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The Backlash Against Investment Arbitration: Perceptions and Reality

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The Backlash against Investment Arbitration: Perceptions and Reality

By Michael Waibel, Asha Kaushal, Kyo-Hwa (Liz) Chung and Claire Balchin

Recent decades have seen tremendous acceleration in international investment arbitration. A rapidly-expanding web of international treaties has substantially increased the protection of foreign investment and given investors direct remedies against host governments. But, over the last few years, cracks have started to appear in the investment regime. Investment arbitration now attracts a substantial amount of public scrutiny. With arbitrators sitting in judgment over a wide range of national policies, some stakeholders challenge their legitimacy.

Commentators increasingly question whether a backlash against the foreign investment regime is underway.¹ This book, the outgrowth of a conference organized by the editors at Harvard Law School on April 19, 2008, aims to uncover the drivers behind the backlash against the current international investment regime. A diverse set of contributors reflect on the current state and the future direction of the international investment regime, and offer some tentative solutions for improvement: academics, practitioners, government officials and civil society.

Contributors assess whether the current regime of investment arbitration is in crisis. They take a step back to look at the long-term prospects of investment arbitration, including reforms that could bring substantial improvements to the investment arbitration process. Some contributors answer questions that Gus Van Harten posed in his public law critique of the current international investment regime.² Others offer refinements, propose alternative viewpoints and

¹ INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY – ESSAYS IN HONOUR OF CHRISTOPH SCHREUER (CHRISTINA BINDER ET. AL, EDS.), Part VIII, pages 801-916 examines the future of investment arbitration. In the Preface, the editors note that international investment law and arbitration “while no doubt still a booming branch of international law, currently face challenges that aim at the heart of the matter”; Charles N. Brower, Charles H. Brower II, and Jeremy K. Sharpe, *The Coming Crisis in the Global Adjudication*, 19 ARBITRATION INTERNATIONAL 415 (2003) (noting that the traditional “elements and perceptions of legitimacy are too often spectacularly absent”); Charles N. Brower, Michael Ottolgenhi, and Peter Prows, *The Saga of CMS: Res Judicata, Precedent, and the Legitimacy of ICSID Arbitration*, in INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY – ESSAYS IN HONOUR OF CHRISTOPH SCHREUER (CHRISTINA BINDER ET. AL, EDS.), 843-864, at 845 (referring to “the increasingly strident legal and political pushback [...that...] call into question in various ways whether ICSID arbitration will continue to be a useful and legitimate forum for resolving international disputes.”); David W. Rivkin, *Towards a New Paradigm in International Arbitration: The Elder Town Model Revisited*, 24 ARBITRATION INTERNATIONAL 375 (2008), at 377 (acknowledging “a crisis that we must find ways to resolve if international arbitration is going to continue to be the favored means of resolving international disputes”); Alan Beattie, *Concern grows over global trade regulation*, Financial Times, March 12 2008 (“quoting Hillary Clinton: “We are going to take out the ability of foreign companies to sue us because of what we do to protect our workers.”) The British Institute of International and Comparative Law has organized several conferences that address elements of the backlash: “Implications of the global financial crises for investment arbitration” (February 2009), “Investment Protection – Change or Decline?” (March 2009), “Host State Perspectives” (May 2009) and “Ethics, Issue Conflicts and Arbitrator Challenges” (September 2009). In April 2009, the Institute for Transnational Arbitration and the American Society for International Law hosted a conference entitled “When Arbitration goes Bad”. In January 2009, the Vale Columbia Centre on Sustainable International Investment, a joint undertaking of Columbia Law School and the Earth Institute, sent a Memo to President Obama on “Improving the International Investment Regime: priorities for a new U.S. Administration” (“the legitimacy and effectiveness of the international investment regime hinges on its ability to serve the interests of all its principal stakeholders and hence to maintain its global acceptance”).

² GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2007).

defend the status quo. Still others address overlooked topics, such as denial of benefits clauses³ and the potential unsettling effect of bilateral investment treaties (BITs) declared to be incompatible with European Union law.⁴

To dispel potential misconceptions in advance, this book affirmatively does not aim to add further fuel to the backlash. Rather, the project is premised on the belief that an investment arbitration regime in listening mode and ready to adapt may draw tremendous strength from constructive criticism.⁵ It is worth keeping in mind that it is far easier to criticize existing arrangements than to propose meaningful and viable alternatives. But a range of serious questions addressed in this volume about the sustainability and future direction of investment arbitration demand answers capable of general acceptance.

These questions can no longer be ignored or be dismissed as esoteric criticisms by fringe groups or outsiders with no stake in the system. Without appropriate remedial action, the rising discontent over the perceived and actual problems of the international investment regime risks undermining the tremendous gains in the rule of law on cross-border investment flows achieved over the last decades. Unless acknowledged and addressed, these concerns could throw the baby out with the bathwater. All parties would lose: not only host countries and investors, but also arbitration practitioners.

The Nature of the Critique: Procedural or Substantive?

The critiques aimed at the investment regime tend to divide into two categories: procedural and substantive. For several years now, particularly following the entry into force of the North American Free Trade Agreement (NAFTA), academics and civil society groups have called for additional procedural safeguards. These demands fall under the broad banner of transparency, which may be understood to encompass, among other aspects, requirements of publicity and administrative fairness.

In 2001, the following powerful indictment of NAFTA Chapter 11 proceedings in the *New York Times* gained notoriety:

Their meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a small number of international tribunals handles disputes between investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations challenged.⁶

³ Mark Beckett & Rachel Thorn, xxx.

⁴ Markus Burgstaller explores how a recent judgment by the European Court of Justice could unravel a number of intra-EU BITs, or at least, require their renegotiation, xxx.

⁵ Brower, Ottolenghi & Prows, *supra* note 1, at 863 (“ICSID arbitration has drawn its share of criticisms from all sides and this ultimately may be reflective of the overall vitality of the system. As a practical matter, any system of dispute settlement called upon to review the propriety of official acts will result in winners and losers.” “Some growing pains were probably inevitable.” They end on an optimistic note: “the continued good faith and critical eye of the international arbitration community, are providing a sound foundation for the future.” (at 864).

⁶ Anthony DePalma, *Nafta’s Powerful Little Secret: Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say*, *New York Times*, March 11 2001 (highlighting the public’s unease about ad hoc panels drawn from lists of academics and international lawyers almost unknown outside their highly specialized fields and quoting Joan Claybrook, president of Public Citizen, referring to “secret government”, where “governments [are] using Nafta not

This quote encapsulates widespread and serious concerns about the operation and effects of investment arbitration, especially from *outsiders* who hear about investment arbitration only indirectly: an alleged lack of democratic accountability, a shrinking of domestic policy space⁷ and pervasive confidentiality. But even some arbitration practitioners, increasingly question the traditional advantages of this tailor-made method of dispute resolution across borders—such as speed, low cost and neutrality.⁸ There are growing concerns that international arbitration is losing its long-standing edge over litigation in domestic courts.

Another procedural criticism levelled at the investment regime concerns the conflicts of interest at play in the world of international arbitration. Professor William Park describes the many possible conflicts that may arise and provides some suggestions for identifying and resolving them. He acknowledges the potential for conscious and unconscious bias, differentiating between the various levels of conflict that may characterize the arbitral arena. Yet he remains committed to the current model of international arbitration and hopeful about the capacity for evolution.

Yet the progress toward procedural transparency since that *New York Times* article has been promising. International arbitral tribunals have consistently permitted third party participation through the submission of *amicus curiae* briefs and NAFTA tribunals have opened up their hearings to the public. Developed country investors and host States alike seem to understand the importance of securing democratic legitimacy. Nonetheless, pleadings and even decisions often remain confidential, making meaningful *amicus curiae* participation difficult and leaving the public to speculate about the allegations and reasoning behind the result.

