There is a growing concern that an arbitrator's nationality may inappropriately affect his/her impartiality in a dispute.<sup>71</sup> Yet one empirical study found no statistically significant relationship between the nationality of an arbitrator and his/her ruling in a case, casting significant doubt upon such fears of bias.<sup>72</sup> Nevertheless these criticisms persist, showing the general dissatisfaction with the international arbitration system.

Another critique alleges that arbitrators are biased due to personal financial incentives to secure future panel appointments.<sup>73</sup> There is a relatively small pool of qualified international investment arbitrators, which means, in practice, that arbitrators must serve on multiple panels.<sup>74</sup> Some argue that these system dynamics encourage arbitrators to earn a reputation for ruling in a particular way, either pro-claimant or pro-respondent, while still grounding decisions in the applicable law, in order to be repeatedly hired by either claimants or respondents.<sup>75</sup> Empirical work on the subject concludes that “[i]n the 102 awards from the eighty-two different cases, there

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69. Franck, *supra* note 2, at 79.

70. *Id.*

71. See e.g., Franck, *supra* note 2, at 449; Ilhyung Lee, *Practice and Predicament: the Nationality of the International Arbitrator (with Survey Results)*, 31 *FORDHAM INT'L L.J.* 603, 612 (2008) (discussing the importance of an arbitrator's nationality).

72. Franck, *supra* note 2, at 439-40.

73. Donziger, *supra* note 41, at 12 (“Under the inchoate standards that govern these proceedings, some arbitrators have ruled in favor of investors repeatedly across numerous cases. Since there is no database of decisions and little or no public scrutiny, there is no system-wide check on any perceived or actual bias. Once a panelist develops a pro-investor reputation grounded in a solid grasp of international law, he or she becomes part of a highly coveted pool of candidates who are repeatedly appointed.”).

74. Coe, *supra* note 40, at 1351-52.

75. Donziger, *supra* note 41, at 12; see also Stiglitz, *supra* note 24, at 541 (“There are also serious concerns with the way arbitrators are selected. Arbitrators are not employed full-time, and often are representing parties in other cases where related issues are in dispute. The way arbitrators are appointed may expose them to undue political pressure.”).

were 145 different arbitrators. Some, but by no means a majority of arbitrators, served in multiple cases.”<sup>76</sup> It is unclear to what extent such characteristics of the system actually lead to the alleged bias.

### 7. Regulatory Chill

One of the most prominent criticisms of the investment arbitration system is that the investment system has a “regulatory chill” effect in critical areas such as human rights and environmental protection.<sup>77</sup>

Although some describe [the international investment system] as a win-win situation for both capital-importing and capital-exporting countries, others perceive an adversarial game between multinational corporations (and their capital-exporting country sponsors) and low-income developing countries. This can also be seen as a clash between two systems of rights, such as the rights of international business versus the rights of countries to direct their own development.<sup>78</sup>

The regulatory chill effect occurs when a state is discouraged from enacting regulation in furtherance of human rights or the protection of the environment as a direct result of its obligations under international investment law.<sup>79</sup> This may come about

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76. Franck, *supra* note 2, at 77.

77. Riesenberger, *supra* note 5, at 988-89; SARAH ANDERSON & SARA GRUSKY, CHALLENGING CORPORATE INVESTOR RULE 4 (2007), <http://www.ips-dc.org/wp-content/uploads/2009/05/challenging-Corporate-Investor-Rule-final.pdf> (“[T]he threat of massive damages awards can put a ‘chilling effect’ on responsible policy-making.”); AARON COSBEY ET AL., INT’L INST. FOR SUSTAINABLE DEV., INVESTMENT AND SUSTAINABLE DEVELOPMENT 13 (2004), [https://www.iisd.org/pdf/2004/investment\\_invest\\_and\\_sd.pdf](https://www.iisd.org/pdf/2004/investment_invest_and_sd.pdf) (“A secondary concern is that regulators who are held liable for their impacts on investors will not regulate to the extent that they should (the regulatory chill argument.”).

78. Christopher Borgen, *Transnational Tribunals and the Transmission of Norms*, 39 GEO. WASH. INT’L L. REV. 685, 697 (2007).

79. See, e.g., Jacob, *supra* note 4, at 13 (“Crucially, not only the actual but also the potential financial and political cost of investor-state arbitration or the threat thereof might suffice to cause a ‘chilling effect’ on national regulation.”); Kaushal *supra* note 1, at 511-12; Riesenberger, *supra* note 5, at 988-89.

because investors threaten to initiate a costly arbitration dispute in order to deter states from pursuing certain regulations.<sup>80</sup>

Some critics have argued that BIT instruments themselves represent an effective bar to regulation in contravention of a state's sovereign authority because states fear that MNCs may take retaliatory measures under the BIT in response to the passage of undesirable regulation.<sup>81</sup> Or, even if BITs may not effectively prevent regulation, they certainly increase the cost of enacting such regulation by requiring measures such as fair and adequate compensation when the regulation is deemed an indirect expropriation under the BIT.<sup>82</sup> Some have posited that such pressure against regulation in areas such as human rights and environmental protection could lead to a "race to the bottom" as states compete with one another for investment protection.<sup>83</sup>

Critics, such as Joseph Stiglitz, argue that robust investment protection is inappropriate for developing countries because it limits a state's regulatory authority.<sup>84</sup> Regulatory

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80. Riesenber, *supra* note 5, at 988-89.

81. Kaushal, *supra* note 1, at 511. One prominent example of this was when Phillip Morris International sought \$25 million in damages from the government of Uruguay for imposing stricter cigarette packaging regulations than the Uruguay-Switzerland BIT allows. *Uruguay Bilateral Investment Treaty (BIT) Litigation*, PHILLIP MORRIS INT'L, [http://www.pmi.com/eng/media\\_center/company\\_statements/Pages/uruguay\\_bit\\_claim.aspx](http://www.pmi.com/eng/media_center/company_statements/Pages/uruguay_bit_claim.aspx).

82. Jacob, *supra* note 4, at 14; SUZY H. NIKIEMA, INT'L INST. FOR SUSTAINABLE DEV., *COMPENSATION FOR EXPROPRIATION* 9-10, 16 (2013).

83. Stiglitz, *supra* note 24, at 490 ("Even if it could be shown that signing such an agreement led to more investment in a cross-section empirical study, it does not mean that developing countries as a whole benefit. As in other areas of competition, there can be a race to the bottom. The Nash equilibrium entails each developing country sacrificing its own interests (for example, with lower environmental or worker protections) in hope that it will gain enough additional investment to more than offset the losses. But, of course, when they all do so, none gain.").

84. *Id.* at 515-16; see, e.g., Andrew Paul Newcombe, *Regulatory Expropriation, Investment Protection and International Law* (1999) (unpublished Masters of Laws thesis, University of Toronto) (on file with the University of Toronto) (arguing that the requirement for developing states to pay compensation for deprivations of private rights deters state regulation); Evaristus Oshionebo, *Stabilization Clauses in Natural Resource Extraction Contracts: Legal, Economic, and Social Implications for Developing Countries*,

flexibility is particularly crucial for countries at an early stage of development.<sup>85</sup> Additionally, Stiglitz argues that many risks that BITs are meant to protect against are already factored into prices, in which case compensation in the context of an investment dispute may be inappropriate:

Consider, moreover, the case of a country debating passage of a law regulating toxic waste dumps. With foreign firms – not domestic firms – protected with a regulatory takings provision, prices of toxic waste dump sites would be depressed as a result of the expectation of the passage of the law. A foreigner could then buy the land, and when the law is passed, demand compensation, though, in effect, the price was already discounted to reflect the expectation of the regulation.<sup>86</sup>

As Stiglitz points out, sophisticated foreign companies can use investment protection even when they have suffered no actual financial loss.

Additionally, in certain cases, by providing compensation, international investment law can actually exacerbate the effect of externalities. Instead of forcing the polluter to pay for the external harm being unleashed on the public, certain state regulatory measures that decrease the value of the polluter's investment could be found to be in breach of international investment obligations and awarded compensation. This "vitiates the Polluter-Pays Principle; gives the corporation, in effect, the right to pollute; and, given strong budgetary constraints, results in political pressures preventing the adoption of robust regulatory and tort regimes."<sup>87</sup>

Both those arguing for and against the existence of the "regulatory chill" effect tend to couch their arguments in terms of abstract concepts or examples of specific investment disputes.<sup>88</sup> There has yet to be any comprehensive empirical

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10 ASPER REV. INT'L BUS. & TRADE L. 1, 29 (2010) (suggesting erosion of state's regulatory authority in fear of compensation provisions under BIT).

85. Stiglitz, *supra* note 24, at 515-16.

86. *Id.* at 532-33.

87. *Id.* at 535.

