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Opinion **beyondbrics**

Time to modernise investor dispute arbitration

The current system is fractured, dysfunctional and stuck in a time warp

When Philip Morris brought a $26m claim against Uruguay, arguing that tobacco regulations violated bilateral investment treaties, the case's combined expenses exceeded the claim © Bloomberg

Harry Broadman MARCH 7 2020

During months in which the US and Chinese governments have battled ineffectually over Beijing's treatment of US companies, it has been easy to forget that arbitration by independent tribunals to settle disputes between foreign businesses and the governments of their host countries is the fastest-growing area of international law governing cross-border investment.

Over the past three decades, the number of cases initiated globally using third-party arbitration for investor-state dispute settlement (ISDS) is more than 940, and its growth has accelerated significantly — there were 71 such cases in 2018 alone.

So commonplace is the practice that parties to "south-south" transactions — investments made by businesses domiciled in one emerging market into another, a comparatively new feature of the world economy yet now a significant driver of its growth — have been quicker adopters of the framework than participants in traditional "north-south" commerce.

However, unlike the unified set of rules governing trade on which the WTO is built, in the case of cross-border investment, there is not a globally integrated framework guiding independent arbitration for ISDS.

Today's protocol, with its roots in the 19th-century founding of the City of London Chamber of Arbitration, is in a time warp. Some disputes follow the rules of the International Center for Settlement of Investment Disputes, a part of the World Bank. Some fall under the purview of the UN Commission on International Trade Law. Others use mechanisms managed by entities in London, Hong Kong, Paris, Stockholm and Sydney.

Regardless of the arbitration rules chosen, they are codified in sovereign treaties. The most common form of these are bilateral investment treaties (BITs). At present, there are more than 2,930 BITs in force. While some complain that independent international arbitration clauses in these treaties erode sovereignty, especially of developing countries, over the past 30 years, 36 per cent of cases were decided in favour of states compared with 29 per cent in favour of investors.

As foreign direct investment continues to grow worldwide — between 2000 and 2018 the stock of inbound FDI quadrupled from $7bn to $32bn — much is at stake in attempts to reform the ISDS arbitration system to keep the wheels of global commerce turning.

Given that both developed and developing countries routinely rely on independent ISDS arbitration, the prospects for modernisation should be ripe, in five areas especially.

Greater efficiency in resolving disputes The duration of ISDS arbitration has lengthened greatly. In part, this is because "shopping" among the different regimes can entail more effort and complexity. It is also because the stakes of losing — measured by damages suffered on which compensation is owed — have grown. Taking a cue from the WTO, achieving greater uniformity in — indeed centralisation of — the ISDS arbitration process is needed.

Reducing arbitral expenses While hourly tribunal costs and lawyers' and experts' fees have been rising in line with market fundamentals, costs of arbitration have increased sharply due to the greater complexity and longer duration of cases.

To take an illustrative, yet extreme, example, years ago Philip Morris brought a $26m claim against Uruguay, arguing that the country's tobacco regulations violated the Swiss-Uruguay BIT. The company lost the case and its legal fees and tribunal costs amounted to $17m. Uruguay spent $10m defending itself. The combined expenses for the case exceeded the claim.

One way of mitigating arbitral expenses — beyond properly handicapping the odds of winning before entering arbitration — is to reduce the duration of cases.

Transparency Materials presented in ISDS arbitration are often confidential. (The majority of BITs do not require public disclosure of disputes.) When cases are settled, their details are rarely revealed. However, when tribunal decisions are rendered, awards mandated can be public. Such asymmetry breeds suspicion.

While companies should be able to keep bona fide proprietary data private, tribunals should act to build greater public trust in the independent ISDS arbitration process. Not doing so runs counter to the impartiality goal of the framework itself.

Selection and quality of arbitrators Unless the parties can agree on using a single arbitrator, there is typically a tribunal of three arbitrators — one chosen by each side and a third, to chair the tribunal, chosen by those two.

Arbitrators who are thorough, systematic and fair inspire confidence among states and investors. Naturally, they are in high demand. The result is that some arbitrators are appointed many times and their availability to take on new cases becomes limited, leading some parties to believe they do not have access to the "best" arbitrators. This can cause delays, which can inflate the alleged damages. Fortunately, more lawyers are being appointed as arbitrators. Although this is bringing relief, parties still need to realise that the best arbitrators will still be able to command premium fees.

Third-party funding to finance arbitral expenses and damages payments Despite the efficiency ISDS arbitration engenders compared with conventional court litigation in determining the faulty party, arbitrators cannot enforce payment of damages.

Litigation financing by third parties — such as investment banks or hedge funds — offers an innovative approach to fill this gap: financial resources are provided in exchange for payment of a return. Such funding generally covers not only claimants' (or respondents') legal fees, tribunal costs and other arbitration-related expenses but also the payment of damages.

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