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The Shifting Landscape of Investor-State Arbitration: Loyalists, Reformists, Revolutionaries and Undecideds

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The investor-state arbitration landscape is shifting under our feet. The utility and legitimacy of traditional investor-state arbitration have come under fire, but states have not converged on a viable alternative. In simplified terms, three main camps are developing, which I call the “loyalist,” “reformist,” and “revolutionary” camps. The vast majority of states, however, are yet to take a public position on whether and, if so, how to reform investor-state dispute settlement. These “undecided” states are not a homogenous group, nor are they necessarily passive. Many states within this group are actively watching these developments and debating the various reform proposals.

One of the big strategic questions for the investment treaty system in the next few years will be whether the loyalists, reformists or revolutionaries will be able to attract a critical number of the undecideds to their cause in order to create a reasonable measure of convergence on a particular approach. The alternative is that the undecideds will split among the existing camps and/or develop their own distinct or hybrid positions. Another question is whether any members of the existing camps will shift their alliances. It is unclear how this will ultimately play out. What is clear, however, is that the [tide appears to be turning](#) against the traditional model of investor-state arbitration as it has few – if any – real supporters among states.

Loyalists, Reformists and Revolutionaries

The “**loyalists**” are states that continue to actively champion investor-state arbitration as the primary form of dispute resolution, even in the face of mounting criticisms by other states and civil society. Yet these

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loyalists might be understood as embracing incremental reform.

The two primary examples of loyalists are the United States and Japan. They argue that those who are advocating for broader scale institutional reform have not been able to clearly articulate what the problems with investor-state arbitration are, how their reforms would fix these problems, and how the reforms would not create a host of other problems. They point to some of the benefits of the existing system, such as the ready enforceability of investor-state awards and the depoliticisation of investor-state disputes. They criticise aspects of the alternatives, such as the added delay and expense that would follow from introducing an appellate mechanism or the lack of neutrality involved in relying on domestic courts. To the extent that problems exist, they argue that these can be addressed through targeted reforms – like introducing transparency, developing mechanisms to screen out frivolous claims at an early stage, and imposing rules on arbitrator conflicts, qualifications and ethics.

“Reformists” can take many forms. What distinguishes the current reformists from the loyalists is that they don’t think that it is enough to improve the existing model of investor-state arbitration. Rather, they believe that the system needs more fundamental, institutional reform, like the introduction of an international investment court and/or an appellate mechanism, in order to salvage its legitimacy.

The most widely recognised reformists in the current system are the European Union (EU) and Canada. Spurred by significant criticism of investor-state arbitration within both the EU and its member states, the European Commission developed an alternative model, which is an international investment court with a built-in appellate mechanism. The EU and Canada adopted a bilateral investment court in [CETA](#) and have jointly advocated developing a [multilateral investment court](#). They argue for a new form of dispute resolution that is more in keeping with other international courts charged with resolving public law disputes, like the World Trade Organisation or the European Court of Human Rights. Instead of continuing with an ad hoc model of “private justice” that has its origins in commercial arbitration, they propose establishing a standing court with judges who are appointed by the treaty parties

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“revolutionaries” think that they don’t go far enough. What the loyalists and the reformists have in common is that both agree that investors should be able to bring international claims directly against states, but they disagree on what form that should take (ad hoc arbitration versus a standing court). The key to identifying the revolutionaries is that they reject the wisdom of permitting investors to bring direct claims before international tribunals, preferring instead to require investors to pursue domestic remedies and limiting international dispute resolution to (at most) state-to-state arbitration.

Two exemplars of this approach are Brazil and South Africa. Brazil has never ratified an investment treaty providing for investor-state dispute settlement. More recently, it has started signing [Cooperation and Investment Facilitation Agreements](#) that encourage the use of alternative dispute resolution mechanisms, such as conciliatory settlement of disputes through Ombudsmen that are subject to a Joint Committee of the treaty parties, and ultimately permit state-to-state arbitration but not investor-state arbitration. In 2012, South Africa began a process of terminating its investment treaties and in their place has passed the [Protection of Investment Act 22 of 2015](#), which gives primacy to domestic remedies, including mediation and domestic courts. South Africa may consent to international arbitration over an investment dispute, but this would be subject to exhaustion of domestic remedies and would also take place on a state-to-state basis.

States that are Unclear or Undecided

The above sketch provides a helpful framework for understanding the three main camps that have been developed to date. But it is unclear how some states fit within this scheme, while others are yet to privately decide or publicly declare their positions.

