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The UK Should Include ISDS in its Post-Brexit International Investment Agreements

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ABSTRACT:

This article argues that the United Kingdom should include Investor-State Dispute Settlement (ISDS) in the new International Investment Agreements (IIAs) which it concludes following its departure from the European Union. Focusing on the procedure of ISDS rather than the substantive protections afforded by IIAs, the article supports this assertion by reference to advantages engendered by ISDS from the perspective of the UK as both a capital importer and capital exporter. ISDS does not exhibit systemic bias in favour of investors or states and offers an efficient, often lower cost alternative to domestic courts, particularly in jurisdictions where there is weak rule of law. The UK's own commitment to rule of law suggests that the risk of adverse claims by foreign firms through this system is minimal. The article briefly considers the two chief alternatives to ISDS in IIAs: the EU's new Investment Court System and state-to-state dispute settlement, neither of which should be viewed as a suitable alternative to ISDS for the UK.

I Introduction

When it went into force in 2009, the Lisbon Treaty established that competence in the negotiation of international investment agreements (IIAs) lies with the European Commission¹, not each individual EU Member state, as it had in the past. Following the UK's departure from the EU (at some point within the next few years), this competence will return to the UK. The new Department of International Trade will be charged with negotiating all investment as well as trade treaties with other states, including the EU itself. All indications suggest that the UK government intends to pursue such bilateral relations aggressively and a number of countries have already been cited as potential treaty partners, including the United States, Australia and many of the Commonwealth Countries.² While the eventual conclusion of such trade and investment treaties following "Brexit" is without question, their precise contents remains to be seen. Outside of the EU, the UK will seek to tailor these instruments in a manner that furthers its own economic agenda, leveraging its strengths and addressing areas of greatest need while balancing risks (both economic and political) of any attendant liberalization.

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¹ Modifying Art 3 and Art 206 of the Treaty on the Functioning of the European Union

² Prime Minister Theresa May's speech on Brexit (17 January 2017)

One of the most contentious issues during the negotiation of the UK's future IIAs, whether as stand-alone agreements or as investment chapters in Free Trade Agreements (FTAs), concerns the process of dispute settlement. More specifically, there is the question whether these treaties should include the now high profile and much-maligned Investor-State Dispute Settlement (ISDS). Although the White Paper issued by the UK government setting out the planned approach to the UK's departure from the EU specified that sustaining high levels of foreign investment would be a top priority³, there was no clear indication as to the investment protections the UK would establish through anticipated FTAs with other countries (including with the EU), nor the type of dispute settlement mechanisms such arrangements would feature. The document did provide the rather enigmatic statement that: "Any arrangements must be ones that respect UK sovereignty, protect the role of our courts and maximise legal certainty, including for businesses, consumers, workers and other citizens."⁴ This could arguably imply that any form of supra-national dispute settlement, such as ISDS, will be rejected in future instruments because it is circumscribes the jurisdiction of UK courts. It may equally indicate that the government's main priority is legal certainty within future IIAs, as a tool to advance commercial interests. Otherwise stated, there remains uncertainty as to whether, on the assumption that the UK will conclude IIAs, such agreements will contain ISDS.

This article will argue that the UK's future IIAs should include the procedural protection of ISDS. This process is advantageous to the UK both from its perspective as a place which receives foreign investment and as one which sends foreign investment overseas. This is because as an adjudicatory procedure under international law it is well-established, fair, efficient, and safe. This article will defend this recommendation first by exploring the advantages of ISDS to the UK as a Host State, then as a Home State, followed by a discussion of the two chief alternative procedures to modern ISDS: The Investment Court System and state-to-state dispute settlement. It will operate under the assumption that the UK wishes to continue importing and exporting FDI as a matter of policy, as specified in the White Paper. Whether or not all forms of FDI indeed represent a value to the UK economy will not be examined.

From the outset, it must be clarified that this article is not intended to operate as a full critique or defence of the procedure of ISDS. Rather its focus is on the usefulness of this

³ The United Kingdom's Exit from and New Partnership with the European Union (February 2017) at 9.4 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/589191/The_United_Kingdoms_exit_from_and_partnership_with_the_EU_Web.pdf

⁴ At 2.10

procedural dispute settlement mechanism to the UK as a developed country which is both a capital importer and exporter and as such stands to engage with the system in a particular way based on its economic and regulatory profile. Secondly, this article is not intended to proffer opinion on the substantive components of UK IIAs, such as whether and to what extent these should extend protections to indirect expropriation or portfolio investment. Clearly one of the main advantages of ISDS is that it facilitates the enforcement of substantive treaty rights, some of which may be unavailable under relevant domestic laws. Before turning to the discussion of the particular merits of ISDS in the context of the UK's future international investment relations, it is necessary to briefly outline some of the criticisms of ISDS along with the IIA regime in which it is found.

II Overview of Investor-State Dispute Settlement

There are more than 3000 IIAs in existence, most of which were signed in the last 15 years during a flurry of treaty signage which appears to have grown commensurately with economic globalization. These treaties provide substantive protection for foreign investors against non-commercial risks, such as guarantees against expropriation and prohibitions on discrimination. Under almost all of the modern treaties concluded since the late 1980s, claims for breach of these protections may be brought directly by investors against host states in specialized international arbitration tribunals, typically precluding the need for use of domestic courts. This process is a form of mixed arbitration in that it involves private parties bringing claims against sovereign states, identified by the now well-known acronym ISDS. This is a departure from state-to-state dispute settlement through the International Court of Justice which appeared in historic economic treaties or which specified exhaustion of local remedies.

As one of the world's leading economies, the UK was among the first users of investment treaties and has signed 106 Bilateral Investment Treaties (BITs), among the most of any country. The first such treaty, with Egypt, came into force in 1975. Its final BIT (before the Lisbon Treaty took effect) was with Columbia in 2010. The UK is party to an additional 67 treaties with investment provisions as a Member of the EU, the most recent of which was the Comprehensive Economic and Trade Agreement (CETA) with Canada, finalized in 2016. Without exception, each of these treaties includes ISDS in some form and ISDS appears in Article 8 of the UK's Model BIT of 2008. Some of UK's earlier instruments contained the

requirement of prior exhaustion of local remedies⁵ whereas later ones do not.⁶ Most of these treaties were concluded with developing countries, evincing the UK's objective of securing investment protections for its firms operating overseas.