Agreement on the substantive problems of investment arbitration and desirable modifications is more elusive. Progress is hard to assess by any standard. *One* criticism has to do with the interpretation and application of investment law. For example, the CMS Annulment Committee⁹ remarked that the CMS tribunal applied the law “cryptically and defectively”¹⁰ and regarded a central part of the award’s legal reasoning as erroneous, stating:

to defend trade but to challenge the functioning of government.”). A recent article in *The Economist*, hardly a suspect of hot-headed radicalism, expresses similar concerns, Behind closed doors – A hard struggle to shed some light on a legal grey area (“things which may well be in the public interest to know are hidden from view”). Cf. also Robert Y. Jennings, *The Judiciary, International and National and the Development of International Law*, 45 ILCQ 1 (1996) (in international adjudication it is “difficult to find out what is going on, much less to study it”, at 5). Charles Brower II, Obstacles and Pathways to Consideration of the Public Interest in Investment Treaty Disputes, in *INTERNATIONAL INVESTMENT LAW AND POLICY YEARBOOK 2008-2009* (ED. KARL SAUVANT) (2009), at 367 (the view that investment arbitration serves to “exclude the potential for troublesome arguments regarding the public interest ... fuels mainstream concerns that investment treaties subvert the democratic process. Because this position tends to invite backlash, because investment treaties are not suicide pacts, and because it makes no sense to ignore the issues that have become preoccupations for host countries ...”).

⁷ For a similar argument in the WTO context, Joost Pauwelyn, *The Transformation of World Trade*, Mich. L. Rev. (emphasizing the need for input legitimacy and for enough politics in international trade law).

⁸ Rivkin, *supra* note 1 (urging a radical return to basics in settling disputes through arbitration).

⁹ *CMS Gas Transmission v. The Argentine Republic*, ICSID Case No. ARB/01/8, Annulment Decision, 15 Sept. 2007, <http://ita.law.uvic.ca/documents/CMSAnnulmentDecision.pdf>.

¹⁰ CMS Annulment, Para. 136.

Throughout its consideration of the Award, the Committee has identified a series of errors and defects. The Award contained manifest errors of law. It suffered from lacunae and elisions. All this has been identified and underlined by the Committee.¹¹

Yet the ICSID Convention permits annulment only for “manifest errors of law”.¹² The Committee’s expansive commentary on that point, despite its limited mandate, seems to be directed at the general investment arbitration community. Such criticism from *within* fulfils a dual function. First, it shores up the system’s legitimacy by bringing bad practices to light and opening the way for catharsis in future cases. Second, it serves as a warning shot: Change course or risk putting the long-run health of the entire regime at risk.

Louis Wells makes a broader point in his contribution to this volume. As he explains, many members of the international investment arbitration community continue to be immersed in points of law, rather than exploring the viability and the effects of investment arbitration as a whole.¹³ He urges arbitration panels to take a more pragmatic approach. Foreign investors seek renegotiations of their investment contracts with some frequency when conditions for their investment have changed materially. Yet when similar adverse circumstances affect the host government, tribunals adopt a very rigid view of contracts, rather than encouraging the parties to realize potential joint gains from renegotiating their agreement.

In a similar vein, Anne van Aaken suggests that host state’s *ex ante* commitment needs to be balanced with a degree of flexibility *ex post*. Contract theory suggests that under changing conditions overly strict commitments are detrimental to the long-run interests of the parties. Overly broad commitments without states being accorded sufficient flexibility by tribunals may lead to states voting with their feet and leaving the system altogether. Alternative measures are also increasingly used, such as renegotiation or termination of BITs, restrictions on international arbitration in constitutional law, the non-compliance with awards or the clarification of ambiguous terms by authentic interpretation of the two state parties.

Ilija Mitrev Penusliski explores alternatives to arbitrating investment disputes. In some cases, foreign investors and host governments leave gains on the table by resorting to a purely right-based, adversarial approach. Often, arbitration escalates the dispute, is long, expensive and severs business relations permanently. Interest-based alternatives such as mediation might leave both parties better off.