India provides a good example of a state whose position is **“unclear.”** India radically revised its [Model BIT](#) in 2015 to eschew traditional approaches to investor-state arbitration, but its overall position is uncertain. India is loyalist in the sense that it still provides for investor-state arbitration, yet it comes close to being revolutionary given how much it restricts access to such arbitration. For instance, before an investor can bring an investor-state claim, it must first seek to exhaust

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BIT also suggests an openness to an appellate mechanism, so it is potentially reformist as well.

The vast majority of states have not yet taken a public position on whether and, if so, how to reform investor-state arbitration. One might be tempted to place these “**undecided**” states in a group supporting the traditional approach to investor-state arbitration because many of them have a significant number of investment treaties with these clauses on the books. But this would be a mistake as many of these states are concerned about or unhappy with investor-state arbitration and are actively considering their options. One of the biggest questions for the investment treaty system in the coming years is what positions these states will take.

One major player within this camp is China. Instead of aligning itself squarely with an existing camp, China may well develop its own distinct or hybrid approach. In keeping with the high levels of variance across its treaties, China may be happy to develop its approach on an incremental, case-by-case basis instead of seeking to forge a multilateral or regional one-size-fits-all solution. Indeed, China’s existing practice has elements of all three approaches, though its dual interests as a capital importer and exporter suggest that it is likely to align itself somewhere between loyalty and reform. China has accepted investor-state arbitration in many of its treaties. China’s experience in the World Trade Organisation may well make it comfortable with developing an appellate mechanism – as it adverted to in [ChAFTA](#). In some recent treaties, China has also required partial exhaustion of the domestic administrative remedies.

Other states in the undecided category are more likely to view themselves as law-takers rather than law-makers. On a bilateral level, some of these states will end up adopting the position advocated by whichever stronger treaty party they happen to be in negotiation with. For instance, Vietnam accepted a bilateral investment court in its Free Trade Agreement with the EU, but it has not joined with Canada and the EU in promoting this as a multilateral solution. Instead of expending considerable energy coming up with their own approach, many law-taking states think it makes sense to watch how the various reform options develop, including which states are adopting which positions

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change during this window. For instance, if more states start adopting the revolutionary approach, other states may have less fear that joining that group will do them reputational damage as being unfriendly to investment.

Evolution, Change and Shifting Alliances

The investment treaty system is a dynamic field and the question of institutional reform is going to be a key concern in coming years. There are a number of important negotiations to watch, including the potential re-enlivening of the Trans-Pacific Partnership (which adopts a loyalist approach) and the Regional Comprehensive Economic Agreement (which is yet to publicly announce an approach). Various developments in South America are also lending support to the revolutionary approach, including in [Ecuador](#) and with the [Mercosur](#) states.

Hovering above all of this analysis is the question of what will happen with the United States. The United States has been a loyalist of the system, partly because it has benefited greatly from the bilateral approach. Its investors have been able to push for strong, investor-friendly interpretations of investment agreements against a variety of other states. At the same time, the United States has been able to successfully defend every case brought against it and has pushed to develop a relatively more sovereignty-protective approach under NAFTA, which is the treaty under which it has generally been sued. Yet what the US position (or positions) will be under President Trump remains anyone's guess.

The preferences of some states may also depend on the actions of other states. For instance, the loyalists may prefer to stick with investor-state arbitration, but if these states see a large number of states being at risk of defecting to the revolutionary camp, they are more likely to embrace modest reform proposals to keep these potential defectors within the tent. If so, we might see intermediate positions develop between the more minimalist reforms of the loyalists and the more maximalist reforms of the EU and Canada. Options would include: having states play a role in selecting initial panels of arbitrators from which the

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appellate body.

What is unlikely to happen, however, is that many (or any) states will shift their position from being loyalist, reformist or revolutionary back toward embracing the traditional model of investor-state arbitration. Change is coming; it is just a question of what change will occur and when and how it will transpire. In this regard, it is noteworthy that [reform of investor-state dispute settlement](#) is on UNCITRAL's agenda as a possible future work stream, to be considered at the Vienna session in July 2017. Perhaps states will be able to agree on the need to discuss such reforms in a multilateral forum, even if they remain unable to agree (at least for now) on what reform or reforms might need to be adopted.

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Rob Howse says

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Great post. I do however want to pitch my concept paper on investment law and arbitration, which tries to sort all this out to the extent that existing work in economics, political economy, etc. allows it to be sorted out.

Available as NYU IILJ working paper

<http://www.iilj.org/publications/international-investment-law-arbitration-conceptual-framework/>