While this article does not aim to defend IIAs as instruments of augmenting foreign investment, either generally for the UK specifically, the extent to which the treaties themselves have achieved this aim deserves some attention. There is extensive academic literature, mostly from the field of economics, which has attempted to discern whether IIAs (many of which contain ISDS) actually leads to an increase in foreign direct investment.⁷ While these studies are largely inconclusive, the lack of clear evidence in favour of promoting foreign direct investment is often cited as an indication that IIAs are unnecessary and that recourse to ISDS should be available as a recourse only through investment contracts. One of the most appropriate responses to this allegation is of that most IIAs do not aim to liberalize foreign investment, but rather to protect existing investments once the decision to invest has been made, at which point exposure to interference by host governments poses the greatest risk. In that sense they operate as a “credible commitment”⁸ device guarding against the withdrawal of existing investment. Very few IIAs contain pre-establishment guarantees of non-discrimination and most impose extensive conditions on admission. More tellingly for the purposes of this article, few of these studies recognize that IIAs offer variable levels of protection, including in some cases lacking ISDS entirely (many pre-1985 treaties) or specifying an exhaustion of local remedies.⁹ Still, IIAs are correctly viewed as risk-mitigation devices in that they make investors feel more secure that their expenditures will not be interrupted arbitrarily. This acts as an incentive to foreign investment, especially in developing countries where foreign capital is most badly needed and where perceived risks are highest. This was the original purpose behind the World Bank's creation of the International Centre for the Settlement of Investment Disputes (ICSID) in the 1960s and is one of the reasons that investment treaties form part of the package of measures advised by UNCTAD as an aid to development.¹⁰

⁵ UK-Egypt Art 8(1) (11 June 1975) Specifying three months of use of local remedies before resort to ICSID

⁶ UK-Mexico (12 May 2006)

⁷ See generally, L Sachs and K Sauvant eds. *The Effect of Treaties on Foreign Direct Investment* (Oxford University Press, 2011)

⁸ A Guzman, “Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties,” 38 *Virginia Journal of International Law* 639 (1998)

⁹ A point identified by J Webb Yackee, “Conceptual Difficulties in the Empirical Study of Bilateral Investment Treaties” 33 *Brooklyn Journal of International Law* 405 (2008)

¹⁰ UNCTAD World Investment Report 2016 at 103 <http://unctad.org/en/PublicationsLibrary/wir2016_en.pdf>

As with British practice, almost all modern IIAs contain provision for ISDS, typically in conjunction with a choice of forum between ICSID or tribunals operating under UNCITRAL rules. ICSID enjoys near universal membership and awards issued by its tribunals are automatically enforceable in all member states.¹¹ UNCITRAL based awards are enforceable either under the New York Convention or the relevant IIA's own provisions which specify that parties agree to be bound by an award issued pursuant to the treaty's ISDS rules.

Turning now to the topic of this article, ISDS itself is a well-established adjudicatory procedure through which more than 600 cases have been brought over many decades around the world and across many sectors of the economy. While it is not the place to outline the advantages of international arbitration over conventional litigation here¹², international arbitration is widely viewed as a just and efficient means of dispute settlement preserving the relationship between parties while upholding the rule of law.¹³ Arbitrators have specialist expertise in the field of international investment law and often in the relevant sector upon which the dispute is focused. Although it has become more formalized in recent years, arbitration remains a flexible procedure which emphasizes a pragmatic outcome tied to the parties' intentions and reasonable expectations, as expressed in the treaty (or less often, the contract) from which the arbitral tribunal derives its jurisdiction.¹⁴ ISDS aims to de-politicize disputes by removing them from diplomatic intervention and from review by domestic courts. This separation is important because, as many commentators have urged, the belief that politics can be kept out of administrative decision-making by constitutional law (as exercised by the domestic courts) is naïve.¹⁵ Since others have asserted that investment tribunals also end up adjudicating over political disputes¹⁶ it may be that there is an inescapable political element in any dispute which engages with public policy, regardless of the forum.¹⁷ In this case the

¹¹ ICSID Convention, Arts 53 and 54

¹² E.g. N Blackaby, C Partasides, A Redfern and M Hunter, *Redfern and Hunter on International Arbitration* (Oxford University Press, 2009)

¹³ In the words of Y Fortier: "The success of international arbitration, its capacity to establish and shape a system based on international legal principles and to hold states accountable under those principles, cannot be denied." Proceedings of the Standing Senate Committee on Foreign Affairs and International Trade (Canada) Issue No. 6 - Evidence - Meeting of May 4, 2016

¹⁴ J Karton, "The Arbitral Role in Contractual Interpretation" [2015] *Journal of International Dispute Settlement* 4

¹⁵ E.g. A Bianchi, *International Law Theories* (Oxford University Press, 2016) at 52

¹⁶ E.g. C Titi, 'Are Investment Tribunals Adjudicating Political Disputes' 32:3 *Journal of International Arbitration* 261 (2015)

¹⁷ E.g. *AWG Group v Argentina* (Decision on Liability) 30 July 2010 at [264] in which the tribunal ruled that Argentina had in part contributed to its economic crisis because of "internal political dissention and problems inhibiting effective policy-making."

preference for domestic courts over international tribunals based on a commercial law paradigm is cosmetic rather than substantive.

Criticisms of consistency and predictability in ISDS as a specialized form of commercial arbitration persist, especially within the academic community,¹⁸ however there is now a significant and growing body of international investment law jurisprudence upon which tribunals regularly draw in rendering their decisions. The increasing judicialization of international arbitration, while lamented by some¹⁹, has further contributed to overall improvements in terms of expected outcomes and the integrity of the legal reasoning which produces them. Cautions that ISDS outcomes are unpredictable because of the inherently indeterminate nature of IIAs' substantive standards (for example Fair and Equitable Treatment) appear by implication to be asserting that the alternative (domestic courts reviewing domestic laws) operate in a highly deterministic or scientific manner. This ignores the wide role judicial discretion plays in this system and the reality that predictability is an elusive goal in any adjudicatory system.

