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Investor-State Disputes: The Record and the Reforms Needed for the Road Ahead

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Executive Summary

There are some 2,500 international investment agreements (IIAs) in force around the world, whether as stand-alone treaties or incorporated into bilateral or regional free trade agreements (FTAs). They are a significant feature of the international business scene.

A main feature of these agreements is to allow foreign investors to invoke binding arbitration where it is alleged that the host governments have breached fair and equitable treatment and other treaty obligations towards the investors. This is known as Investor-State Dispute Settlement or "ISDS".

The process gives foreign investors comfort that if things go wrong in host countries, they have recourse to neutral, third-party dispute resolution. It thus provides important elements of risk reduction for foreign investors and their investments, notably aiding the flow of capital from industrialized countries to the developing world.

There has been dramatic escalation of investor arbitration claims over the last two decades. This makes it timely and useful to review the situation, looking at the value of ISDS as well as the criticisms that have emerged over the years. The conclusion is that IIAs and the arbitration process are valuable parts of the corpus of international order and will remain an integral part of the international business scene for the foreseeable future. The issue facing governments, therefore, is how to respond to criticisms by improving, as opposed to abandoning, the ISDS process. This paper suggests some pragmatic ways forward.

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A Canadian company, First Quantum Minerals, and the government of Panama are reported to have settled a long-standing tax dispute allowing the company to resume operations at the Cobre Panama mine in that country.[1] Earlier reports were that if the dispute was not resolved by negotiation, the company would invoke arbitration rights under the Canada-Panama Free Trade Agreement.

Had the dispute proceeded, it would have been another example of hundreds of arbitrations that have proliferated around the globe, initiated under various international investment agreements (IIAs) that give private parties the right to bring binding arbitration against governments under Investor-State Dispute Settlement (ISDS) procedures. Those rights can be invoked, for example, where investors allege lack of fair and equitable treatment, discrimination or expropriation without adequate compensation contrary to that country's treaty obligations.

In addition to investment treaties, numerous free trade agreements incorporate separate investment dispute settlement provisions, including the former North American Free Trade Agreement (NAFTA); the Canada-EU trade agreement (CETA); the Trans-Pacific Partnership (CPTPP) Agreement; and bilateral free trade agreements, such as those between Canada and countries like Chile and South Korea, among others.

As a consequence, ISDS has become a significant feature of the ground rules for investments in many parts of the world, particularly those made into developing countries. Because of the rights given to private parties, these agreements have become increasingly controversial, especially in an era of expanding governmental measures on climate change, sustainability, human rights and more that impact foreign investors and their investments.

In light of these developments, it is useful to briefly update the ISDS record with regard to Canada, look at what lessons might emerge, both in the global and the Canadian context, and suggest some elements to monitor as we go forward.[2]

A Brief History

The ISDS process was originally designed several decades ago, but really burst into prominence with the scores of bilateral investment treaties concluded in the 1980s and 1990s. A main objective behind these agreements was to aid the flow of investment capital from industrialized to developing countries (i.e., foreign direct investment or FDI), providing a secure framework for investors through binding third-party dispute settlement if things went terribly awry in host countries. It was a way of mitigating investment risk.[3]

There are now an estimated 2,500 investment agreements around the world, most containing some form of dispute settlement provisions.[4] Recent data from the UN Conference on Trade and Development (UNCTAD) show that close to 1,300 separate ISDS claims have been launched under these agreements since the 1990s, with

1 "First Quantum finalizes draft contract to restart copper mine in Panama," *Financial Post*, 8 March 2023.

2 There is a vast amount of work underway in improving the ISDS process at the multilateral, regional and bilateral levels, far too extensive to cover here. The amount of literature on the subject of ISDS is extensive. This short commentary offers only a very general survey of some recent trends of interest to the Canadian business community.

3 While there are many factors involved, data show that capital flows to developing countries have increased substantially over the past thirty years. See *World Investment Report 2022*, United Nations Conference on Trade and Development (UNCTAD): https://worldinvestmentreport.unctad.org/world-investment-report-2022/.