Louis Wells and Gabriel Bottini advocate that arbitration tribunals display more sensitivity to allegations of corruption. Bottini goes so far as to suggest that tribunals should, as a general rule, decline to exercise jurisdiction over investment disputes tainted by corruption. Corruption renders investments illegal. This bright-line rule is said to be in line with international public policy, lowering economic growth as well as weakening state institutions and the rule of law in host countries. Arbitral tribunals ought to work hand-in-glove with national courts that are often better at gathering evidence on corruption and other illegalities.

¹¹ CMS Annulment, para. 158.

¹² Christina Knahr’s contribution discusses the requirements of annulments and the challenges it presents in greater detail, xxx.

¹³ [xxx].

This is related to a *second* critique that cuts to the substance of the investment regime. Raised most frequently by states in Latin America, this critique focuses on the broad interpretation of treaty obligations. William Burke-White argues that the responses given by arbitral tribunals to Argentina's deep economic crisis in the early 2000s puts the entire investment arbitration regime at risk. Tribunals have, by and large, made it impossible for states to invoke necessity under customary international law and the security exception in BITs when they find themselves in economic crises. Tribunals fail to give host states an adequate margin of appreciation in relying on necessity, despite contrary intent of the state parties to the BIT. If Argentina were to exit the system as a result of such overbroad interpretations, investor-state arbitration would suffer a serious crisis of confidence. All those interested in having a viable international investment regime in place beyond the medium-term need to urgently realize what damage overzealous treaty interpretation in favour of the investor is doing to the system in the long run.

Tim Nelson disagrees with the contention that the current international investment regime is fragile. Historical experience, he contends, shows that the institution of investor-state arbitration is very durable, capable of surviving changing economic and political conditions, and even revolution and civil upheaval. Both states and investors value the certainty and the added enforcement probabilities that investor-state arbitration provides. The concern that a regionally limited backlash against ICSID, in particular in the form of the ALBA movement in Latin America, could snowball into a global revolt against investor-state arbitration is unfounded. The investment regime will survive this hick-up, just like others in the past.

To this end, some analysis of particular treaty obligations is helpful. Mark Beckett and Rachel Thorn explore the denial of benefits clause in BITs and the definition of investor. **[NTD: Describe further]**.

Alejandro Turyn and Facundo Perez Aznar take a different tack as they seek to find the balance between host State regulatory space and foreign investor protections. Their chapter examines the transfer of funds clause that could become a focal point of future arbitrations, as the recent financial crisis has put exchange controls back in fashion. They place the clause in the context of general international law, and conclude that the obligation was never intended to provide the investor with an absolute right to transfer funds out of the country. Moreover, Turyn and Aznar contend that the free transfers provision must be understood to be in a relationship with other treaty and customary international law obligations, such as state defences. Alexis Martinez explores a whole range of state defences in greater detail.

To complicate the picture, some criticisms have both procedural and substantive aspects, such as concerns about parallel proceedings and conflicting awards. Richard Kreindler and August Reinisch analyze the consequences of forum shopping in fascinating detail. They explore the many different forms that parallel proceedings may take and the troublesome results of adjudicating a claim with more than one seat of arbitration, set of arbitral rules, and applicable substantive law. Christina Knahr develops this analysis further, exploring the possibilities for conflicting awards in the context of annulment. She concludes that ICSID annulment procedures, while valuable, are not sufficient to resolve the issue of conflicting awards.

Historical Context

The historical context is important. The current regime builds on the remnants of past dispute settlement mechanisms. Investment disputes have existed for decades, long before the revolution of direct investor standing and the proliferation of BITs. Disputes were resolved through diplomatic protection, negotiation, or sometimes litigation in national courts.

James Crawford recently identified a number of continuities in the “brave new world” of international dispute settlement, which turns out to share a great deal with arbitration in the 19th century.¹⁴ One of these continuities is a struggle against ad hoc dispute settlement in the form of increased institutionalization that started in the 20th century and remains incomplete. History lurks in the shadows. Sometimes perhaps even today arbitrators remain too beholden to the parties to deliver just and legally sound decision to the arbitrators.