One of the common criticisms of ISDS particularly among academic commentators is that it eliminates the need for domestic courts and as such it may be perceived as an assault on "the rule of law" particularly since many of the hearings are held in private without public scrutiny.²⁰ But of course the selection of ISDS for the resolution of disputes brought under IIAs is based on the consent of the parties to the treaty, presumably because they value the system's efficiency and confidentiality. Holding the hearings are held in private saves both the investor and the government from the reputation damage of public scrutiny as well as the accordant pressure to settle. Moreover, due to the recognition that some investment disputes have a public element, in recent years several ISDS disputes have been given fully public hearings. This is the consequence of the widespread adoption of changes to ICSID and UNCITRAL²¹ procedural rules respectively which have augmented transparency. Awards of tribunals are

¹⁸ The classic criticism of ISDS is that of Van Harten in G Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford University Press, 2007) but more moderate criticisms abound, e.g. C Titi, "International Investment Law and the European Union: Towards a New Generation of International Investment Agreements" 26: *European Journal of International Law* 639 (2015)

¹⁹ E.g. Blackaby, Partasides, Redfern and Hunter above n 6 at 41 [referring to international commercial arbitration generally]

²⁰ See e.g. D Schneiderman, *Constituting Economic Globalization* (Cambridge University Press, 2010). The allegation that international arbitration as distinct from civil litigation in local courts is an affront to the rule of law would possibly carry more weight were the phrase "assault on the rule of law" not deployed in so many situations, including notably any attempt at criticism of the judiciary.

²¹ United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (New York, 2014) (the "Mauritius Convention on Transparency") (10 December 2014)

readily available on-line and hearings are regularly streamed live on the internet.²² Media coverage of ISDS disputes is extensive, as seen for example in the recent very high profile Philip Morris cases.²³ The charge that the process lacks public scrutiny is much less tenable today than in the past given the success of default publicity rules. Even to the extent that the process remains partially confidential, it has been correctly pointed out that ISDS is not as “public” in nature as is often suggested and in that sense it is not as deserving of the transparency associated with civil litigation. Claims and defences brought before tribunals do not always engage with issues of sovereignty or public welfare, often dealing instead with matters more closely aligned with commercial arbitration. Remedies are in the form of monetary damages, not quashing of decisions. Many of the measures challenged in ISDS are those undertaken by judicial and unelected agencies, rather than those which are democratically constituted.²⁴ Finally, it is regularly posited that ISDS lacks legitimacy for many of the reasons articulated above some of which are arguably more substantive features of IIAs than procedural features of ISDS. This is a difficult claim to challenge because the notion of “legitimacy” is itself an indeterminate concept, often used to defend certain pre-conceived normative stances. It would seem that the most plausible way to understand the legitimacy of any dispute settlement process is by reference to its capacity to induce compliance among those who use it.²⁵ In this regard, ISDS is associated with a very high rate of compliance, possibly as high as 90 per cent according to one study²⁶, which is a strikingly good record for any adjudicatory process.

III Advantages to the UK as a Host State

Having outlined ISDS as a component of IIAs, this section will consider the benefits of including ISDS in the UK’s future post-Brexit IIAs from the perspective of the UK as a capital importer, meaning as a destination of foreign capital. It is important to emphasize again that this article is not intended as a recommendation that the UK pursue IIAs. Rather, it advocates

²² *Vattenfall v Germany* ICSID Case No. ARB/12/12 (10 October 2016)

²³ (ICSID Case No. ARB/10/7) (6 July 2016)

²⁴ J Alvarez, “Is Investor-State Arbitration Public?” 7:3 *Journal of International Dispute Settlement* 534 at 26 (2016)

²⁵ T Franck, *Fairness in International Law and Institutions* (Oxford University Press, 1998)

²⁶ “International Arbitration: Corporate Attitudes and Practices” Queen Mary University, at 13 <http://www.arbitration.qmul.ac.uk/docs/123294.pdf>

procedural system of ISDS which is contained within them and specified in many investment contracts.

The UK held approximately US \$1.2 billion worth of foreign direct investment in 2015.²⁷ The chief source of the UK's inward FDI are other OECD countries, notably the US and the rest of the EU, although India was also a leading supplier.²⁸ After the US and China, the UK is third in the world as a destination for foreign investment and is the top destination for foreign investment in Europe. This is a status which the UK government seeks to preserve following the departure from the EU.

A recent study suggested that the UK's global inward FDI flows will not decrease following its departure from the EU given its favourable regulatory environment and commitment to the rule of law.²⁹ While the perennial attractiveness of the UK as a destination for foreign investment is the result of many factors, it is without question that the UK legal system is perceived as transparent, stable and unbiased. This is in terms of the laws governing the establishment and running of businesses (which have analogous concepts in the substantive features of IIAs such as Fair and Equitable Treatment and non-discrimination) and in the legal system's capacity to support claims between private parties and against the state itself (as captured by ISDS). With a domestic system that is broadly designed to uphold principles of fairness and rule of law, the UK should not expect an onslaught of claims against it under IIAs such as been experienced by some countries which have engaged in targeted attacks against foreign firms, such as Argentina and some Eastern European states. In other words, the risk posed by offering ISDS to foreign investors is minimal.

The low risk of ISDS to the UK as a respondent host state is even more so given that allegations of pro-investor bias in the system appear to be unfounded. During the period in which there has been a growing stridency in the attacks against ISDS, a broad set of statistical data has become available (thanks largely to the efforts of UNCTAD) which has revealed a very different picture of the system than that which has been traditionally presented. The pioneering study by Susan Franck, which demonstrated a lack of systemic bias among ICSID tribunals in terms of outcomes³⁰, has been bolstered by recent data illustrating that ISDS is a

²⁷ Office of National Statistics Foreign direct investment involving UK companies: 2015 at 2 (2 December 2016)

²⁸ UKTI Inward Investment Report (2014-15) (17 June 2015)

<https://www.gov.uk/government/publications/ukti-inward-investment-report-2014-to-2015/ukti-inward-investment-report-2014-to-2015-online-viewing>.