88. See, e.g., CHRISTIAN TIETJE ET AL., THE IMPACT OF INVESTOR-STATE-DISPUTE

work providing convincing evidence for or against the tangible effects that investment protection has on a state's behavior. One skeptic notes that there have actually been very few cases in which human rights have directly conflicted with a state's obligation under a BIT.<sup>89</sup> Moreover, in those limited cases in which there was a conflict, no Tribunal has ever directly ruled that a state's obligations to investors under a BIT obviate the need for a state to comply with its duties under international human rights law.<sup>90</sup> In many cases where there was a conflict between human rights and investor protection, the tribunal ruled against the investor in favor of the host state.<sup>91</sup> And even where the tribunal may find in favor of investors at the expense of the host state, the government still has the authority to regulate; regulation is simply more costly. In so far as a regulatory chill exists, the skeptic argues, it is the fault of the state, which has agreed to abide by its commitment under the BIT in full knowledge of both the potential implications that this decision will have on its regulatory ability and obligations to its population.<sup>92</sup> Yet the reality in the context of grossly underdeveloped states with limited legal and political capacity is that it is unlikely that the government committed to BITs with full knowledge and understanding of the implications.

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SETTLEMENT (ISDS) IN THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP 42-45 (2014) (contrasting the arguments for and against the existence of a regulatory chill effect of investment arbitration); Riesenber, *supra* note 5, at 987-88 (discussing abstract arguments such as, "the threat of an investment dispute has rendered traditional governmental protection of health, safety, and human rights prohibitively expensive," "investor-state arbitration has gone from being a protective shield for defending investors against unfair and discriminatory treatment to a sword used by those investors to attack legitimate government regulation," and, investment treaties are brandished as a legal stick to apply informal pressure upon host states).

89. Fry, *supra* note 22, at 100.

90. *Id.* at 100-02.

91. Yira Segrera Ayala, *Restoring the Balance in Bilateral Investment Treaties*, 32 REVISTA DE DERECHO, UNIVERSIDAD DEL NORTE 137, 155 (2009) ("In several occasions, investment arbitrations awards have referred to human rights jurisprudence in order to support substantive or procedural rules, or to deal with alleged conflicts between human rights and international investment law.").

92. Fry, *supra* note 22, at 104-05.

### B. A Conceptual Framework for Criticisms

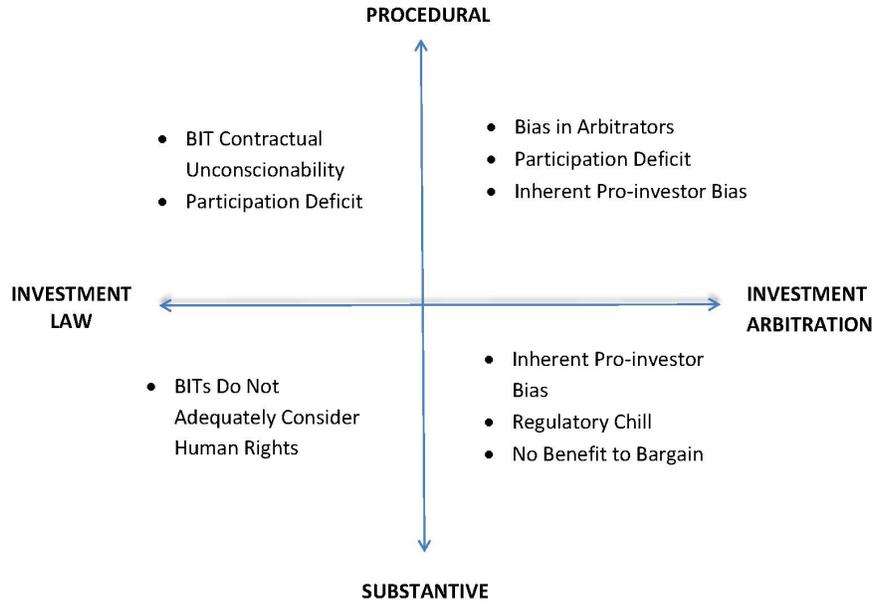


Figure 1: Breakdown of Investment Arbitration Law Criticisms

Criticisms of the international investment system can be broken down along two central binaries: Procedural/Substantive and Investment Law/Investment Arbitration.<sup>93</sup> Figure 1 utilizes these conceptual dichotomies to map the major criticisms discussed above.<sup>94</sup> Substantive criticisms of the investment system address the underlying protections as guaranteed by the treaty. Contrapuntally, Procedural criticisms deal with the underlying unfairness in the way in which international investment law is constructed and enforced.

93. See Kaushal, *supra* note 1, at 492 (“The source of this backlash may be distilled into two causes: substantively, the expansive interpretation of foreign investor protections by tribunals; and procedurally, the broad rendering of the arbitrability of disputes by arbitrators.”).

94. See *supra* Fig. 1.

Criticisms of Investment Law deal with issues that arise in the creation of investment treaties. These criticisms include claims that mirror both procedural and substantive unconscionability contract claims under U.S. law.<sup>95</sup> By comparison, critiques of Investment Arbitration deal with issues that arise after the investment treaty has been negotiated, once a dispute has arisen. On the Procedural side, complaints deal with the fairness of the mechanics of the system. On the Substantive end are claims that deal with the implications that the system has for states, particularly for capital importing states.

As can be seen from a quick glance at Figure 1, criticisms of the investment dispute system fall all over the map. This has a few practical implications. First, and most obviously, criticisms of unfairness are not concentrated in any phase or component of the investment system. Criticisms address the formation of the treaty and the operation of the arbitration system in both procedural and substantive terms. Second, criticism persist even when there is empirical evidence suggesting that the basis for the criticism may be unfounded. Moreover, many critics blur various criticisms together, failing to clearly articulate the precise basis of their complaint with the investment regime. This suggests that criticisms of the investment system may operate on a positive feedback loop. That is, criticisms in one area may promote further criticism in an entirely unrelated aspect of the investment arbitration process.

I argue that there is merit behind some, but not all of the criticisms lodged against the international investment arbitration system. Given that the system replaced that of gunboat diplomacy and given also that it significantly contributes to the rule of law internationally, it is unlikely that the system will be majorly overhauled anytime soon. The system does not work perfectly, or even equitably, but it does institute some global accountability and rule of law. Critics of the

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95. Sabine Schlemmer-Schulte, *Fragmentation of International Law: The Case of International Finance & Investment Law Versus Human Rights Law*, 25 GLOBAL BUS. & DEV. L.J. 409, 421 (2012).

international investment system would be wise to couch their criticisms more in legal or statistical arguments, rather than trying to claim that investment protection is inherently at odds with human rights and environmental protection. The latter argument is misleading and unhelpful in the quest to address the current problems in the investment system.

#### IV. THE LEGITIMACY CRISIS AND EFFICIENCY GAINS

I argue that criticisms of the international investment system represent a signal that the system is suffering from a lack of legitimacy. In the same way that international protests signaled a legitimacy crisis in the structure of the WTO,<sup>96</sup> the backlash against international investment law represents a similar signal.<sup>97</sup> Daniel Esty observed that the widespread protests over the trade negotiations in Seattle in 1999 represented a definitive signal that the WTO lacked international legitimacy.<sup>98</sup> In a series of articles, Esty established that, although international organizations like the WTO lack legitimacy in the form of direct electoral

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96. See, e.g., Daniel C. Esty, *The World Trade Organization's Legitimacy Crisis*, 1 *WORLD TRADE REV.* 7, 7-15 (2002) (arguing that widespread protests at major international meetings show that the WTO needs to re-establish its legitimacy and re-build its reputation); *World Trade Organization Protests in Seattle*, SEATTLE MUN. ARCHIVE, <http://www.seattle.gov/cityarchives/exhibits-and-education/digital-document-libraries/world-trade-organization-protests-in-seattle> (last visited Sept. 27, 2015) (describing how the November 1999 WTO conference in Seattle inspired one of the largest political protests ever seen in the city); *Cancun Trade Talks Begin Amid Protests*, BBC NEWS (Sept. 10, 2003), <http://news.bbc.co.uk/2/hi/business/3092502.stm> (describing how demonstrators tried to break through barricade around the site of the 2003 WTO meeting in Mexico); Philip P. Pan, *Protestors March as WTO Session Opens*, WASH. POST (Dec. 14, 2005), <http://www.washingtonpost.com/wp-dyn/content/article/2005/12/13/AR2005121300642.html> (describing protest against the WTO during its 2005 conference in Hong Kong).

97. Jason Webb Yackee, *Toward a Minimalist System of International Investment Law?*, 32 *SUFFOLK TRANSNAT'L L. REV.* 306, 308 (2009) (arguing inconsistent investment awards has led even supporters of the current regime to believe there is a legitimacy crisis in international investment law that needs to be solved by making changes).

98. Esty, *supra* note 96, at 7.

representation, there are other forms of legitimacy, which can create good governance at the international level.<sup>99</sup>

Similarly, I posit that the criticism of the international investment system should be taken as a sign that the system is undergoing a legitimacy crisis. Even though international arbitration is structured to provide a private means of adjudication, citizens in capital-importing and capital-exporting countries have a vested interest in the means by which such adjudication is conducted. The recent backlash seems to suggest that the system, as it is currently structured, fails to provide a baseline of legitimacy that satisfies its constituents. As explored above, commentators have taken issue with nearly every aspect of investment law. In some cases, allegations of bias have persisted even where there is empirical evidence dispelling such claims. The system lacks widespread legitimacy and seems to be losing, rather than gaining, international legitimacy.