4 The terminology for these investment agreements differs. They are referred to as International Investment Agreements, or IIAs, by certain organizations. Canada calls them Foreign Investment Promotion and Protection Agreements (FIPAs), while the US government describes them as Bilateral Investment Treaties (BITs). They all mean essentially the same thing.

approximately 350 disputes pending.[5] The result is that investment litigation has been and will continue to be a fact of international business life for decades.

Criticisms of ISDS

As investor arbitrations have proliferated, so have the criticisms, making ISDS one of the more controversial aspects of global governance.[6] Here are some of the main ones:

- IIAs have given private companies broad rights to challenge host-country actions that can fall within legitimate fields of public regulation, especially now in an era of decarbonization and other national crises like COVID 19.
- The process involves one-way litigation, with no corresponding right of host countries to bring arbitration cases against investors for disregarding laws, practices and standards of business conduct.
- The growth of third-party financings of investor claims has stimulated, or at least encouraged, the initiation of ISDS cases.
- Investment agreements bypass the customary international law norm that requires claimants to first exhaust local remedies before bringing an international claim against a host country.
- The ISDS structure is defective because its *ad hoc* tribunals – put together to hear a particular case – make long-term, binding decisions affecting laws or policies enacted for the public interest.
- Arbitrators' decisions are final and binding with no avenue of appeal, whether on errors of fact or of law.
- Because of its *ad hoc* nature, the system lacks institutional continuity. Public confidence in the system suffers.
- Arbitrators are appointed from a small -- if not closed – pool of international lawyers who are free to act for private interests as counsel in other cases, leading to appearances of conflict and adding to diminished public confidence in the process.[7]

There are answers to these critiques but the over-arching response, as alluded to above, is that resolving investor-state disputes based on legal norms within an accepted procedural framework remains a significant achievement in the progressive development of international law. As observed in one analysis,

> "During the last decade a number of the shortcomings have indeed been addressed and remedied. It is reasonable to assume that this has been done – at least partially – based on the realisation that investment treaty arbitration is the most efficient and reliable dispute settlement mechanism for disputes between foreign investors and host States. There is simply no better, realistic alternative."[8]

As already mentioned, ISDS in its various manifestations provides an important element of stability and risk insurance when investing in jurisdictions where legal rules may not be mature or respected, aiding the flow of capital to developing countries and thus presumably helping to meet the international community's aid and development goals. The system may not be perfect, but efforts are afoot to improve it at many levels, as discussed below.

5 *IIA Issues Note*, (UNCTAD, September 2021); *Investment Policy Hub* (UNCTAD, 19 April 2023): https://investmentpolicy.unctad.org/investment-dispute-settlement.

6 Among one of many hundreds of articles, see: https://jusmundi.com/en/document/publication/en-backlash-in-investment-arbitration; https://ccsi.columbia.edu/content/primer-international-investment-treaties-and-investor-state-dispute-settlement.

7 Some of these criticisms (as well as the advantages of Canada's investment agreements) are reflected in a 2021 report of the Canadian House of Commons Standing Committee on International Trade: https://www.ourcommons.ca/Content/Committee/432/CIIT/Reports/RP11415350/ciitrp08/ciitrp08-e.pdf.

8 Hobér, K. "Investment Treaty Arbitration and its Future-If Any," (2015) 7 *Arbitration Law Review*.

The Process of Improvement

Many IIAs provide for use of the International Center for the Settlement of Investment Disputes (ICSID) under the World Bank's auspices as the administering body.[9] Others incorporate the Paris-based ICC Court of International Arbitration, the London Court of International Arbitration (LCIA), the Permanent Court of Arbitration (PCA) in The Hague or other regional dispute settlement bodies.[10]

There has been a good deal of activity within these international bodies to improve the workings of the system, including establishing a code of conduct for adjudicators (such as in the CPTPP) and making the ISDS process more transparent to the public. Progress has been made in this respect through the issuance of the 2022 ICSID arbitration rules.[11] The UN Commission on International Trade Law (UNCITRAL) has added to these efforts.[12] There is active discussion in these and other multilateral bodies about devising some form of appeal process to allow the losing side recourse to a superior body on matters of law, responding to one of the criticisms noted above.[13]