²⁹ L Kekic, "FDI to the UK will Remain Robust Post-Brexit" Columbia FDI Perspectives No. 195 (13 March 2017)

³⁰ S Franck, "Empirically Evaluating Claims About Investment Treaty Arbitration" 86 North Carolina Law Review 1 (2007)

remarkably balanced procedure in terms of outcomes, at least as expressed via win-loss ratios. The most recent available data shows that, contrary to the myth of anti-state animus, states normally win ISDS cases. By the end of 2015 in 444 reported cases, the state won 36% of cases and the investor won 27% of cases, with the rest either settled, discontinued, or decided in favour of neither party.³¹ Other more nuanced empirical studies have shown that developed states, like the UK, tend to fare even better under the system than developing countries.³² In cases decided on the merits, meaning that the claim passed the jurisdictional stage, the picture is somewhat different, but still hardly alarming, with 60% of cases decided in favour of the investor and 40% decided in favour of the state.³³ As an adjudicatory procedure it is difficult to assert that anything near the 50:50 success rate for claimants and defendants³⁴ is manifestly biased. Any system of dispute resolution that deviates too far from this ratio would be unsustainable – either claimants or defendants would stop using it if their chances of success were too slim. In the case of ISDS, investors would concede that their activities were too risky and stop investing (investment chill) or states would stop enacting laws which affected foreign investors (regulatory chill). Neither appears to have occurred. Still, the win/loss ratio reveals little about any underlying bias in the substantive rules of international investment law. It may be that the breach of rights afforded to investors in IIAs should be construed as exceptional outcomes, in which case any investor wins should be considered extreme events and win-loss ratios are accordingly meaningless.³⁵

With respect to the quantum of awards levied against states, there has been much agitation about the multi-billion dollar claims won by Yukos against Russia³⁶ as well as the many awards issued against Argentina for which payment has not been forthcoming³⁷ and which, if paid, could represent a grave harm to the state's public accounts. These outliers notwithstanding, the average successful claim in ISDS is considerably less than US \$100 million, which is substantially less than claimed by investors.³⁸ This is by no means a small sum, especially for a developing country, but for a government like the UK it is largely

³¹ UNCTAD World Investment Report, at 107

³² T Schultz and C Dupont, "Investment Arbitration: Promoting the Rule of Law or Overpowering Investors? A Quantitative Empirical Study" 25:4 *European Journal of International Law* 1147 (2014)

³³ Ibid

³⁴ G Priest and B Klein, 'The Selection of Disputes for Litigation' 13:1 *Journal of Legal Studies* 1 (1984) at 2

³⁵ J Bonnitcho, L Poulsen and M Waibel, *The Political Economy of the Investment Treaty Regime* (Oxford University Press, forthcoming) at 39-40

³⁶ Yukos v Russia, Case No. AA 227 (18 July 2014)

³⁷ E.g. Vivendi v Argentina, ICSID Case no. ARB/97/3 (20 August 2007)

³⁸ <http://investmentpolicyhub.unctad.org/ISDS/FilterByAmounts> (Amounts awarded were significantly less than those claimed by investors)

insignificant, particularly when compared to inward foreign investment flows. It is certainly not of a magnitude to justify rejection of a regime which, at least in theory, renders the jurisdiction more attractive to foreign investment.

The UK's track record under ISDS has been exemplary. It has been the respondent in only one recorded investment claim, the outcome of which is unknown because it was not disclosed. This dispute, *Sancheti v UK*, concerned a lease of commercial property which was owned by the City of London and for which the rent was increased markedly, leading to a claim of expropriation under the UK-India BIT. The case is mentioned here to illustrate that, despite a history of concluding IIAs with dozens of states and attracting billions of dollars in foreign investment, the UK has not been faced with anything near an oppressive level of arbitration by foreign investors. The reason for this is clear – the UK has strong rule of law and a democratic, accountable government which treats business entities fairly. Indeed, a recent study showed that the most successful claims in ISDS are those which contest measures which specifically target the claimant, rather than those which challenge regulations in the broader public interest.³⁹ In short, the UK has little to fear from accepting the jurisdiction of international arbitration tribunals in its future investment treaties. Of course, there is no guarantee that the UK will not be faced with a billion dollar claim by an investor in the future, nor that it will be able to defend itself successfully against such a claim should one arise. ISDS disputes can arise in any sector and the UK government in its many constituent agencies and departments must remain vigilant that they do not impose arbitrary or discriminatory measures against foreign firms, particularly in highly regulated sectors. It must also ensure that there is a justifiable public purpose behind all measures which have the potential to inflict economic harm. Such caution should be viewed as simple good governance rather than unjustified fears of regulatory chill.

The one-sidedness of ISDS may lead to the impression that host states are bound to suffer under the system. States cannot use ISDS to bring treaty claims against investors, although cross-claims by host states have been instigated through investment contracts.⁴⁰ In that sense, including ISDS in its IIAs could harm the UK government in that these instruments expose the state to liability but do not enable it to assert its rights, which it could do, for example, if it pursued contractual arrangements with individual investors with a choice of forum to domestic courts. But this critique identifies but one feature of a larger system of

³⁹ A S Sweet, "Arbitral Lawmaking and State Power: An Empirical Analysis of Investment Arbitration" (17 February 2017). Available at SSRN: <https://ssrn.com/abstract=2919723>

⁴⁰ E.g. *Gabon v. Société Serete S.A.*, ICSID Case No. ARB/76/1 (21 Oct 2015)

commercial relations between the government and private entities operating within its jurisdiction. It fails to capture the overall picture of a regime in which the host state is empowered, simply by being the sovereign in control of the relevant jurisdiction, to enact a wide range of measures against foreign investors and to assert influence over them by launching claims in their own domestic courts. The UK preserves its right to take action against investors which break its laws through the phrase “subject to its right to exercise powers conferred by its laws”⁴¹ which appears in every British IIA in one form or another and which precludes investors from asserting their treaty claims when they do not conform to the host state’s legal requirements. Accordingly, after its departure from the EU, the UK will be able to let in precisely the types of investors it wishes, in precisely the sectors it wishes, by establishing admission requirements through domestic legislation.