This legitimacy crisis threatens to destabilize the entire system of international investment law. One commentator observed that backlash to the international investment system has led to a “reevaluation [of the investment system] on the part of both developed and developing countries.”<sup>100</sup> Many countries have in fact begun to roll back their commitments to international investment protection, especially in Latin America. In 2007, Bolivia denounced the ICSID Convention<sup>101</sup> followed by Ecuador, which withdrew its consent to ICSID in a non-binding statement for oil and mining contracts, and then Venezuela in 2012<sup>102</sup> Argentina has failed to comply with some

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99. *Id.* at 16-17; see also Daniel C. Esty, *Good Governance at the Supranational Scale*, 115 *YALE L.J.* 1490, 1515-22 (2006); Daniel C. Esty, *Good Governance at the World Trade Organization*, 10 *J. INT'L ECON. L.* 509, 511 (2007).

100. Kaushal, *supra* note 1, at 492.

101. *Bolivia Submits a Notice Under Article 71 of the ICSID Convention*, ICSID NEWS RELEASE (May 16, 2007), <https://icsid.worldbank.org/ICSID/StaticFiles/Announcement3.html>.

102. *Ecuador's Notification Under Article 25(4) of the ICSID Convention*, ICSID NEWS RELEASE (Dec. 5, 2007), [https://icsid.worldbank.org/apps/ICSIDWEB/Pages/News.aspx?CID=107&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&variation=en\\_us](https://icsid.worldbank.org/apps/ICSIDWEB/Pages/News.aspx?CID=107&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&variation=en_us); Notificación de Maria Fernanda Espinosa Garcés, Ministra de Relaciones Exteriores, Comercio e Integración, al Centro Internacional de Arreglo de Diferencias

ICSID awards.<sup>103</sup> Russia has withdrawn from the multilateral Energy Charter Treaty after issuing statements indicating that the treaty was biased in favor of consumers.<sup>104</sup> Jamaica unilaterally withdrew from ICSID, due to what is believed to be a dispute over jurisdiction concerning a mining concession.<sup>105</sup> Recently South Africa has withdrawn from a number of bilateral treaties in favor of national legislation protecting foreign investments.<sup>106</sup> Countries around the world are beginning to reconsider their participation in the international investment arbitration system. In some cases, these actions are motivated by a concern over the substance of investment protection rather than a concern with the legitimacy of the investment system. Still, many of these actions have still been cloaked in the rhetoric of legitimacy and tend to fuel the fire of criticism.

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Relativas a Inversiones (CIADI) [Notification from Maria Fernanda Espinosa Garcés, Minister of Foreign Affairs, Trade and Integration of Ecuador, to International Centre for Settlement of Investment Disputes], (Nov. 23, 2007), [https://icsid.worldbank.org/apps/ICSIDWEB/Documents/Ecuador's%20Notification%20under%20Article%2025\(4\)%20of%20the%20ICSID%20Convention.pdf](https://icsid.worldbank.org/apps/ICSIDWEB/Documents/Ecuador's%20Notification%20under%20Article%2025(4)%20of%20the%20ICSID%20Convention.pdf); *Venezuela Versus the ICSID Convention*, GLOBAL ARB. NEWS, (Feb 24, 2015), <http://globalarbitrationnews.com/venezuela-versus-icsid-convention-20120422/>.

103. Luke Eric Peterson, *Sudden Debt Overtime*, AM. LAW. (July 1, 2009), <http://www.americanlawyer.com/id=1202431654200/FOCUS-EUROPE/Sudden-Debt-Overtime>.

104. IRINA POMINOVA, RISKS AND BENEFITS FOR THE RUSSIAN FEDERAL FROM PARTICIPATING IN THE ENERGY CHARTER 1 (2014), [http://www.energycharter.org/fileadmin/DocumentsMedia/Occasional/Russia\\_and\\_the\\_ECT\\_en.pdf](http://www.energycharter.org/fileadmin/DocumentsMedia/Occasional/Russia_and_the_ECT_en.pdf); Robin Paxton, *Russia PM Putin Rejects International Energy Charter*, REUTERS (Aug. 6, 2009), <http://in.reuters.com/article/idINL639469220090806>.

105. INT'L CTR FOR SETTLEMENT OF INV. DISPUTES, CONTRACTING STATES AND MEASURES TAKEN BY THEM FOR THE PURPOSE OF THE CONVENTION 2 (2015), <https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/ICSID%208-Contracting%20States%20and%20Measures%20Taken%20by%20Them%20for%20the%20Purpose%20of%20the%20Convention.pdf>. See generally, John T. Schmidt, *Arbitration Under the Auspices of the International Centre for Settlement of Investment Disputes (ICSID)*, 17 HARV. INT'L L.J. 90 (1976) (discussing the attempt by Jamaica to withdraw its consent to ICSID jurisdiction over its bauxite mining industry).

106. Gerhard Erasmus, *Investment Protection Agreements*, (Tralac, Working Paper No. S15WP18/2015, 2015), <http://www.tralac.org/discussions/article/8282-investment-protection-agreements-the-implications-of-south-african-policy-and-legislative-changes.html>.

Without a sufficient backbone of legitimacy, the international investment system is at risk of some sort of collapse with respect to the rule of law. Moreover, even if *perceptions* of unfairness within the system become too great, the system is likely to suffer a degree of destabilization.<sup>107</sup> One commentator echoes this idea, noting that the system of international investment arbitration must not become too prejudiced in favor of investors or else states will refrain from participating in the system altogether.<sup>108</sup> Another observer suggests that impartiality and rule of law within the international investment system are essential for its survival.<sup>109</sup> If “the system is perceived to lack integrity, civil society groups may articulate concerns through methods ranging from organized programmatic critique to civil unrest.”<sup>110</sup>

I offer a very simplistic model to demonstrate that strengthening the legitimacy of the investment system results in system-wide efficiency gains. In some cases these gains may take the form of Pareto improvements and in others they will be Kaldor-Hicks efficient outcomes. My basic point is that most participants either value legitimacy intrinsically, or else they value the stability of the international investment system, which can be the result of enhanced legitimacy.

Pareto improvements, a concept derived from neoclassical economics, stresses the notion that efficiency gains may be made

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107. Franck, *supra* note 26, at 453. One commentator has suggested that the mere perception of inequity could have a cumulative effect that sets off a chain of events: “[I]t is time to recognize that there is a perception of unfairness which can no longer simply be ignored. If the perception persists, it is to be expected that more states will withdraw from investment treaties and from ICSID, and more will simply refuse to agree to any international arbitration.” George Kahale, III, *A Problem in Investor/State Arbitration*, 6 *TRANSNAT'L DISPUTE MGMT.* 1, 5 (2009).

108. Riesenber, *supra* note 5, at 1011-12.

109. Franck, *supra* note 26, at 437-38; accord U.N. Conference on Trade & Dev., Reform of Investor-State Dispute Settlement, *Reform of Investor-State Dispute Settlement: In Search of a Roadmap*, IIA ISSUES NOTE, June 2013, at 2-3, [http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf) (discussing the importance of maintaining impartiality in international dispute resolution involving arbitral panels).

110. Franck, *supra* note 26, at 438.

to any system where a change to the status quo, or current system, causes some participants to be made better off without making any other participant worse off.<sup>111</sup> Kaldor-Hicks is a related concept by which those who are made better off by a system change could in theory compensate any participants who are made worse off by the change.<sup>112</sup> A system is efficient within the Kaldor-Hicks model if after such compensation occurs, a Pareto improvement results from the change.<sup>113</sup> Consider, then, a model system of international investment law with three constituent groups: states (both capital importing and capital exporting), MNCs, and NGOs (promoting a public interest agenda in the host state, which for simplicity will be either conceptualized as human rights or environmental protection). I argue that where the international investment system threatens intrinsically important state values, such as human rights or environmental protection, there is a destabilizing tension introduced into the international investment system. This tension changes the normal cost-benefit calculation for each participant with respect to their support for legitimacy strengthening alterations to the investment system. Thus, participants such as capital-exporting states and MNCs, who may have previously believed that such legitimacy-enhancing alterations were unnecessary or against their self-interest, will generally recognize the need to strengthen legitimacy in order to preserve the stability of the system. In such contexts, legitimacy-strengthening changes to the system may represent a Pareto Improvement, or at least a result that is Kaldor-Hicks efficient.

Beyond pointing out the existence of such efficiency gains, I argue that, from a normative perspective, the legitimacy of the international investment system deserves significant attention. Many have called for drastic changes in the international investment system, if not for its complete overhaul, due to what

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111. Matthew D. Adler & Eric A. Posner, *Implementing Cost-Benefit Analysis When Preferences Are Distorted*, 29 J. LEGAL STUD. 1105, 1108 (2000).

112. *Id.*

113. *Id.*

they consider to be its fundamental biases.<sup>114</sup> I do not take a position on such reform proposals other than to note that aggressive attempts to reform the international investment system have met with little success.<sup>115</sup> My premise is simply that, if this system of international investment law is to continue to govern, then its sources of legitimacy ought to be strengthened.

## V. FORESTI V. SOUTH AFRICA: A CASE STUDY

In this section I provide a concrete example of my argument for legitimacy enhancements as efficiency gains through a case study of the *Foresti* arbitration dispute. I posit that the legitimacy enhancing decisions by the tribunal regarding NDP participation and cost shifting represent the type of efficiency gains described in the model above.