Together with multilateral efforts, steps are being taken at the regional level. For example, under the umbrella of the CPTPP, Canada, New Zealand and Chile issued a joint declaration in 2018 "to promote transparent conduct rules on the ethical responsibilities of arbitrators in ISDS procedures, including conflict of interest rules that prevent arbitrators from acting, for the duration of their appointment, as counsel or party appointed expert or witness in other proceedings."[14]

Progress is also being made at the bilateral level. Canada's new (2021) model FIPA includes, among other things, enhanced transparency provisions and a code of conduct for arbitrators to guard against real or potential conflicts of interest.[15]

In short, in response to the concerns summarized above, multilateral, regional and bilateral efforts are continuing toward making improvements to the ISDS system in terms of efficiency, transparency and other aspects, including permanent appointments and a system of appeals.

On the substance of disputes, newer agreements, such as the 2007 US-Korea Free Trade Agreement, the 2016 CETA, and the 2018 CPTPP, have sharply curtailed the ability of investors to claim compensation for the impact of non-discriminatory measures that governments may implement to achieve legitimate policy objectives, beyond what domestic investors may be able to claim in domestic courts. In turn, this should address concerns that ISDS creates "regulatory chill" – a hesitancy by

9 https://icsid.worldbank.org/about.

10 The most frequently employed institution in these agreements is ICSID followed by the PCA. See UNCTAD, *Investment Policy Hub, supra*.

11 https://icsid.worldbank.org/procedures/arbitration/convention/confidentiality-transparency/2022. See also the ongoing work of ICSID in this regard as one example of efforts to de-mystify and regularize the adjudicative process. See https://icsid.worldbank.org/sites/default/files/publications/ICSID_AR21_CRA_bl1_web.pdf

12 *UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration*: See https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/rules-on-transparency-e.pdf

13 As examples, see: Rathmore, A., and Chawla, A. "Appeal Mechanism in Investment Arbitration: Time to Revisit ICSID Convention." September 2021, *Arbitration Workshop*: (https://www.thearbitrationworkshop.com/post/conceptualizing-appeals-mechanism-in-icsid-through-the-lens-of-multilateral-investment-court);
M-L Jaime. "Could an Appellate Review Mechanism 'Fix' the ISDS System?" *Kluwer Arbitration Blog,* 11 February 2011 http://arbitrationblog.kluwerarbitration.com/2021/02/11/could-an-appellate-review-mechanism-fix-the-isds-system.

14 https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/cptpp-ptpgp/declaration_isds-rdie.aspx?lang=eng

15 https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/2021_model_fipa_summary-2021_modele_apie_resume.aspx?lang=eng

governments to adopt legitimate measures in social, environmental or other areas, for fear of being forced to pay compensation to a foreign investor.

The Record

While not all investment arbitration proceedings or awards are publicly reported, many are, such as those conducted through institutions like ICSID in Washington or the Permanent Court of Arbitration in The Hague. Looking at the public record over the last thirty or so years is illuminating.

A recent UNCTAD report shows that, between 1987 and 2020, the number of ISDS arbitrations has grown dramatically, with very few in the early years (up to 2000), then escalating from 2013 onward to around 70-80 cases annually (before declining slightly in 2020 to slightly less than 70 claims).[16] Of those reaching some form of conclusion, whether by withdrawal, settlement or final award, 37 percent favoured the state and 29 percent were in favour of the investor.

The data also show that of the final panel decisions over that period (that is, excluding settled or withdrawn claims), 57 percent favoured the investors, while 39 percent of claims were dismissed. While those odds are not too bad for investors, it's far from a slam dunk, as they say. On the other hand, over the decades, arbitration awards have escalated from tens of millions of dollars in the 1990s to hundreds of millions in the early 2000s, to recent awards in the billions of dollars.[17]

Canadian Data: The Canadian dimension in the UNCTAD data is interesting. It shows that between 2011 and 2020. Canada was among the top ISDS respondent countries, on a par with Mexico, Croatia, Colombia, India and Russia (while the US doesn't appear on the list).[18] Canada similarly ranks high as respondent (i.e., host) state between 1987 and 2020.[19]

While Canada's ranking may be surprising, this seems almost entirely due to cases brought against Canada by American investors under the former NAFTA. Notably, Canada ranks well above Mexico as a NAFTA respondent state over the 1987-2000 period.