With respect to the concern that ISDS facilitates frivolous claims against states pressuring settlement, cost shifting is now quite common in ISDS cases and this should act as a disincentive against this strategy. UNCITRAL Arbitration Rules provide that costs will in principal be borne by the unsuccessful party.⁴² ICSID tribunals, which have the discretion to allocate costs as they fit, have been quite willing to hold investors to account for costs.⁴³ Some modern IIAs even expressly provide that the tribunal may award the state reasonable costs and lawyers’ fees if it determines the investor’s claims to be frivolous.⁴⁴ Considering these safeguards, the UK should not fear the expense of defending itself against unmeritorious claims brought by foreign firms.

The expense and duration of domestic court procedures for the UK government both as defendant as well as funder of the court system is another reason why ISDS is a favourable procedure for the UK. Costs for the average respondent in ICSID arbitrations over a 5-year period between 2010-2015 were calculated to be just under US \$5 million per case.⁴⁵ The average duration of an ICSID case from request of registration to the issuance of a final award is approximately 3.5 years.⁴⁶ While admittedly this is neither cheap nor fast in an absolute sense, ISDS will in many circumstances be less expensive and time consuming than domestic

⁴¹ E.g. UK-El Salvador Art 2(1)

⁴² UNCITRAL Arbitration Rules 2010, Rule 42

⁴³ *Transglobal Green Energy v Republic of Panama* ICSID Case No. ARB/13/28 – Award (2 June 2016)

⁴⁴ As in the Trans Pacific Partnership Art 9.23(6)

⁴⁵ JP Commission “How Much Does an ICSID Arbitration Cost?”

<http://kluwerarbitrationblog.com/2016/02/29/how-much-does-an-icsid-arbitration-cost-a-snapshot-of-the-last-five-years/> Tribunal costs were on average approximately an additional US \$800,000 on average.

⁴⁶ I Uchkkunova, “ICSID Curious Facts” <http://kluwerarbitrationblog.com/2012/10/25/icsid-curious-facts/> (25 October 2012)

court procedures on the same matter for the parties which use it. In the UK, civil justice costs are widely regarded as excessive, both to the parties and to the government which funds the system. This is no less so for judicial review matters, which is the forum where claims by foreign investors against the state would likely be brought in the absence of ISDS provisions in treaties.⁴⁷ Were investment claims heard in the commercial courts (perhaps tied to a breach of contract) costs would most certainly be even higher, particularly relative to the value of the award.⁴⁸ The cost and delay associated with the use of local courts for investment claims also represents a potential bar to access to justice for claimants, particularly smaller investors.

It could be argued that having claims against the UK under IIAs brought in local courts rather than in international tribunals would advantage UK barristers and solicitors who would be engaged to act in these disputes taking place within the jurisdiction. It is unquestionably true that British courts are held in high regard around the world and the UK legal profession is a thriving component of the country's service economy which must be preserved post-Brexit. However, keeping disputes involving the UK under IIAs within the sphere of specialized international arbitration will not detract from this privileged status because the revenue generated by this form of dispute settlement primarily consists of fees paid to counsel, many of which will be British barristers and solicitors. British lawyers will remain popular choices for counsel, particularly given the preponderance of English law as the choice of law for many investment contracts and the fact that British legal professionals enjoy rights of audience in many seats where international arbitration tribunals are constituted. Many ISDS hearings take place in the UK in institutions like the London Court of International Arbitration. There is no reason to believe that ISDS heard in international tribunals rather than civil litigation in local courts represents a risk to the profitability of the UK as a centre of legal practice.

IV Advantages to the UK as a Home State

This section will examine the value of ISDS to the UK in its role as a source of foreign direct investment. In other words it will consider how such a mechanism could help UK investors

⁴⁷ The Jackson Report noted that prohibitive costs can undermine access to justice in judicial review cases at 303 <https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf>

⁴⁸ This author's own study revealed average costs in ISDS cases of only approximately 10% of the award: M Broom, D Collins, P Thomas and H Vu, "The Four Regions of Settlement Space: A Game Theoretical Account of Investment Treaty Arbitration" https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2717057. Costs in UK civil litigation would regularly exceed 50% of damages awarded.

operating abroad. UK firms held just over US \$1.2 billion in outward foreign direct investment in 2015,⁴⁹ just slightly more than it held in inward investment. Although most of these investments remain located in developed countries with independent and effective courts, such as elsewhere in Europe and North America⁵⁰, many are not. The emphasis on Asia in UK government policy is noteworthy. This represents a risk to British companies which ISDS can help address.

Unlike the UK, which is governed by rule of law and has independent courts and government accountable to its citizens, many attractive destinations of capital suffer from poor governance, corruption and civil unrest. The UK is currently ranked 10th in the world on the Rule of Law Index, meaning that there are 103 countries on the list which place lower.⁵¹ Many of these receive foreign investment from British companies. Investing in countries with weak rule of law is fraught with risk, not only because arbitrary interference is more likely but also because courts cannot be trusted to provide adequate remedies. A recent study undertaken by the Bingham Centre for the Rule of Law identified strong rule of law as among the most important factors for multinational enterprises when deciding upon the location of foreign investment activity.⁵² The value of ISDS as a bulwark against the absence of unbiased courts in host states can be inferred from these results. In other words, it is quite likely that the managers of these large firms appreciate the ability to avail themselves of ISDS when their lawyers inform them of its existence in as much as it can operate as a substitute for inadequate rule of law, including the lack of independent courts in the host state. Another well-known study from 2009 asked the general counsel of large US companies whether the presence of an IIA influenced their foreign investment decisions,⁵³ but unfortunately it did not address ISDS directly. The study further evinced rather poor familiarity with IIAs generally, suggesting that a procedure which facilitated direct access to international arbitration against states may have been an underappreciated component of these instruments. One would expect that this knowledge gap has changed significantly in recent years due to the greater number of ISDS