### A. *The Case Background*

The arbitration dispute *Foresti v. South Africa* stirred up considerable international controversy because it involved a challenge to South Africa's Black Economic Empowerment (BEE) policies, which were designed as remedial measures to alleviate the effects of racial discrimination from the apartheid era.<sup>116</sup> Although the Tribunal never reached a decision on the

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114. Riesenber, *supra* note 5, at 986-89 (discussing the rejection of investor-state arbitration by Bolivia, Ecuador, Russian Federation, Argentina, United States, Australia, and Japan); *accord* Esty, *supra* note 96, at 7 (arguing that the WTO needs to re-establish its legitimacy based on wider links into the public around the world and rebuild its reputation for efficacy); Kaushal, *supra* note 1, at 492-95 (discussing the growing number of concerns regarding the international-arbitration system from both developed and developing countries); NATHALIE BERNASCONI-OSTERWALDER & DIANA ROSERT, INT'L INST. FOR SUSTAINABLE DEV., INVESTMENT TREATY ARBITRATION 11-17 (2014), [http://www.iisd.org/pdf/2014/investment\\_treaty\\_arbitration.pdf](http://www.iisd.org/pdf/2014/investment_treaty_arbitration.pdf).

115. Riesenber, *supra* note 5, at 989.

116. See Whitsitt, *supra* note 9; Damon Vis-Dunbar, *South African Court Judgment Bolsters Expropriation Charge Over Black Economic Empowerment Legislation in the Mining Sector*, INV. TREATY NEWS (Mar. 23, 2009), <http://www.iisd.org/itn/2009/03/23/south-african-court-judgment-bolsters-expropriation-charge-over-black-economic-empowerment-legislation/>. See generally S. AFR. DEPT OF TRADE & INDUS., A STRATEGY FOR BROAD-BASED BLACK ECONOMIC EMPOWERMENT, <https://www.thedti.gov>

merits, the Tribunal's interim decision on third party participation and its default award on costs helped alleviate some of the pressure from critics and strengthened the legitimacy of the international arbitration system generally.<sup>117</sup> The Tribunal's actions in this case highlight some potential areas where tribunals can institute legitimacy enhancing efficiency gains by altering the system in ways that both protect the integrity of the investment system and smooth its friction when investment obligations conflict with human rights.

The *Foresti* dispute began officially in November 2006 when ICSID received a request for arbitration against South Africa by a group of Italian nationals and the company Finstone, incorporated in Luxembourg.<sup>118</sup> The claims were premised on South Africa's 2002 Mineral and Petroleum Resource Development Act (MPRDA), a law eliminating all old order mineral rights and leases, which required companies to apply for new order mineral rights.<sup>119</sup> The Claimants alleged that through the conversion process, companies could never recover their full mineral rights, and the additional regulatory requirements effectively strip the mineral rights of their economic value.<sup>120</sup> As part of the BEE strategy, companies who wished to obtain new order rights must have achieved twenty-six percent ownership by historically disadvantaged South Africans (HDSA) by 2014.<sup>121</sup> Although the law provides that such shares are to be sold at fair market value, claimants argued that this was not economically possible.<sup>122</sup> The Claimants, therefore, argued that

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.za/economic\_empowerment/bee-strategy.pdf

117. *Foresti v. Republic of South Africa*, ICSID Case No ARB(AF)/07/1, Award, ¶ 116 (Aug. 4, 2010) (merits); *id.*, Procedural Order, 1-2 (Sept. 25, 2009) (third party participation); *id.*, Award, ¶¶ 130-33 (default award).

118. *Id.*, Award, ¶ 1.

119. *Id.* ¶¶ 22, 54-55 (citing Mineral and Petroleum Resources Development Act 28 of 2002 (S. Afr.)).

120. *Id.* ¶¶ 59-62.

121. *See id.* ¶ 56 (stating the Government of South Africa's position that historically disadvantaged South Africans benefit and participate in the exploitation of mining and mineral resources).

122. *Id.* ¶ 64 (noting that claimants argued that the equity divestiture scheme created by the government made it impossible to sell the shares even at a discounted

such state measures constituted indirect expropriation because of the state's failure to pay compensation, discrimination in the application process, and lack of due process.<sup>123</sup> The Claimants additionally alleged that the measures constituted a violation of fair and equitable treatment and South Africa's national treatment obligations under its BITs.<sup>124</sup>

The Respondents countered by arguing that any expropriation that occurred was lawful because the measure: (1) was for a public purpose (remedying racial discrimination), (2) provided fair and adequate compensation (providing new order mineral rights), (3) was non-discriminatory (within the acceptable margin of difference), and (4) was carried out under due process of law (following the MPRDA procedures).<sup>125</sup> In the alternative, the Respondents argued that there was no expropriation: (1) where there was no total loss of rights over the minerals, and (2) where the action represents a rational and proportional government regulation.<sup>126</sup>

### *B. The Controversy*

The *Foresti* dispute attracted significant attention both within South Africa and abroad.<sup>127</sup> Many have speculated as to the effect *Foresti* would have on the investment arbitration system's jurisprudence concerning the outer boundaries of a state's regulatory power and the "regulatory chill" effect of international investment law on domestic human rights legislation.<sup>128</sup> Marianne Chow, for example, traced the tensions

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market value, and therefore created an indirect expropriation).

123. *Id.* ¶¶ 65-66.

124. *Id.* ¶ 78.

125. *Id.* ¶¶ 69-73.

126. *Id.* ¶¶ 74-76.

127. *See, e.g.,* Whitsitt, *supra* note 9. *See generally* Andrew Friedman, *Flexible Arbitration for the Developing World: Piero Foresti and the Future of Bilateral Investment Treaties in the Global South*, 7 *BYU INT'L L. & MGMT. REV.* 37 (2010) (discussing the importance of the *Foresti* case in terms of the tension between international obligations – protecting foreign investment and safeguarding human rights – and a nation's ability to enact corrective legislation to redress past social wrongs).

128. *See, e.g.,* Nicholas DiMascio & Joost Pauwelyn, *Nondiscrimination in Trade*

between South Africa's conception of equality and the standard definition of equality under international investment law, noting that "[f]irst, under South African law, equality entails a positive duty to promote the advancement of disadvantaged groups of people, whereas international law's concept of equality is a negative duty to refrain from discrimination."<sup>129</sup> This implies that such discrepancy between these conceptions of equality could place a burden on states, which seek to adopt more aggressive affirmative action policies.

Chow also argues that South Africa suffers from a capacity deficit in its ability to negotiate investment agreements.<sup>130</sup> Specifically, she points to understaffing, insufficient experience, a lack of resources, and an overly broad exemption procedure allowing some international treaties to bypass bicameral legislative review.<sup>131</sup> Additionally, international agreements in South Africa are primarily considered a foreign policy matter, and only recently have government officials begun to realize the domestic regulatory implications of such agreements.<sup>132</sup> In this way the *Foresti* dispute embodies many of the critiques of the international investment system explored above.

### C. Transparency and the Participation of Non-Disputing Parties

One unique feature of the *Foresti* arbitration was the extent to which Non-Disputing Parties (NDP) were allowed to participate in the arbitration process. In July 2009, four NGOs – the Centre for Applied Legal Studies (CALS), Legal Resources Centre (LRC), the Center for International Environmental Law

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and *Investment Treaties*, 102 AM. J. INT'L L. 48, 86 (2008) (explaining the national treatment principle's role in international trade and investment law); Jacob, *supra* note 4, at 14-15.

129. Marianne W. Chow, *Discriminatory Equality V. Nondiscriminatory Inequality: The Legitimacy of South Africa's Affirmative Action Policies Under International Law*, 24 CONN. J. INT'L L. 291, 315 (2009).

130. *Id.* at 330-31.

131. *Id.*

132. *Id.* at 330 (discussing South Africa's new formation of "clusters" for the purpose of international trade and investment negotiations).

(CIEL), and INTERIGHTS<sup>133</sup> – petitioned the Tribunal for limited participation as NDPs.<sup>134</sup> These NGOs sought amicus participation in order to address the issue of how South Africa’s human rights obligations should affect its investment obligations under its BITs.<sup>135</sup> They argued that South Africa’s obligations under its BITs should not be read so as to contradict its obligations to address issues of fundamental human rights and to use affirmative action policies if necessary:

The South African Government’s domestic constitutional obligations to pursue the progressive realisation of human rights – including substantive equality and the right to a healthy environment – are clear. Any award by this Tribunal that directly contradicts or effectively nullifies the South African Constitution, even if unwittingly, could potentially lead to a domestic invalidation of the BITs, which would obviously be to the detriment of all concerned.<sup>136</sup>

In accordance with ICSID Additional Facility Rules, the Tribunal consulted the parties on their views as to whether NDPs should be allowed to make submissions.<sup>137</sup> By September, the Tribunal determined that the NDPs were allowed to make submissions in the dispute and required the parties to submit redacted evidence to the NDPs for the purpose of constructing their submission.<sup>138</sup> The Tribunal decided, in this unprecedented move, to allow NDP access to case documents against the will of the Claimants.<sup>139</sup> The Tribunal justified its decision to require the submission of redacted evidence to NDPs with the following reasons:

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133. Petition for Limited Participation as Non-Disputing Parties at 4-7 (Aug. 4, 2010), *Foresti v. Republic of South Africa*, ICSID Case No. ARB(AF)/07/1 (Aug. 4, 2010) [hereinafter NDP Petition], <http://www.interights.org/files/123/PetitionforlimitedparticipationasnondisputingpartiesFINAL.pdf>.