Other UNCTAD data show that Canadian investors have taken full advantage of ISDS clauses in Canada's FIPAs around the globe. Of the ISDS cases world-wide between 1987 and 2020, Canada is home to complainants in 58 of these, ranking Canada among the highest users of the system. In comparison, the US is home state for 86 claimants over that period.[20] On a relative basis, it seems that Canadian investors (seemingly weighted in the mining sector) are more aggressive in asserting arbitration rights to safeguard their offshore interests.

Having summarized the broad global picture, this paper now discusses interesting facets of Canada's experience under these investment treaties and trade agreements, including under the NAFTA from 1994 until it was superseded in 2020 by the Canada-United States-Mexico Agreement (CUSMA).

16 *IIA Issues Note* (UNCTAD, September 2021), *supra*.

17 Bonnitcha, J., and Brewin, S. "Compensation Under Investment Treaties: What are the problems and what can be done?" IISD, December 2020. See https://www.iisd.org/system/files/2020-12/compensation-investment-treaties-en.pdf.

18 *IIA Issues Note*, UNCTAD (September 2021), *supra* Figure 2 p. 2.

19 *Ibid*., Annex 2.

20 *Ibid*. The UNCTAD data include the ten or so cases whether Canadian claimants have filed cases against the US under Chapter 11 of the NAFTA.

NAFTA Experience: In the course of the NAFTA renegotiations during the Trump administration, Canada and the US agreed to end investor disputes between the two countries as of June 30, 2023.[21] In the case of NAFTA investment disputes between 1994 and 2020, a previous C. D. Howe Institute update (October 2019)[22] noted that, among the three NAFTA parties, Canada was respondent in the largest number of claims, all filed against Canada by American investors. That report also said that Canada had been fairly successful in having most, but not all, of those claims dismissed.[23]

CUSMA phases out Canada-US investor claims after June 30, 2023, allowing "legacy" investment claims – those arising before the cut-off date – as well as those already in the pipeline to proceed to conclusion. Should US investors succeed in those new or pending cases, even partly, it would alter the win-loss record. Because new NAFTA cases could still be filed prior to the three year cut-off, we will have to wait to get a final tally of Canada's final NAFTA win-loss record.

Briefly turning to the roster of NAFTA claims in the pipeline when CUSMA entered into force in 2020, four have been dismissed:

Westmoreland Mining v. Canada involved a claim over the Alberta government's phasing out of greenhouse gas emissions from coal-fired electricity generation by 2030. The case was terminated by the panel on January 31, 2022, because Westmoreland Mining was found not to have standing as a NAFTA investor when its claim was filed. The tribunal directed each party to bear their own costs and share the arbitration costs equally.

Resolute Forest Products v. Canada, begun in 2015, involved the claimant's investment in paper mills in Québec and the effect on that investment of the Nova Scotia government's assistance provided to a purchaser of a paper mill in Nova Scotia. The claim, for at least US$121 million, was dismissed by the NAFTA tribunal on July 25, 2022.

Tennant Energy v. Canada was based on refusal of compensation when certain projects were ended under Ontario's Green Energy legislation but, as in Westmoreland Mining, the panel concluded that the claimants failed to qualify as NAFTA investors. The panel was critical of the unsupported case of the complainants and by the generality of its arguments and in its October 2022 award it penalized Tennant with 100 percent of the arbitration costs plus 80 percent of Canada's legal costs, totalling over $2 million.

Lone Pine Resources v. Canada was started in 2013 after revocation by Quebec of petroleum and natural gas exploration permits in the Utica shale basin, including part beneath the St. Lawrence River. The company's US$104 million was dismissed in November 2022, with the tribunal ordering each of the disputing parties to bear their own costs

21 Investment disputes between Canadian investors and Mexico and between Mexican investors and Canada may be arbitrated under the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership* (CPTPP), to which Canada and Mexico (but not the US) are parties. Chapter 14 of CUSMA, however, maintains state-to-state obligations for all three governments respecting treatment of investments and investors, such as fair and equitable treatment, non-discrimination, and so on.