⁴⁹ Office of National Statistics Foreign direct investment involving UK companies: 2015 at 2 (2 December 2016)

⁵⁰ Office of National Statistics, Foreign Direct Investment Involving UK companies: 2015 at 5 (2 December 2016)

⁵¹ World Justice Project "Rule of Law Around the World" (2016) <http://worldjusticeproject.org/rule-law-around-world>

⁵² "Risk and Return: Foreign Direct Investment and the Rule of Law" (Hogan Lovells, Bingham Centre for Rule of Law, British Institute of International and Comparative Law, 2014) at 6-7. The survey was conducted among 301 "senior decision-makers" at Forbes 2000 companies with global annual revenues of at least US \$1 billion annually.

⁵³ J Webb Yackee, "Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence" 51:2 Virginia Journal of International Law 397 (2010)

cases coupled with extensive media coverage emphasizing the tactical utility of the system to multinationals. The commercial value of ISDS as a means of enforcing investor rights against states is readily reflected in the International Chamber of Commerce's recent statements in favour of ISDS.⁵⁴ The value of the procedure is perhaps most acutely felt by investors in the extractive sector where very large up-front costs leave companies at the mercy of temperamental governments.

The costs of domestic court procedures in terms of financial expenditure and wasted time to British companies in foreign states is another reason that the UK should seek ISDS in its new investment treaties. The average claimant costs for an ICSID arbitration for the period 2011-2015 was approximately US \$5.5 million,⁵⁵ a good deal more than that borne by respondents. It would take a comprehensive study of the costs of all national civil justice systems in the world to determine how these costs compare to the non-ISDS alternative, i.e. domestic litigation in the host state, but certainly many of these systems will be cheaper for UK investors, particularly given favourable exchange rates. However, as noted earlier, the average duration of an ICSID case from request of registration to the issuance of a final award is a modest 3.5 years.⁵⁶ Given the excessive delay associated with judicial processes in many foreign jurisdictions, notably developing states such as India and Brazil, one should expect that on balance the ICSID procedures should be attractive for British firms operating overseas. ISDS should lead to faster and by implication less costly resolution of claims.

UK investors have enjoyed a reasonable success rate in ISDS over the years. As of the time of writing, UK investors have been claimants in 67 ISDS cases against many states. The first of these took place in 1987, the famous *AALP v Sri Lanka*⁵⁷ dispute, which concerned the respondent state's interference with the British company's shrimp fishing fleet during a period of civil unrest. This claim, which was won by AALP, is illustrative because it is difficult to imagine that the company would have received adequate and timely compensation for its grievances had it been compelled to use Sri Lanka's domestic courts, particularly during such a tumultuous period of the country's history. Of the 27 decided ISDS cases involving British companies for which there are recorded awards, the investors won 13. Again, the near

⁵⁴ As seen for example in the International Chamber of Commerce Commission on Trade and Investment Policy Statement on Trade and Investment Policy, 05/04/2016 | Document Number : 103-329 at 2

⁵⁵ JP Commission, "How Much Does an ICSID Arbitration Cost?"

<http://kluwarbitrationblog.com/2016/02/29/how-much-does-an-icsid-arbitration-cost-a-snapshot-of-the-last-five-years/> Tribunal costs were on average approximately an additional US \$800,000 on average.

⁵⁶ I Uchkunova, "ICSID Curious Facts" <http://kluwarbitrationblog.com/2012/10/25/icsid-curious-facts/> (25 October 2012)

⁵⁷ ICSID Case No. ARB/87/3 (27 June 1990)

approximation to 50% in terms of investor vs state reflects a distinct lack of one-sidedness in the regime. There are a number of claims by UK-based investors currently pending against countries such as India, Bolivia and Sri Lanka. Again, it is not easy to envision that these companies would achieve positive outcomes with the domestic court procedures in these places, which even if they were accepted to be impartial and sufficiently knowledgeable, would almost certainly take years if not decades to issue awards. A recent empirical study of ISDS demonstrated that larger companies tend to have higher success rates particularly at the merits stage and, perhaps unsurprisingly, tend to receive larger awards than smaller companies.⁵⁸ While some British SMEs may choose to avail themselves of the ISDS procedure, one would expect that the UK's large multinationals will be the dominant users of the system, as they have been thus far. Another recent study, mentioned above, showed that most successful ISDS claims involve challenges to governmental acts specifically targeting the investor, rather than general regulatory measures.⁵⁹ British companies are well accustomed to operating in a domestic environment where the state has broad regulatory powers to pass laws which are in the public interest. They do not seek to internationalize to escape such a regime. As such, continuing favourable outcomes for British firms in ISDS can be anticipated.

V Alternative Dispute Settlement Regimes for UK IIAs

Having presented reasons why ISDS is beneficial to the UK as both a host state and home state of international investment this article will now briefly outline the principle alternatives to ISDS in modern IIAs, the Investment Court System (ICS) and state-to-state dispute settlement.

i) Investment Court System (ICS)

It appears ICS will be a key component of the EU's international investment policy. The ICS, which essentially includes a second level appeal mechanism comprised of a body of standing judges (in the model of the World Trade Organization's Appellate Body) has featured in some of the EU's recent free trade agreements, including the Comprehensive Economic and Trade Agreement (CETA) with Canada and the EU-Vietnam FTA. It is worth recalling that, since the UK's departure from the EU is expected to result in a reduction of inward FDI from the rest of

⁵⁸ G Van Harten and P Malyshueski, "Who Has Benefited Financially from Investment Treaty Arbitration? An Evaluation of the Size and Wealth of Claimants" Osgoode Legal Studies Research Paper No. 14/2016 (19 Jan 2016)

⁵⁹ A S Sweet, "Arbitral Lawmaking and State Power: An Empirical Analysis of Investment Arbitration" (17 February 2017). Available at SSRN: <https://ssrn.com/abstract=2919723>

Europe to the UK of approximately 25%⁶⁰, maintaining a liberalized investment regime with the EU-27 should be seen as a priority. Consequently, the UK may have to accept this system as a condition of any agreement with the EU.