134. *Foresti v. Republic of South Africa*, ICSID Case No. ARB(AF)/07/1, Procedural Order, 1-2 (July 31, 2009).

135. NDP Petition, *supra* note 133, at 8-20.

136. *Id.* at 19.

137. *Foresti*, ICSID Case No. ARB(AF)/07/1, Procedural Order, 1 (July 31, 2009).

138. *Id.* at 1-2; *Id.*, Award, ¶ 28 (Aug. 4, 2010).

139. *Id.*, Procedural Order, 1-2.

(1) NDP participation is intended to enable NDPs to give useful information and accompanying submissions to the Tribunal, but is not intended to be a mechanism for enabling NDPs to obtain information from the Parties.

(2) Where there is NDP participation, the Tribunal must ensure that it is both effective and compatible with the rights of the Parties and the fairness and efficiency of the arbitral process.<sup>140</sup>

The Tribunal was somewhat more conservative with respect to open hearings. The NDPs had requested the opportunity to attend the hearings and make oral submissions.<sup>141</sup> In September 2009, the Tribunal noted that it did not anticipate that NDPs would be permitted to attend or make oral submissions at the hearing but that it would reserve the question until after the parties had responded to the NDP written submissions.<sup>142</sup>

In a more progressive move, the Tribunal allowed the NDPs to offer brief comments on the fairness and effectiveness of the procedures adopted for NDP participation in this case.<sup>143</sup> The Tribunal would “then include a section in the award, recording views (both concordant and divergent) on the fairness and efficacy of NDP participation in this case and on any lessons learned from it.”<sup>144</sup> In this decision, the Tribunal essentially committed itself to engage with the “contentious question of NDP participation in ICSID arbitrations” on a level never before seen.<sup>145</sup> The final award in fact contained no section incorporating the NDPs’ views on the participation and fairness of process.<sup>146</sup> This likely arises from the fact that Claimants

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140. *Id.* at 1.

141. NDP Petition, *supra* note 133, at 44-46.

142. *Foresti*, ICSID Case No. ARB(AF)/07/1, Procedural Order, 2.

143. *Id.*

144. *Id.*

145. Whitsitt, *supra* note 9.

146. *Foresti*, ICSID Case No ARB(AF)/07/1, Award, ¶¶ 98-133.

sought discontinuance and therefore the Tribunal only presented a default award on fees and costs.<sup>147</sup>

The Tribunal's decision in *Foresti* to allow for substantial NDP participation can be situated in the broader discussion over the proper scope of amicus participation and transparency in investment arbitration proceedings. The international investment system, as previously mentioned, has endured criticisms for its lack of transparency. With a few notable exceptions, BITs do not explicitly provide for transparency of procedure.<sup>148</sup> Each individual dispute resolution forum has its own distinctive procedures on transparency, and none require that the arbitration award be published without the consent of the parties.<sup>149</sup> There has been some movement towards greater transparency and participation. For example, in 2001, NAFTA clarified its position on the duty of confidentiality implied in Chapter 11 proceedings by noting:

Nothing in the NAFTA imposes a general duty of confidentiality on the disputing parties to a Chapter Eleven arbitration, and, subject to the application of Article 1137(4), nothing in the NAFTA precludes the Parties from providing public access to documents submitted to, or issued by, a Chapter Eleven tribunal.<sup>150</sup>

In 2004, the United States, at the forefront of the transparency movement, altered its model BIT to allow for amicus participation and open hearings.<sup>151</sup> In 2006, ICSID revised its rules and procedures to allow explicitly for the submission of amicus briefs and to permit open hearings under certain

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147. *Id.* ¶ 79.

148. Jacob, *supra* note 4, at 24 (noting that the general rule is that investment agreements do not contain provisions regarding arbitral transparency, but there are some exceptions, such as CAN. MODEL BIT, art. 38 (2004) and U.S. MODEL BIT, art. 10 (2004)).

149. *Id.*

150. Free Trade Comm'n, *Notes of Interpretation of Certain Chapter 11 Provisions*, ORG. OF AM. STATES (July 31, 2001), [http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding\\_e.asp](http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp).

151. U.S. MODEL BIT (2004), <http://www.state.gov/documents/organization/117601.pdf>.

circumstances.<sup>152</sup> Scholars have debated the costs and benefits to expanding transparency and NDP participation. Arguments cautioning against greater transparency often begin with the premise that transparency runs contrary to the nature of the investment arbitration system as a creation of a semi-private contractual agreement.<sup>153</sup> International investment arbitration arises from a contractual agreement (usually from a state's pre-commitment under the relevant investment treaty) to resolve the parties' dispute in the private arbitration forum in lieu of litigation in domestic courts.<sup>154</sup> Because the choice of arbitration as a forum is derived from the consent of the parties, the determination of arbitration procedures are likewise generally left to the consent of the parties. Arbitration is assumed to proceed more quickly than the alternative domestic adjudication. Some have also argued that allowing amicus participation substantially increases the cost on both parties by slowing down the arbitration process.<sup>155</sup> This argument has

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152. *Amendments to the ICSID Rules and Regulations*, ICSID NEWS RELEASE, Apr. 5, 2006, [https://icsid.worldbank.org/apps/ICSIDWEB/Pages/News.aspx?CID=115&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&variation=en\\_us](https://icsid.worldbank.org/apps/ICSIDWEB/Pages/News.aspx?CID=115&ListID=74f1e8b5-96d0-4f0a-8f0c-2f3a92d84773&variation=en_us) (noting the amendment to ICSID CONVENTION, RULES & REGULATIONS, R. 37 (2006)).

153. See, e.g., Coe, *supra* note 40, at 1342 (suggesting that part of the appeal of arbitration is less transparency because the standard commercial arbitration model ensures that proceedings will be private, the tribunal's public disclosures will be limited, and the parties may agree to prohibit disclosures); Cindy G. Buys, *The Tensions Between Confidentiality and Transparency in International Arbitration*, 14 AM. REV. INT'L ARB. 121, 123 (2003) (suggesting that confidentiality in arbitration may be valuable in order to prevent exposure of certain allegations to the public, protection of publicity, and protection of sensitive business information and trade secrets); Catherine A. Rogers, *Transparency in International Commercial Arbitration*, 54 U. KAN. L. REV. 1301, 1308-09 (2006) (suggesting that transparency in all cases might not be beneficial to the public because the international commercial arbitration system primarily adjudicates private law claims between private parties).

154. See Coe, *supra* note 40, at 1346-47 ("[I]nvestor-state arbitration typically depends on post-dispute mutual assent formed after the investor becomes aggrieved.").

155. See, e.g., Andrea K. Bjorklund, *The Emerging Civilization of Investment Arbitration*, 113 PA. ST. L. REV. 1269, 1293 (2009) (stating that the filing of amicus briefs increases time and cost burdens on attorneys and arbitrators); Coe, *supra* note 40, at 1363-64 (suggesting that the inclusion of amici naturally implies added time-consuming costs); S. CTR., DEVELOPMENTS ON DISCUSSIONS FOR THE IMPROVEMENT OF THE FRAMEWORK FOR ICSID ARBITRATION AND THE PARTICIPATION OF DEVELOPING COUNTRIES 11 (2005), <http://www.southcentre.int/wp->

been applied to the issue of public hearings, where one commentator noted that public hearings would provide additional procedural challenges and increased costs and could even threaten exposing parties' trade secrets.<sup>156</sup>

Weighing against such concerns is the desire to harmonize the international investment arbitration with the international human rights regime. Jacob argues:

For one, *amicus curiae* participation could be further widened in order to bring a broader perspective to the table, in particular when neither investor nor state are minded to invoke human rights points. Participation by observers without a direct interest in the case can be of great assistance to a Tribunal by drawing attention to relevant matters not pleaded by the parties and through the furnishing of special expertise.<sup>157</sup>

This thesis is elucidated by Fry, who notes:

Transparency is essential for the realization of human rights as it promotes access to information concerning the allocation of resources in the context of progressively realizing economic, social and cultural rights, including the right to water. Such information is essential for effective public action and monitoring of both the public and private sector.<sup>158</sup>

Fry further alleges that the lack of transparency may contribute to the "regulatory chill" effect because, without published awards from past arbitrations to rely on, states cannot accurately predict the lawful outward bounds of state action.<sup>159</sup> Others have argued that even though the system of international investment arbitration does not abide by the

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content/uploads/2013/07/AN\_INV1\_Improvement-of-the-Framework-for-ICSID\_EN.pdf (listing reasons accepting *amicus curiae* will impact the substantive proceedings of arbitration).

156. Coe, *supra* note 40, at 1361-62.

157. Jacob, *supra* note 4, at 37.

158. Fry, *supra* note 22, at 114 (quoting U.N. Economic and Social Council, Sub-Comm. on the Promotion of Human Rights, *Report of the High Commissioner for Human Rights, Human Rights, Trade and Investment*, ¶ 28, U.N. Doc. E/CN.4/Sub.2/2003/9 (July 2, 2003)).