Few contest the insufficiency of these mechanisms in today’s globalized economy. In his chapter, Tillmann Rudolf Braun examines the effects of globalization on the development of international investment law. He analyzes the juridification of key relationships in the global economy, the changing role of states, and the resulting pressures on national sovereignty. Other chapters, such as the one by Markus Burgstaller, focus on specific new challenges that face the BIT regime in a dynamic world. He writes about the relationship between European Union Law and BITs. As both regimes expand their reach, they complement and conflict in unexpected ways, leading to strains and inconsistencies.

Yet Stephan Schill reminds us in his contribution that investor standing is a revolutionary development worth keeping. Investor-state arbitration evolved to fill gaps and shortcomings in the existing foreign investment dispute settlement framework and should not be discarded lightly, nor should detractors sell the system short without considering meaningful alternatives. Schill describes the shortcomings of earlier alternatives, revealing the flaws in each.

Nonetheless, a step into the past is always a useful starting point for an assessment of the present. During the short time frame stretching from the first BIT, concluded in 1959, to the present, the investment regime has already undergone several waves. Capital-importing states, formerly opposed to the obligations contained in such treaties, signed on with vigour. The earlier opposition by developing countries became the proclamation of a New International Economic Order (NIEO). This culminated in Resolution 3281, which codified the Charter of Economic Rights and Duties of States.¹⁵ The Charter asserted national sovereignty over the property rights of foreigners and clarified that the compensation for expropriation would be settled under the domestic law of the nationalizing state and by its tribunals. There was no mention of international law or international arbitration.

¹⁴ James Crawford, Continuity and Discontinuity in International Dispute Settlement, in INTERNATIONAL INVESTMENT LAW FOR THE 21ST CENTURY – ESSAYS IN HONOUR OF CHRISTOPH SCHREUER (CHRISTINA BINDER ET AL, EDS.), at 802.

¹⁵ Charter of Economic Rights and Duties of States, G.A. Res. 3281 (XXIX), U.N. Doc. A/9631 (Dec. 12, 1974), 14 I.L.M. 251 (1975) [1974 Charter]. See also Declaration on the Establishment of a New International Economic Order, G.A. Res. 3201 (S–VI), U.N. Doc. A/9559 (May 1, 1974), 13 I.L.M. 715 (1974); Programme of Action on the Establishment of a New International Economic Order, G.A. Res. 3202 (S–VI), U.N. Doc. A/9559 (May 1, 1974), 13 I.L.M. 729 (1974).

The rapid pace at which BITs were concluded after the 1980s had much to do with structural changes on the international scene.¹⁶ The reversal of stance that brought these countries to the BIT negotiating table was slow and steady, picking up momentum as the arbitration world moved into the 1990s, and accelerating after the fall of the Berlin Wall and the onset of economic transition to market-based economies in many countries around the world. Foreign investment became the buzzword of international relations, espoused by international institutions and promoted by economists. Yet, the rapid fire conclusion of BITs has since slowed and the symptoms of the backlash continue to grow.

What is the legacy of the comparatively short history of the BIT?

On a broad level, inherent contradictions characterize the BIT revolution over the last decades. Underlying the surge in bilateral investment treaties is a belief that protection of investor interests will invariably, without further state intervention, lead to the public good. This is tied to the belief that BITs increase or facilitate foreign investment, a premise called into question in the contribution by Zachary Elkins, Andrew Guzman and Beth Simmons, Their statistics reveal a tenuous relationship between foreign direct investment and bilateral investment treaties. The central reason is that the pool of money that investors are willing to invest in developing countries is limited. States compete for this scarce pool by offering ever more attractive conditions to foreign investors, engaging in an arms race. They would likely be better off if they could collectively commit not to undertake this race to the bottom.