22 Herman, L., *Keeping Score: Investor-State Dispute Awards between the US and Canada*. C.D. Howe Institute E-Brief, 31 October 2019.

23 Some of the cases launched against Canada involve provincial measures, such as *Ontario's Green Energy Act*. Each of the cases currently in the pipeline (see below) involve challenges of provincial measures.

and to share equally in the costs of the arbitration.[24]

A number of NAFTA claims remain on the roster, either in process when NAFTA was terminated on July 1, 2020, or filed before the June 30, 2023, cut-off date. The best known are Koch Industries' 2020 claim regarding the Ontario government's cancellation of the provincial cap-and-trade system in 2018 and Windstream Energy's claim, also begun in 2020, involving Ontario's moratorium on offshore wind development. The amounts claimed collectively in these and the other ongoing cases are in the billions of dollars.

While decided before NAFTA was terminated in 2020, the 2019 *Clayton/Bilcon* award is worth a comment. The case involved the rejection of a quarry permit on environmental grounds, with the claimants alleging discrimination and lack of fair and equitable treatment and seeking US$440 million in damages. Begun in 2008, there was a lot of hand wringing when the arbitrators ultimately found Canada (as the respondent, even though it concerned the provincial government's actions) in breach of NAFTA obligations. However, the damages awarded by the panel in 2019 totalled a mere $7 million, likely not even enough to cover legal costs.

Adding up all of these awards over NAFTA's 25-year history, the amount comes to around $60 million.[25] If amounts of settled claims are added,[26] the total paid by Canada comes to approximately $245 million over that 25-year lifespan. While not insignificant, it needs to be contrasted with the billions of dollars originally claimed by US investors, and the over half a trillion dollar increase in the value of US direct investments in Canada since the NAFTA took effect in 1993.

This win-loss record could be changed significantly, of course, should any of these ongoing cases favour the claimants.

Canadian Investor Claims Abroad: The Canadian government maintains an active bilateral investment treaty program. As of today, Canada has 38 FIPAs in force (and 14 under different stages of negotiation).[27] As mentioned, Canadian investors have been frequent users of arbitration procedures in these agreements, launching some 32 separate disputes between 1999 and mid-year 2022.[28] A large number of these have been against Latin American countries, notably Venezuela, Colombia, Peru and Ecuador, some have been successful, while a number are pending.[29]

Some of these disputes are worth a comment. *Winshear Gold Corp. v Tanzania* involves a dispute with the Tanzanian government over cancellation of mining licences, including those covering Winshear's rights for its SMP gold project. In

24 All of these awards can be accessed via various reporting sites, including Global Affairs Canada's site https://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp; UNCTAD https://investmentpolicy.unctad.org/; the Permanent Court of Arbitration https://pca-cpa.org/en/cases; *Investment Arbitration Reporter* https://www.iareporter.com/arbitration-case); International Arbitration Forum https://arbitration.org/.

25 The $60 million is the total for awards rendered in final arbitration panel decisions. It excludes cases settled by agreement: the *Ethyl Corporation* case ($20 million); the *Abitibi-Bowater* case ($130 million); and the *Murphy Oil-Mobile Oil* case ($35 million).

26 That is, resolved by agreement and proceeding to final panel awards on the merits.

27 The current status of Canadian agreements in force, concluded but not in force and under negotiation are found at the Global Affairs website: https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng#dataset-filter.

28 *Investment Policy Hub* (UNCTAD, *supra*): https://investmentpolicy.unctad.org/investment-dispute-settlement/country/35/canada.

29 *Ibid*.