159. *Id.* at 115.

principle of *stare decisis*, uniform publication of decisions nevertheless would enhance predictability and therefore increase the probability of settlement.<sup>160</sup> Along those lines, the predictability arising from the publication of arbitration materials could also promote investment confidence.<sup>161</sup>

If one conducted a cost-benefit analysis to determine whether the investment arbitration system should be altered to incorporate greater transparency and participation, this analysis should not be conceived as a static calculation divorced from context. Specifically, where the intersection of human rights and investment law generates significant backlash to the investment law system, there are increased benefits to expanding transparency. In a speech about ethics and transparency, Charles Brower, one of the arbitrators in the *Foresti* case, discussed the panel's strides towards greater transparency.<sup>162</sup> He then closed his speech with the following words:

In our continued efforts to enhance the legitimacy of arbitration as a form of dispute resolution we must constantly keep in mind two principles: first and foremost, the system must continue to serve the needs of those who actively use the system, while at the same time accommodating the needs of external parties who are affected by arbitral processes; and second, we must continue to aspire to fulfill Lord Hewart's

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160. See Elina Zlatanska, *To Publish, or Not To Publish Arbitral Awards*, 81 INT'L J. ARB. MEDIATION & DISP. MGMT. 25, 28 (2015) (suggesting publication of arbitral awards would, among other things, increase foreseeability of outcomes and inclination to resolve disputes without resorting to arbitration); see also Coe, *supra* note 40, at 1357-58 ("[W]hen one tribunal speaks to issues critical to other cases, it will often change for each disputant in those other cases the perceived risks of proceeding and, concomitantly, the attractiveness of settlement . . .").

161. See Coe, *supra* note 40, at 1358-59 (suggesting that investor confidence is a function of a host state's record of honoring promises to arbitrate and its official stances for important protections and doctrines, which may be ascertained by arbitration materials such as awards).

162. See Charles N. Brower, Keynote Address, *The Ethics of Arbitration*, 5 BERKELEY J. INT'L L. PUBLICIST 1, 29-30 (2010) (stating that the *Foresti* Tribunal, upon determination of necessity, granted non-disputing parties unprecedented access to the opposing side's filings prior to submission of amici briefs).

pronouncement that “[i]t is of fundamental importance, that justice should not only be done, but should manifestly and undoubtedly be seen to be done.”<sup>163</sup>

Brower seems to suggest that there are three key elements to maintaining the legitimacy of the current arbitration system: (1) the interests of those in maintaining the investment protections offered by the system, (2) the externalities caused by the system, and (3) the perceived unfairness of the system. Empirically, it has been the externalities of the system in combination with the perceived unfairness of the system which has generated the greatest destabilizing forces. I propose that these periods of destabilization will be countered by the introduction of transparency as an attempt to accommodate third parties and combat perceived unfairness.

Furthermore, I posit that when a case implicates perceived conflicts between international investment law and the human rights regime, there are additional benefits to promoting transparency – namely, preserving the stability of the investment system as a whole. Promoting transparency in this context represents a Pareto improvement. If we think of the interests of capital-exporting states as roughly aligned with MNCs then the introduction of the destabilizing tension means that, in this context, transparency-enhancing decisions make them at least no worse off (if not better off). NGOs, in our simplistic model, are made better off because they seek transparency so they can better monitor the system. Finally, capital importing states are made no worse off, for they often depend on NGOs to monitor the system.

This likely explains why tribunals have made some of the most aggressive steps in expanding openness of the arbitration system during those times when the system was threatened by a perceived unfairness arising from a conflict with public rights. In *AWG v. Argentine Republic*, an ICSCID Tribunal permitted

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163. *Id.* at 30-31 (quoting *King v. Sussex Justices, Ex parte McCarthy* [1924] 1 KB 256, 259).

petitioning NDPs to provide their views on the case.<sup>164</sup> In arriving at this conclusion the Tribunal noted:

The factor that gives this case particular public interest is that the investment dispute centers around the water distribution and sewage systems of a large metropolitan area, the city of Buenos Aires and surrounding municipalities. Those systems provide basic public services to millions of people and as a result may raise a variety of complex public and international law questions, including human rights considerations. Any decision rendered in this case, whether in favor of the Claimants or the Respondent, has the potential to affect the operation of those systems and thereby the public they serve.<sup>165</sup>

In *Methanex*, the tribunal, operating under UNCITRAL procedures, determined that it had the “procedural flexibility” and discretion to allow for amicus petitions.<sup>166</sup> This decision came at a critical time, when criticism over NAFTA’s Chapter 11 had reached a height. For one, the *Methanex* case came directly after the *Metalclad* decision, which some feared would turn the “polluter pays” tenet of environmental liability on its head.<sup>167</sup> One observer describes the NGOs arguments in its petition:

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164. AWG Group v. The Argentine Republic, ICSID Case No. ARB/03/19, Decision on Liability, ¶ 13 (July 30, 2010), <http://www.italaw.com/documents/SuezVivendiAWGDecisiononLiability.pdf>.

165. *Id.*, Order in Response to a Petition for Transparency and Participation as Amicus Curiae, ¶ 19 (May 19, 2005), 21 ICSID REV.–FOREIGN INV. L.J. 342, 347 (2006).

166. Coe, *supra* note 40, at 1375; *see Methanex Corp. v. United States*, Decision of the Tribunal on Petitions From Third Persons to Intervene as “Amici Curiae”, 14-15 (Jan. 15, 2001), <http://naftaclaims.com/disputes/usa/Methanex/MethanexDecisionReAuthorityAmicus.pdf> (discussing the tribunal’s conclusion that it could allow third parties to make amicus submissions based on the wording of Article 15(1) of the UNCITRAL Arbitration Rules); *see also* UNCITRAL Arbitration Rules, G.A. Res. 31/98, U.N. GAOR, 31st Sess., art. 15(1) Supp. No. 17, UN. Doc. A/31/17 (Apr. 28, 1976) (“Subject to these Rules, the arbitral tribunal may conduct the arbitration in such manner as it considers appropriate, provided that the parties are treated with equality and that at any stage of the proceedings each party is given a full opportunity of presenting his case.”).

167. Coe, *supra* note 40, at 1370 (quoting *Methanex Inc. v. United States*, Final IISD Submission Re the Petition of IISD for Amicus Status, ¶ 17, (Oct. 16, 2000), <http://www.state.gov/documents/organization/3934.pdf>); *see also* Marc A. Munro,

Soon after the *Metalclad* award was issued, an NGO that sought to participate in the *Methanex* case posited that, in light of *Metalclad*, its petition had become all the more worthy and urgent. It noted the lack of amici in the *Metalclad* proceedings, the NAFTA states perceived failure in that case to stress environmental priorities, and the outcome – an apparent finding that environmental regulation had worked an expropriation.<sup>168</sup>

Because the case in point, *Methanex*, concerned a conflict between environmental protection and investor protection, many argued that amicus participation was essential at illuminating important considerations that would not otherwise be expressed. Amicus petitioners also played off of the widespread criticism that NAFTA endured at this time. They argued that expanding access and transparency in international arbitration would help restore NAFTA's reputation:

The public credibility of the NAFTA Chapter 11 process is at a critical point. By providing for an orderly process for amicus participation, the Tribunal will not only enable itself to better address the issues that are both directly and indirectly at stake in this case, but it will also provide a sound basis for other Chapter 11 tribunals to deal with requests for amicus status.<sup>169</sup>

Finally, the *Foresti* case continues this jurisprudence. The Tribunal's unprecedented expansion of the role for amicus (NDP access to confidential documents and the solicitation of the NDPs' views on the fairness and efficacy of process) came in the

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*Expropriating Expropriation Law*, 5 ASPER REV. INT'L BUS. & TRADE L. 75, 96 (2005) ("Under the *Metalclad* tribunal interpretation of Article 1110, the well-established international law principle of polluter pays, first enunciated by the OECD in 1972, has been transformed into pay the polluter."); Jenny Harbine, *NAFTA Chapter 11 Arbitration*, 29 ECOLOGY L.Q. 371, 389 n.118 (2002) ("Chapter 11 turns the 'polluter pays principle' on its head by requiring the government [effectively, the public] to pay for the right to regulate for a healthy environment rather than requiring those who pollute the environment to compensate the general public for the injury.").

168. Coe, *supra* note 40, at 1370.

169. *Id.* at 1372 (quoting *Methanex Corp. v. United States*, Final Submissions Re the Petition of IISD for Amicus Status, ¶ 40, (Oct. 16, 2000), <http://www.state.gov/documents/organization/3934.pdf>).

shadow of significant concern over South Africa's right to enact affirmative action laws to uphold its human rights obligations.<sup>170</sup>

#### *D. Costs and Fees*

The cost of international investment disputes has become a matter of increasing concern. Commentators have expressed particular unease with respect to small and low income countries, for which large arbitration claims represent a substantial or even insurmountable burden on state resources.<sup>171</sup> Previous estimates of investment arbitration costs and fees have largely been inconsistent and anecdotal.<sup>172</sup> In one recent empirical study, a researcher placed the average estimated amount in damages awarded by tribunals at U.S. \$10.4 million, a number which is much lower than most previous estimates.<sup>173</sup> It is also significantly lower than the average amount claimed in the original petition for relief; the amount

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170. *See supra* Part IV.B (suggesting that conflicting concepts of equality between international law and South African law interfered with South Africa's ability to enact more aggressive affirmative action laws).