A second thread is a deep distrust of government, seen as prone to populist pressures, with a weak commitment to legal predictability and contract enforcement, beholden to irrational goals. Arbitrators serve as an objective safety valve, impartial, objective and independent.¹⁷ They ensure that private property is shielded from state interference and impose compensation when property rights are violated. This function shares similarities with national courts ensuring that governments do not take property without adequate compensation. The contributions of Anne van Aaken and Stephan Schill explore this point, among others, in greater detail.

At bottom, such contradictions and concerns often boil down to the concept of sovereignty. Sovereignty is a highly contested concept and tends to look different depending on the vantage point. It can be subdivided seemingly *ad infinitum* so that there is economic sovereignty, regulatory sovereignty, political sovereignty, military sovereignty and so on. Concerns and critiques about the investment regime tend to locate themselves somewhere within the concept. Procedural demands often invoke domestic sovereignty by requiring democratic legitimacy and accountability on the part of the host State. Substantive demands may invoke regulatory sovereignty as the host State seeks to carve out a space safe from the scrutiny of international arbitration. The key point for the backlash, however, is that the concept of sovereignty is fluid and dynamic. It can and has been mobilized by groups on all sides of debate. From the Calvo Clause to the NIEO to calls for restraint under NAFTA Chapter 11, sovereignty has proven its malleability. For that very reason, some regard it as an empty shell. Meaningful

¹⁶ Gus van Harten, *supra* note 2, at 42.

¹⁷ Martti Koskeniemi, *The Ideology of International Arbitration*, Sept. 7 2007, The Hague; *see generally* DAVID SCHNEIDERMAN, *CONSTITUTIONALIZING ECONOMIC GLOBALIZATION – INVESTMENT RULES AND DEMOCRACY’S PROMISE* (2008).

discussions about the backlash will need reach some accommodation on the meaning and scope of the term.

Despite periodic assertions to the contrary, no consensus on the international rules governing cross-border capital flows and investment has emerged. Even though the debate is less ideologically charged today compared to the 1970s, positions continue to diverge substantially. The superficial consensus that enabled the conclusion and widespread acceptance of the ICSID Convention is fragile. At least in that respect, the end of history was a chimera. The most spectacular example of these frictions is the failed MAI, but this is just the most obvious.¹⁸ Against this background, to confine the real and important debates to the ash heaps of history seems mistaken. If critical questions are ignored or simply glossed over as is common nowadays, they are likely to return with a vengeance.

Investment Arbitration and its Discontents

One may deny that there is systemic crisis in international investment arbitration, but it is no longer possible to deny that a backlash is gathering force. Luke Eric Peterson's contribution explains why public scrutiny and dismay about the system's shortcomings is on the rise. In this sense, at least, the backlash is real, and apparent in a number of recent developments. For instance, the United States rewrote its Model BIT in 2004¹⁹; NAFTA parties issued a clarifying statement that cut back on NAFTA's protections²⁰; a widespread sense that investment tribunals failed to develop balanced solutions for cases arising out of Argentina's financial crises in 2001, and the possibility that Argentina could chose not to comply with the awards.

States – the most important stakeholders – have also started to assume a critical position. Bolivia denounced the ICSID Convention in 2005 and attempted to renegotiate all of its BITs. One aim was to steer dispute resolution to domestic fora, rather than international arbitration. Bolivia alleged bias, and expressed concern about the lack of appeals mechanism and the confidentiality of ICSID proceedings.²¹ This rupture with ICSID generated alarm among international investment lawyers. Yet most took comfort in the fact that Bolivia's economy was too small to really matter, that the move did not trigger a domino effect, as some had feared in Argentina in particular and that many of Bolivia's BITs provide for non-ICSID arbitration such as under UNCITRAL rules.

Ecuador recently joined Bolivia in turning its back on ICSID.²² Other states, in particular in Latin America, have mooted similar moves, including Nicaragua and Venezuela. Their leaders united in June 2009 to host a panel at the United Nations about closing down the ICSID.