2020, the company invoked ISDS under the 2013 *Canada-Tanzania Investment Promotion and Protection Agreement* seeking C$125 million in compensation.[30] The case is ongoing.[31]

Another is the long-running saga involving the US$1.6 billion arbitration award obtained by Crystallex International against Venezuela in 2016 under the Canada-Venezuela investment agreement. Venezuela rejected the award and, given the fraught political situation and the impossibility of enforcement in that country, Crystallex sought to enforce the award against Venezuelan assets in the US, spending years in long and complex US court proceedings. In October 2022, the company ultimately succeeded in obtaining an order for the sale of those Venezuelan-owned assets.[32]

World Wide Minerals v. Kazakhstan involves lengthy proceedings in a uranium licence dispute by Canadian investors under the 1989 Canada-USSR Investment Agreement.[33] The award was challenged by Kazakhstan in the UK courts, overturned and referred back to the arbitration panel after lengthy court proceedings. No information is available on where matters stand today.

These are examples of the difficulties that can occur in these investor-state cases, even when the investor is successful. While not suggesting that this is a common pattern, it does show that ISDS awards can be thwarted after much time and huge investor expense when the host country is intent on putting up enforcement road blocks.

The Road Forward

Investment agreements and ISDS procedures remain a significant factor in many parts of the world, providing important elements of stability and risk mitigation for foreign investors and, by furthering neutral third-party adjudication, contributing to the rule of law and global governance.

While some countries have embarked on a program of terminating their bilateral investment agreements,[34] these agreements will continue to remain part of the international fabric in many parts of the globe. Canadian investors have relied on these agreements and achieved significant success in challenging unfair or discriminatory foreign measures affecting their investments.

At the multilateral level, efforts such as those by ICSID and UNCITRAL have achieved progress in improving the ISDS process in terms of efficiency, transparency and rules of conduct for arbitrators. At the regional and bilateral levels, several governments have taken steps within the architecture of these agreements to improve their workings, enhancing transparency and generally de-mystifying ISDS in the minds of the public, aiding its legitimacy and acceptability.

In terms of further efforts, creating permanent rosters of tribunal members and adding an appellate review processes to existing IIAs involves considerable political and legal complexities. Short

30 https://www.globenewswire.com/en/news-release/2021/07/15/2263861/0/en/Winshear-Seeks-C-124-781-945-in-Damages-from-Tanzania.html

31 https://icsid.worldbank.org/cases/case-database/case-detail?CaseNo=ARB/20/25

32 "U.S. judge approves sales process for shares in Citgo Petroleum's parent." Reuters, 11 October 2022: https://www.reuters.com/markets/us/us-judge-approves-sales-process-shares-citgo-petroleums-parent-2022-10-11/

33 The tribunal awarded US$40 million in compensation in 2019: https://www.newswire.ca/news-releases/wwm-s-claims-against-kazakhstan-are-remitted-to-the-arbitral-tribunal-for-new-determination-on-causation-and-quantum-844425531.html

34 Such as has been done by Canada and the US under CUSMA. India has embarked on a comprehensive IIA termination process, as have South Africa, and a few others. In some cases, as in Indonesia, old treaties have been terminated but more modern ones addressing earlier concerns about ISDS have been negotiated. Similarly, Australia terminated a series of bilateral investment treaties with countries such as Peru, Mexico and Vietnam, but these have been replaced by more modern ISDS provisions under the CPTPP.

of that, ongoing efforts, such as those reflected in Canada's model FIPA, could include: (1) promoting model arbitration clauses to reduce legal uncertainty, enhance consistency and predictability of outcomes; (2) developing codes of conduct and best practices for adjudicators plus rules to ensure their independence; and (3) making sure appointments to tribunals are of the highest quality. Also on the menu, perhaps equally important, governments should publicly support the value of third-party arbitration as an objective and neutral process that leads to peaceful resolution of differences.

Ultimately, investment protection treaties are about risk mitigation. They bind host states by treaty to respect obligations of fair and equitable treatment and other rule-of-law standards. They provide investors with a degree of assurance that, if their investments are thwarted by unfair or discriminatory behavior of host governments, they will have recourse to outside, neutral, third-party adjudication.

While there are legitimate questions as to whether and to what degree investment treaties accomplish these objectives, they remain an important mechanism in global governance. Recent developments have shown that they can be modernized to take into account concerns about their impact on legitimate government policy.