171. Franck, *supra* note 2, at 64-67; *see, e.g.*, Roberto Dañino, Sec'y-Gen., ICSID, Making the Most of International Investment Agreements: A Common Agenda, Opening Remarks (Dec. 12, 2005), <http://www.oecd.org/daf/inv/internationalinvestmentagreements/36053800.pdf> (“[An] issue of concern has been the growing cost of arbitration. This has been particularly true for the low-income countries, and for a few small companies, which cannot afford being represented by the most experienced and sophisticated law firms in the field, as claimants usually are.”); LUKE ERIC PETERSON, ALL ROADS LEAD OUT OF ROME: DIVERGENT PATHS OF DISPUTE SETTLEMENT IN BILATERAL INVESTMENT TREATIES 18 (2002), [http://www.iisd.org/pdf/2003/investment\\_nautilus.pdf](http://www.iisd.org/pdf/2003/investment_nautilus.pdf) (suggesting that contesting an arbitral claim is unattractive to poorer developing countries due to cost).

172. Franck, *supra* note 2, at 66-67 (listing anecdotal costs in various cases estimated at over \$6 million, \$4 million, \$10 million where \$3.3 million was budgeted one year and \$13.8 million was budgeted another year, as well as predicted costs by Canadian officials ranging between \$500,000 and \$1.5 million and an average of \$220,000 by ICSID).

173. *See id.* at 58 (stating that tribunals awarded an average of US \$10.4 million, which is significantly less than US \$343.4 million, the average amount of damages claimed).

*claimed* is on average U.S. \$333 million greater than the amount *awarded*.<sup>174</sup>

Fee shifting by tribunals has not been governed by a clear jurisprudence. The practice has occurred in only a small portion of cases. One study estimates that tribunals shifted costs in twenty-four percent of cases in which there was a final decision rendered.<sup>175</sup> Procedural rules offer little concrete guidance as to whether and how tribunals should shift costs at the conclusion of an investment dispute.<sup>176</sup> Although the process of cost shifting has been relatively unpredictable, one commentator, Riesenber, argues that tribunals have generally followed the American Rule, by which costs remain with the originating party regardless of who prevails on the merits.<sup>177</sup> He also notes that some recent tribunals have rendered decisions consistent with the English Rule, under which the prevailing party is indemnified against costs by the losing party, even in those cases in which there was no alleged bad faith on the part of the Claimants.<sup>178</sup>

Riesenber advocates for universal acceptance of the English Rule in investment arbitration.<sup>179</sup> This, he proposes, would undermine the pro-investor bias by allowing state parties to be made whole in the event that they prevail in an investment dispute.<sup>180</sup> Such reform, according to Riesenber, is crucial at a

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174. *Id.* at 59.

175. *See id.* at 69 (“Out of the 102 awards, fifty-four awards contained PLC decisions, and forty-one awards did not shift PLC. Instead parties bore their own legal costs. Thirteen awards did shift costs. In six cases, investors contributed to the legal costs of the government; and, in seven cases, the government contributed to the investor’s legal costs.”).

176. *See* Riesenber, *supra* note 5, at 998 (citing procedural rules provided by the Washington Convention and UNCITRAL granting arbitrators broad discretion to shift costs).

177. *See id.* at 991 (“[A]n empirical study showed that investor-state tribunals had followed the American rule and ordered parties to pay their own legal fees in about four-fifths of disputes.”).

178. *Id.* at 993-94.

179. *See generally id.* (discussing the advantages of the English rule over the American rule and the pro-claimant rule to mitigate alleged pro-investor bias and the chilling effect on host states’ legitimate use of police power).

180. *Id.* at 992-93.

time when the international investment system is experiencing severe criticism and backlash.<sup>181</sup> For one, the American system of costs encourages the filing of arbitration disputes which carry a low probability of success on the merits but are accompanied by a high amount of damages claimed.<sup>182</sup> Defending against such disputes places tremendous stress on states with limited resources.<sup>183</sup> Today, MNCs typically have financial resources which far outstrip many small or poor developing countries.<sup>184</sup> Additionally, Riesenbergs alleges that the English cost system may provide a better deterrent to nuisance suits because under the American system it is often less costly to settle than to litigate.<sup>185</sup> Commentators have added that the arbitration system should permit sanctions against parties for filing frivolous claims before the final award in order to deter frivolous suits; such sanctions might mirror those under the U.S. Federal Rules of Civil Procedure.<sup>186</sup> Some forms of a Tribunal's

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181. *Id.* at 993.

182. *Id.* at 1005-06.

183. *See id.* at 1008-09 (providing an example of asymmetrical resources in *CDC Group PLC v. Republic of the Seychelles*, where the claimant was represented by a major international law firm specializing in investor-state arbitration while the respondent had unreliable internet access).

184. *See e.g.*, Martin Khor, *The Emerging Crisis of Investment Treaties*, GLOBAL POLY F., Nov. 21, 2012, <https://www.globalpolicy.org/economic-expansion/international-trade-agreements-8-22/52113-the-emerging-crisis-of-investment-treaties.html> (providing examples of international law suits by multinational corporations against nations, such as a \$1.8 billion judgment against Ecuador by U.S. oil company Occidental Petroleum, a \$2 billion suit against Indonesia by UK mining company Churchill, and suits against Uruguay and Australia by multinational tobacco companies).

185. Riesenbergs, *supra* note 5, at 1009-10.

186. Franck, *supra* note 2, at 63; *see also* Susan D. Franck, *The ICSID Effect?: Considering Potential Variations in Arbitration Awards*, 51 VA. J. INT'L L. 825, 910 (2011) (suggesting that ICSID could use its authority to promulgate institutional rules that sanction improper conduct, similar to U.S. Federal Rule of Civil Procedure 11, to require (1) substantiation of claimed damages with evidence or requiring pleading of damages with specificity, (2) permitting assessment of damages at a preliminary phase, or (3) establishment of a good-faith pleading rule in ICSID arbitration and granting a tribunal's authority to sanction parties or their counsel for making frivolous claims, perhaps via cost awards); *cf.* Riesenbergs, *supra* note 5, at 1010 ("Though using awards of legal costs as a penalty for frivolous claims and bad faith is likely to lessen the threat of nuisance suits, this will not be a sufficient deterrent in all instances.").

discretion in cost shifting (the adoption of the English system and sanctions for bad faith) can act as an efficiency gain. Such measures can strengthen the legitimacy of the investment system by equalizing the playing field between states and investors, which can in turn assist in preventing the “regulatory chill” effect. The fewer resources a state is forced to waste defending against frivolous investment claims, the less pressure it will experience to abstain from enacting public rights legislation on account of its investment law obligations. Again, the introduction of an element of tension is necessary for such cost shifting to represent an efficiency gain. For capital importing states, such cost shifting measures obviously represents a net gain. For MNCs and even capital exporting states, it appears that cost shifting measures of this kind would result in a net loss. Yet, when the system is sufficiently threatened by a legitimacy crisis, such legitimacy-strengthening measures may offset this loss.<sup>187</sup> This is particularly true if one considers MNCs and capital-exporting states in the aggregate. Such measures will discourage (and hurt) those MNCs which bring non-meritorious claims. Yet over time the effect should generally be positive for those MNCs who bring meritorious claims. Moreover, those that benefit from the legitimacy enhancements could, in theory, compensate the few MNCs who see their own costs rise and still some participants would be made better off by the legitimacy enhancements. Thus the conditions of Kaldor-Hicks efficiency are met.

The *Foresti* case provides a prime example of a tribunal’s use of cost shifting discretion as an efficiency gain to help resolve the tension between the human rights regime and international investment arbitration. As previously mentioned, the Tribunal in the *Foresti* case did not rule on the merits, but only made a determination with respect to costs and fees. In November 2009, the Claimants sought permission from the Respondents to discontinue the proceedings without prejudice.<sup>188</sup> Claimants alleged that a December 2008

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187. *Id.* at 992-93.

188. *Foresti v. Republic of South Africa*, ICSID Case No ARB(AF)/07/1, Award, ¶

agreement (Offset Agreement) between the DMR and the operating companies granted Claimants their new order mineral rights without requiring the twenty-six percent sale of shares to HDSA.<sup>189</sup> Claimants further alleged that they had tried unsuccessfully to settle the claim on numerous occasions; however, their present economic position in the market coupled with the partial relief they obtained from the December 2008 agreement no longer made it economically viable for them to pursue their arbitration claim.<sup>190</sup>

Respondents filed a response to Claimants' request, opposing discontinuation on the grounds that the claimants would be free to bring the same claims against the government at a later time.<sup>191</sup> Furthermore, South Africa, having already incurred significant costs in defending the claims, did not wish to bear the costs it had incurred in defending against the litigation.<sup>192</sup> The respondents, therefore, requested a default award only with respect to costs and fees.<sup>193</sup>

The parties conceded to the Tribunal's inherent power to issue a default award on costs,<sup>194</sup> but there was significant disagreement over who was to be considered the "prevailing party" in the dispute for the purposes of cost shifting.<sup>195</sup> The Respondents argued that they should be considered the prevailing party because the Claimants did not receive anything in the Offset Agreement beyond that which was given to other similarly situated companies in South Africa.<sup>196</sup> The Respondents further alleged that the Claimants never intended to pursue the arbitration claim to its end, but initiated the claim as a "mere tactical device."<sup>197</sup> Finally, the Respondents argued

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79 (Aug. 4, 2010).

189. *Id.*

190. *Id.* ¶ 80.

191. *Id.* ¶ 81.