There are many problems with the ICS which make it an undesirable alternative to “normal” ISDS. First, commentators have questioned the enforceability of judgements to be rendered under the system, particularly in terms of the lack of clarity with which the proposed appeal system fits with existing ICSID and UNCITRAL procedures.⁶¹ Second, in addition to undermining party autonomy in the selection of arbitrators (arguably the cornerstone of arbitration as distinct from litigation), ICS imposes additional cost and delay without significant benefits in the form of legal correctness or clarity. The system would render investor-state arbitration considerably more expensive for both parties⁶² as well as inflict delay, possibly years, as one would expect the appeal process to be evoked reflexively by losing parties. The fixed annual costs of the ICS (including the salaries of the permanent judges) are estimated at half a million euros per year.⁶³

One of the purposes of the ICS was to address the charge of illegitimacy in existing ISDS due to the lack of an appeal system and the inconsistency and unpredictability resulting from ad hoc arbitration panels. But it is difficult to see how the ICS (at least in the form of a Multilateral Investment Court) can hope to achieve the aim, given that the source of law for the disputes is several thousand treaties, not one multilateral regime as in the WTO.⁶⁴ By establishing a court of permanent investment judges, so the argument goes, the system would be insulated from “arbitrators for hire” who tend to align themselves in favour of states or investors or who engage in so-called double-hatting where they act as counsel in one case then

⁶⁰ ‘The Impact of Brexit on Foreign Investment in the UK’ S Dhingra, G Ottaviano, T Sampson and J Van Reenen, Centre for Economic Performance, Brexit Analysis no. 3 <http://cep.lse.ac.uk/pubs/download/brexit03.pdf>

⁶¹ A Reinisch, “Will the EU’s Proposal Concerning an Investment Court System for CETA and TTIP Lead to Enforceable Awards? The Limits of Modifying the ICSID Convention and the Nature of Investment Arbitration” 19:4 Journal of International Economic Law 761 (2016)

⁶² A study by the Stockholm Chamber of Commerce suggested that an appeal would double the costs of the dispute for the parties: “ISDS Costs: How Much and Who Pays?” <http://idsblog.com/2015/11/19/isds-costs-how-much-and-who-pays/>. Of course some costs, such as those associated with the selection of arbitrators, would be reduced.

⁶³ EU Consultation on Multilateral Investment Court

<https://ec.europa.eu/eusurvey/runner/multilateralinvestmentcourt>. This amount is based on a no-case scenario, meaning that the court does not hear any cases. If it heard two cases per year the cost would be over 1 million euros per year.

⁶⁴ The EU’s ultimate goal of establishing a Multilateral Investment Court seems doomed for precisely this reason – how can one standing court possibly possess sufficient expertise in 3000 treaties, despite the overlap in concepts which characterizes the discipline?

arbitrator in another.⁶⁵ But of course judges are prone to making decisions on ideological grounds just as they are drawn from a class of elite professionals, as are investment arbitrators. The presumption that an appeal mechanism will add legal consistency and predictability to the regime is dubious given the lack of evidence that these are genuine problems with the existing process in this regard (as distinct from the substantive rules in IIAs which arguably lack certainty). ICS therefore has the appearance of unnecessary proceduralism for a species of disputes which are heavily fact-specific and for which an additional layer of legal scrutiny is superfluous.

Moreover, it is not clear that predictability of outcomes in investment arbitration, as would supposedly be achieved by the ICS, is necessarily virtuous. Surely flexibility in the achievement of justice, which is usually highly fact-specific, should be the overarching aim? Even this objective must be balanced against costs, which as alluded to above, are certain to be much greater under ICS because it effectively doubles the length of the procedure. ICS seems to be a largely cosmetic exercise or in the words of one noted commentator a “red herring.”⁶⁶ In this regard, it should be noted that the ICS system was designed partly in response to the massive outcry against ISDS which resulted from the European Commission’s public consultation on the traditional procedure in the run-up to the signing of the Transatlantic Trade and Investment Partnership (TTIP) between the US and the EU. But this campaign was driven in large part by provocative misrepresentations of ISDS in the popular media, leading to widespread misconceptions such as the notion that health services (such as those offered by the British NHS) would be open to tendering from foreign companies.⁶⁷ It further perpetuated the image of ISDS tribunals as sinister “secret courts” assembled at the behest of powerful multinationals. Yet it appears that the EU’s ICS proposal enjoys limited support, even by staunch critics of ISDS, for many of the reasons alluded to here.⁶⁸

ii) State-to-State Dispute Settlement

⁶⁵ See e.g. J Pauwelyn, *The Rule of Law without the Rule of Lawyers? Why Investment Arbitrators are from Mars, Trade Adjudicators from Venus* 109:4 *American Journal of International Law* 761 (2015)

⁶⁶ E.g. M Sornarajah, “An International Investment Court: Panacea or Purgatory?” *Columbia FDI Perspective* No. 180 (15 August 2016)

⁶⁷ D Roberts, “Liam Fox Dismisses NHS Takeover Fears Ahead of US Trade Talks” *The Guardian* (London) (1 February 2017)

⁶⁸ G Van Harten, “ISDS in the Revised CETA: Positive Steps but is it the Gold Standard” *Centre for International Governance Innovation (CIGI), Investor-State Arbitration Commentary Series* No. 6 (25 May 2016)

State to state dispute settlement provisions appear in most modern IIAs, including those concluded by the UK. It is conceivable that this system could be used to address treaty breaches by parties, precluding the need for conventional ISDS, although this would foreclose the ability of firms to receive compensation directly from foreign governments for the harms which they have suffered at their hands. It appears as though Brazil intends to rely on this kind of dispute settlement in its IIAs, having removed ISDS from some of its recent instruments,⁶⁹ none of which is in force. The problem with this approach, which renders it unadvisable for the UK is that, notwithstanding the evident success of the WTO state-to-state Dispute Settlement System, transgressions of investment treaty standards tend to have detrimental impacts on specific firms (as in most expropriations), unlike international trade measures which affect many diffuse suppliers across a given sector of the economy. Under state to state dispute settlement, such firms would need to convince their government to pursue a claim of treaty breach against the host state on the basis of their own injuries. Firms would need to expend resources lobbying the government to pursue this course of action and this might not be feasible for poorly resourced firms, such as SMEs.