¹⁸ The draft agreement, along with the commentary, may be found at <http://www.oecd.org>.

¹⁹ Explain why many see the model as a regression.

²⁰ Provide source.

²¹ Investment Treaty News, May 9, 2008, http://www.iisd.org/pdf/2007/itn_may9_2007.pdf (quoting President Morales from the Washington Post "(We) emphatically reject the legal, media and diplomatic pressure of some multinationals that ... resist the sovereign rulings of countries, making threats and initiating suits in international arbitration"; Letter from 134 NGOs to ICSID, June 21 2007, <http://www.foodandwaterwatch.org/water/world-water/right/icsid-letter> (applauding Bolivia's "courageous and important decision" from ICSID, an institution that is "not an objective, neutral or impartial dispute resolution mechanism", whereas [m]ost ICSID cases result in compensation to the investor."

²²

Argentina, the state that appears most often as a respondent, thus far remains committed to ICSID. However, the country has assumed a combative stance, for instance, by seeking the annulment of every award issued against it. Some Latin American countries plan to renegotiate or else terminate their BITs. Several developed countries adopted legislation to screen foreign investments for national security, a barrier to admission of new investments.²³

Other reasons for the backlash include: doubts about whether BITs increase foreign investment; inadequate representation of developing countries among the panels of arbitrators; an alleged institutional bias or unfairness typical of major arbitral institutions such as ICSID; the tension, and at times subordination, of the public interest to commercial interests; the lack of transparency and conflicts of interest.²⁴

Looking Ahead

The current global economic crisis subjects economic openness in respect of capital flows and investment to stress tests. Over the coming years, governments and users of investment arbitration will re-evaluate their priorities. This shift could have profound implications for the foreign investment regime. The current crisis might turn a minority's critique into the mainstream, and catalyze change that has long been in the offing. When British or German support for investment arbitration wanes, the system could crumble, with no ready alternative in its place.

The Achilles heel of the current investment regime is a loss of confidence among leading stakeholders – major developed countries. As we have seen with debate on inward investment by sovereign wealth funds (SWFs), national anxieties about foreign investment in the developed world run at a similar level of those in developing countries.²⁵ The SWF debate could just be the precursor of a pronounced turn towards autarky in the wake of the global financial crisis that started, in particular if major developed countries are routinely called upon to defend their policy response to the crisis before arbitral tribunals. A string of arbitrations with them as respondents could be the chief vehicle of rising opposition to the central support of the current investment regime. Mehmet Thorat and Thomas Schultz explore this new, and perhaps in the future quite common, reversal of fortunes in their contribution.

Without doubt, the international community needs rules of the game to regulate foreign investment on an equal footing across different states. Likewise, a well-functioning system for settling disputes is indispensable for a globalized economy. The cynical and increasingly widespread view that the current arbitral system serves no one but the lawyers and arbitrators is corrosive of the much needed trust in the fairness and efficiency of international dispute settlement. Against this background, international lawyers in particular should be concerned about safeguarding the fabric of existing international investment law. Major overhauls are probably needed. Such consolidation is particularly important after a period of exponential growth that may carry the seeds of its own destruction.

²³ Cite CIFIUS, German and French legislation.

²⁴ On the last point, *see* William W. Park's contribution to this volume and CATHERINE ROGERS, ETHICS IN INTERNATIONAL ARBITRATION (2009).

²⁵

One can no longer safely say that investment arbitration continues to inspire general confidence. But crucially: existing alternatives, such as national courts in host countries, do not necessarily inspire more confidence. It may well be the current system of resolving investment disputes are a second-best solution for as long as states are unwilling to hand over adjudicative power to well-qualified individuals with security of tenure, such as the international investment court proposed by Gus van Harten. Compared to a baseline of arbitrators beholden to governments that was common in the late 19th century, the current system of ad-hoc mixed with institutional arbitration would seem an improvement. Yet as measured against highly developed domestic adjudication, one that appears presently unattainable in the international realm, the shortcomings of the current system are serious. Reform is essential.