192. *Id.*

193. *Id.* ¶ 83.

194. *Id.* ¶¶ 86-87.

195. *Id.* ¶¶ 85-86.

196. *Id.*

197. *Id.*

that the claim was not ripe because it could have been handled under South Africa's own domestic laws and procedures.<sup>198</sup>

Alternatively, the Claimants argued that they should be considered the prevailing party because, but for the initiation of the arbitration, the DMR would not have entered into the Offset Agreement.<sup>199</sup> Claimants further defended that the arbitration was not a mere tactical device but was based upon the sound advice of counsel in consideration of the conditions at the time the decisions were made.<sup>200</sup> In response to the argument on ripeness the Claimants countered by observing that the BIT does not require exhaustion of local remedies but rather contains a fork-in-the-road provision.<sup>201</sup>

The Tribunal unanimously determined that it had the discretion to issue a default award on costs<sup>202</sup> derived from its discretionary authority under Article 58 of the ICSID Additional Facility Rules.<sup>203</sup> The Tribunal further determined that its discretion was not limited by Article 58 except that its decision on costs should not be arbitrary or capricious but must be "the result of the rational consideration of relevant factors."<sup>204</sup> The Tribunal observed that it should consider those factors which the parties determined were relevant to the determination of costs.<sup>205</sup> It noted that the parties in the present matter seemed to place weight on which party was to be considered the "winner" of in the dispute,<sup>206</sup> despite the fact that the Tribunal did not make a final determination on the merits.<sup>207</sup>

In an unprecedented move, the Tribunal determined that the Claimants should shift a portion of costs to the Respondents, because they were the better cost avoider in the present case.

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198. *Id.*

199. *Id.* ¶ 89.

200. *Id.* ¶ 91.

201. *Id.* ¶ 92.

202. *Id.* ¶ 98.

203. *Id.* ¶¶ 100-104.

204. *Id.* ¶ 105.

205. *Id.* ¶ 106.

206. *Id.* ¶ 109.

207. *Id.* ¶ 111.

First, Claimants could not be considered to have prevailed on those claims that were made null by the Offset Agreement.<sup>208</sup> Had the Offset Agreement been negotiated as an explicit *quid pro quo* for discontinuance, then the Agreement could be rightly considered a settlement.<sup>209</sup> The Tribunal also determined that the Claimants were in a better position to avoid costs, because they failed to timely inform the Respondents about a government employee working on the arbitration who was soliciting bribes in exchange for a promise of settlement; they also failed to timely inform Claimants that they were willing to settle on a “with prejudice” basis.<sup>210</sup> The Tribunal therefore concluded that “the Claimants should bear responsibility for a portion of the Respondent’s costs.”<sup>211</sup>

In determining the actual amount that Claimants were to contribute to Respondent’s costs, the Tribunal failed to construct a workable standard to apply to the case. It considered using a date, June 2009, at which point it would have been reasonable for Claimants to inform Respondents of their willingness to settle on a “with prejudice” basis.<sup>212</sup> The Claimants would then be responsible for any of Respondents’ fees or costs after that point in time. The Tribunal, however, found such a method, insufficient:

There is, however, a problem with approaching costs questions by looking at dates at which proceedings might have been discontinued or costs might have been frozen or minimised by some other means. It is that the outcome of that approach would be determined by accidents of the work and billing schedules of those involved. Moreover, some such expenses would have been incurred regardless of an earlier disclosure of the corruption or an earlier declaration of the (wholly

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208. *Id.* ¶ 116.

209. *Id.* ¶ 117.

210. *Id.* ¶ 119.

211. *Id.*

212. *Id.* ¶ 122.

uncorrupt) willingness of the Claimants to terminate the arbitration on a “with prejudice” basis.<sup>213</sup>

The Tribunal also considered segregating the claims that were successful in order to assign cost.<sup>214</sup> This was rejected for three reasons: (1) this would require the Tribunal to analyze the case on the merits,<sup>215</sup> (2) the Claimants’ prayer for relief does not break down the costs according to claims,<sup>216</sup> and (3) it is not clear in what direction this would influence fee shifting towards the Respondents.<sup>217</sup> The Tribunal finally abandoned any attempt to rule by any general principle.<sup>218</sup>

The Tribunal concluded by justifying its decision to impose cost shifting of 400,000 Euros in the following way:

On that basis the Tribunal has decided that it is a fair and reasonable exercise of its discretion to require the Claimant to make a contribution to the costs incurred by the Respondent. The rationale behind this view is the result of a combination of (i) the fact that it was the Claimants who sought the discontinuance of the proceedings under Article 50 of the Additional Facility Rules and that the Respondent opposed discontinuance, (ii) the fact that the Claimants ultimately abandoned some of their claims, and (iii) the view that the Claimants pressed ahead with the arbitration at a time and in circumstances where it was in a position to avert the need for some part of the Parties expenditure. This approach also reinforces the view that, while claimants in investment arbitrations are in principle entitled to the costs necessarily incurred in the vindication of their legal rights, *they cannot expect to leave respondent States to carry the costs of defending claims that are abandoned.*<sup>219</sup>

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213. *Id.* ¶ 126.

214. *Id.* ¶ 127.

215. *Id.*

216. *Id.* ¶ 128.

217. *Id.* ¶ 129.

218. *Id.* ¶ 131.

219. *Id.* ¶ 132 (emphasis added).

Thus, cost shifting was justified, according to the Tribunal because the Claimants could have avoided some of the costs.

The *Foresti* Tribunal's decision on costs is notable in several respects. For one, cost shifting in and of itself goes against the norm of cost decisions in investment arbitrations, which generally follows the American system, as discussed *supra*.<sup>220</sup> Furthermore, the *Foresti* decision was particularly exceptional, because the Tribunal shifted costs even without reaching a final decision on the merits. This decision goes beyond applying the English system of costs. The Award reflects the notion that, even absent a clear winner or loser on the merits, the tribunal can determine the Claimants should cover a portion of Respondent's costs for having brought claims that they then discontinued. The Tribunal did not establish broadly applicable principles to determine when such cost shifting should apply. Rather the decision reflects general equity concerns for states defending against claims that are later abandoned as part of the Claimants' litigation strategy – even when the litigation strategy is considered reasonable by the Tribunal and is not imputed with bad will.

This decision was positively received in South Africa. In a statement issued jointly by the Department of Trade and Industry and the Department of Mineral Resources, the government noted that they were “pleased to announce the successful conclusion of international arbitration proceedings.”<sup>221</sup> In this statement the government reiterated the Tribunal's message about costs: “[t]he tribunal said that foreign investors who start international investment arbitrations ‘cannot expect to leave respondent States to carry the costs of defending claims that are abandoned.’”<sup>222</sup> Based on South Africa's public interpretation of the arbitration suit as expressed in this statement, it appears that the government does not fear

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220. See *supra* Part I & note 5.

221. *Successful Conclusion to SA - Foresti Arbitration Proceedings*, DEP'T OF TRADE AND INDUSTR. & DEP'T OF MINERAL RES., REPUBLIC OF SOUTH AFRICA (Aug. 5, 2010), <https://www.thedti.gov.za/editmedia.jsp?id=1941>.

222. *Id.*

that its BEE policies are in violation of its obligation under its investment agreements. Additionally:

The Government welcomes the tribunal's recognition that the claimants and the Government have put the adversarial process behind them and started "rebuilding the relationship of trust and mutual commitment between investor and host Government". The government continues to welcome and to work with all responsible mining companies in the country, both foreign and domestic.<sup>223</sup>

Notably absent from this public announcement are statements blaming the Claimants for initiating the arbitration or criticizing the system of investment arbitration altogether. Instead, South Africa expresses a desire to move forward with the Claimants and rebuild a favorable culture of investment. This illustrates the payoff to the investment system of engaging legitimacy enhancements as efficiency gains. These improvements nurture the long-term stability of the investment system and ultimately make everyone better off.

## VI. CONCLUSION

The *Foresti* dispute initially concerned many human rights advocates, who worried that South Africa's human rights obligations would take a backseat to its duties under international investment law. Contrary to such fears, I would argue that the case represents a victory both for human rights and for the stability of the international investment system. The case highlights the tension, both perceived and actual, between international human rights law and the international investment regime. Yet the case also sheds light on potential legitimacy enhancements as efficiency gains – changes that can be made to the status quo to make various constituents of the international investment system better off without making any other participants worse off. In the *Foresti* dispute, the Tribunal made two such legitimacy enhancements. First, the Tribunal increased transparency by providing NDPs greater access and

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223. *Id.*

participation in arbitration proceedings. Second, the tribunal used its discretion to award costs even when a decision on the merits had not been reached. Ultimately, South Africa expressed its satisfaction with the outcome of the case and articulated a desire to move forward with Claimants to work towards harmonious investment in South Africa. This outcome certainly bucks the recent trend by which numerous countries have rescinded their commitments to upholding investment protection, spouting allegations of systemic unfairness. It provides an example of simple legitimacy-enhancing changes that can be made to the investment. Such legitimacy enhancing measures are becoming increasingly important for a system that is suffering from a legitimacy crisis. As Charles Brower reminds us, quoting Lord Hewitt, “[i]t is of fundamental importance, that justice should not only be done, but should manifestly and undoubtedly be seen to be done.”<sup>224</sup>

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224. Brower, *supra* note 160, at 31.