It is further unclear how compensation of the injured investors would work. The offending measure may be ruled illegal and even accompanied by the payment of damages from one state party to the other, but this does not ensure that the individual investor which has been harmed will receive adequate compensation for their loss. Accordingly, some system of political risk insurance (PRI) would be needed to mitigate the risk of foreign investment in conjunction with a state to state system. Such policies are likely not to be cost effective when set against a broad range of potential risks in unstable host states. This may explain their reasonably poor uptake by firms.⁷⁰ The UK Export Finance currently provides PRI to UK firms for investments in many developed and developing states. Without ISDS this agency may need to enhance its offerings. State-to-state dispute settlement may be more feasible for situations where investors have been denied establishment in party states and where a change to the law would be a more appropriate remedy than compensation for future losses which would be difficult to calculate. However, such remedies would only work in conjunction with IIAs containing pre-establishment guarantees, which do not feature in any UK IIAs.

⁶⁹ E.g. Brazil-Malawi (signed 26 June 2015)

⁷⁰ A study from 2008 estimated that 30% of FDI into the developing world is covered by PRI: K Gordon, "Investment Guarantees and Political Risk Insurance: Institutions, Incentives and Development" OECD Investment Policy Perspectives 2008: <https://www.oecd.org/finance/insurance/44230805.pdf>

State-to-state dispute settlement also runs the risk of excessive politicization⁷¹ in part due to the lobbying issue, which will favour powerful firms. Politicization could take the form of increased tension between state parties which would be absent in ISDS. This was precisely the problem that ISDS was designed to resolve by removing the dispute from the diplomatic elements inevitably resulting from interactions between states and between politicians and their constituents and or donors. Indeed, this is specified in ICSID Convention's denial of diplomatic protection for investors.⁷² Lastly, state-to-state dispute settlement would not address the concerns voiced by many over the identity and expertise of the arbitrators who would comprise the ad hoc tribunals typically referenced in IIAs.⁷³

VI Conclusion

This article did not purport to provide a defence of ISDS generally, let alone the substantive provisions of the IIAs in which it appears. Ultimately the effectiveness of ISDS for the UK will depend heavily on the nature of the substantive protections contained in its IIAs relative to equivalent protections available in the UK's domestic legal system (in its capacity as a host state) and those of foreign legal systems (in its capacity as a home state). This article has also, perhaps conspicuously to some, not attempted to assess ISDS on normative grounds. It did not consider, for example, whether its presence in future UK IIAs could act as a disincentive to the strengthening of rule of law in host developing states, a beneficial outcome which could arguably be retained through exhaustion of local remedies provisions.⁷⁴ Considering the UK government's objective, outlined in the Brexit White Paper, of adopting international trade agreements which "protect the role of the UK courts" it may be desirable to include an exhaustion of local remedies requirement in some of the UK's IIAs, such as those with other OECD countries where there is a strong rule of law. Finally, this article did not consider whether various forms of inward and outward foreign investment may genuinely be viewed as economically or socially advantageous to the UK. Each of these issues represents fertile areas of further research.

This article did argue that, as a developed state with highly mobile firms and an accountable, business-friendly government eager to assert itself globally upon departure from

⁷¹ E.g. F Baetens, "Investment Chapters Including Dispute Settlement Mechanisms in Bilateral Trade Agreements" 142 *Royal Dutch Society of International Law Journal* 35 (2015)

⁷² Art 27

⁷³ E.g. UK-Colombia (17 March 2010) Art X

⁷⁴ *Ibid* at 5

the EU, the UK should to maintain its practice of including the procedure of ISDS in its post-Brexit IIAs. ISDS would serve the interest of its own investors, particularly those pursuing opportunities in developing markets and would appeal to many of its potential future treaty partners eager to establish within the UK. While it appears as though the EU and possibly Canada may insist on the ICS system in future,⁷⁵ Australia⁷⁶ and India⁷⁷ have each demonstrated the intention to include ISDS in their future IIAs, in one form or another. In an era of global commerce where ISDS remains a standard feature of IIAs, omitting ISDS from its investment treaties could relegate the UK to the status of a high-risk, anti-business jurisdiction while at the same time subjecting its firms to uncertain local procedures from which their competitors can readily escape. Although ISDS has many inherently advantageous features from a commercial perspective for the UK, there may be states for which ISDS may be an unsuitable or unnecessary procedure, just as there may be instances where IIAs themselves are redundant. As with the issues alluded to above which did not form part of this study, such recommendations have been left for others.

⁷⁵ Canada: Report of the Senate Standing Committee on Foreign Affairs and International Trade at 23-24 (February 2017): “the federal government seeks to negotiate bilateral investment treaties and include investment chapters in FTAs in order to ‘provide a rules-based legal framework that helps protect the investments of Canadian investors operating abroad.’”

⁷⁶ Australian Government, Department of Foreign Affairs and Trade “Investor State Dispute Settlement” at 2: “The Government will consider ISDS provisions in FTAs on a case-by-case basis. The Australian Government is opposed to signing up to international agreements that would restrict Australia’s capacity to govern in the public interest — including in areas such as public health, the environment or any other area of the economy.” (2016)

⁷⁷ D Sikarwar, ‘India Seeks Fresh Treaties with 47 Nations’ The Economic Times, 27 May 2016. India’s new IIAs may include the requirement to exhaust local remedies.