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Q & A

The Risk of ISDS Claims Through National Investment Laws:

Another "Damocles sword" hanging over governments' COVID-19 related measures?

H. Suzy Nikièma
Nyaguthii Maina

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1. What Investor–State Dispute Settlement Risks Arise From Governments' Emergency COVID-19 Measures?

In the months since the COVID-19 pandemic began sending shockwaves across the globe, governments have taken several measures to curb the spread of the virus, ranging from full lockdowns to restrict the movement of citizens to bans on the export of medical and food supplies. Some states have temporarily nationalized their private health care systems to lessen overburdened facilities, while others have buffered up foreign direct investment (FDI) screening rules to protect strategic assets from being acquired by vulture funds. These measures are varied and justifiable, targeting the different facets of this public health and economic crisis. However, even as these efforts and responses advance, governments could face an unprecedented threat of COVID-19-related investor–state dispute settlement (ISDS) claims through international arbitration.

A recent International Institute for Sustainable Development (IISD) commentary considers the risk of treaty-based ISDS claims and how they could stem from the web of over 2,800 existing international investment agreements that governments are party to.[2] The commentary and subsequent consultations[3] on a concerted response to COVID-19-related risk calls on governments to jointly suspend treaty-based investor–state arbitration for all COVID-19-related measures as one of the options available in international law to curb such a risk. But even as treaty-based ISDS risks loom, governments could still be challenged for measures taken in the wake of the crisis through dispute settlement provisions contained in investment contracts and national investment laws.

[1] The authors would like to thank Nathalie Bernasconi-Osterwalder and Howard Mann for their valuable comments on earlier drafts of this policy brief.

[2] Bernasconi-Osterwalder, N., Brewin, S., & Maina, N. (2020, April 14). *Protecting against investor–state claims amidst COVID-19: A call to action for governments*. https://www.iisd.org/articles/protecting-against-investor-state-claims-amidst-covid-19-call-action-governments

[3] IISD. (2020, May). *Consultations on a concerted response to COVID-19 related ISDS risks*. https://www.iisd.org/events/consultations-concerted-response-covid-19-related-isds-risks

Indeed, it is likely that some investors could explore all avenues available to them to claim alleged breaches by states. This policy brief explores how and why investment laws can lead to potential ISDS claims against governments in the wake of the crisis and proposes options to mitigate such risks.

2. Which National Law Provisions Could Lead to ISDS Claims?

As with any international arbitration process, be it treaty, contract, or domestic law based, ISDS requires consent from the disputing parties, either through a pre-existing agreement or a subsequent agreement where consent has been given after the dispute has arisen. Over the years, it has been argued that the disputing parties' consent does not require being embodied in one and the same document, such as a contract. Governments sometimes provide their direct consent to arbitration through investment treaties or national investment laws.[4] In both scenarios, it is deemed that the host state has offered consent to ISDS to a foreign investor. The investor could then "accept" the government's offer and perfect the disputing parties' "consent to arbitration" by lodging an ISDS claim.

According to the United Nations Conference on Trade and Development's (UNCTAD) database, there are currently 125 national investment codes, with the vast majority (102) existing in developing countries.[5] Most of the investment laws (70) provide for domestic dispute settlement mechanisms. However, more than a third (49) include provisions on international arbitration. Of these, 40 provide consent by states to international arbitration for foreign investors.

Investment laws that provide unequivocal consent to arbitration provide an arbitral tribunal with jurisdiction to hear a case. Moreover, some of these laws contain an array of options available to the investor, leaving the choice of the forum and applicable procedural rules up to them.

The drafting of such provisions varies in language and includes formulations such as:

> If the parties fail to reach an amicable settlement … the dispute **shall** be settled, at the request of the injured party, in accordance with an arbitration procedure under: - the Convention of 18 March 1965 for the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention), …. **The consent of the parties** to the jurisdiction of the ICSID or the Supplementary Facility, as the case may be, as required by the instruments governing them, is **constituted, in respect of the Democratic Republic of Congo by this Article** and in respect of the investor by his application for admission to the regime of this Law or subsequently by a separate act.[6]

[4] See Potesta, M. (2011). The interpretation of consent to ICSID arbitration contained in domestic investment laws. *Arbitration International, 27*(2). https://core.ac.uk/download/pdf/85220241.pdf

[5] UNCTAD's Investment Policy Hub hosts the Investment Laws Navigator here: https://investmentpolicy.unctad.org/investment-laws

[6] Unofficial translation; emphasis added. Democratic Republic of Congo, Investment Act 2002, Article 38. Original text: "Si les parties ne parviennent pas à un règlement à l'amiable … le différend sera réglé, à la requête de la partie lésée, conformément à une procédure d'arbitrage découlant: de la Convention du 18 mars 1965 pour le règlement des différends relatifs aux investissements entre Etats et Ressortissants d'autres Etats, (Convention CIRDI), …. Le consentement des parties à la compétence du CIRDI ou du Mécanisme Supplémentaire, selon le cas, requis par les instruments les régissant, est constitué en ce qui concerne la République Démocratique du Congo par le présent article et en ce qui concerne l'investisseur par sa demande d'admission au régime de la présente loi ou ultérieurement par acte séparé."

Or

> A dispute between a foreign investor and a state agency **shall** unless the procedure for its resolution is not defined by way of their agreement, be subject to resolution in courts of Georgia or in the International Center for the Resolution Investment Disputes. Unless the dispute is considered in the International Center for the Resolution of Investment Disputes, a foreign investor **shall be entitled** to apply to any international arbitration body which has been set up by the Commission of the United Nations for International Trade Law - UNCITRAL to resolve the dispute in accordance with the rules established under the arbitration and international agreement.[7]

While it is recognized under customary international law that a state's consent to arbitration cannot be implied, arbitrators and counsel sometimes deduce consent from what could be deemed "unclear" formulations in investment law provisions. Indeed, these unclear provisions leave it to arbitral tribunals to clarify the state's intent to consent to ISDS when drafting the law. For instance, the first known arbitration case brought under an investment law—known as the Pyramid case[8]—was based on Egypt's 1974 investment code. The ISDS clause in question stated:

> Investment disputes in respect of the implementation of the provisions of this Law shall be settled in a manner to be agreed upon with the investor, or within the framework of the agreements in force between the Arab Republic of Egypt and the investor's home country, or within the framework of the Convention for the Settlement of Investment Disputes between the State and the nationals of other countries to which Egypt has adhered by virtue of Law No. 90 of 1971, where such Convention applies.

According to Egypt, the various options listed in its national law did not constitute consent to ISDS, and the clause required a separate implementing agreement with the investor. Further, that the clause was intended only to inform potential investors that the International Centre for Settlement of Investment Disputes (ICSID) arbitration is one of a variety of dispute settlement methods that investors may use to negotiate with Egyptian authorities in appropriate circumstances (para 53).[9] However, the tribunal determined otherwise and proceeded to consider the merits of the case. Egypt was found liable for damages to the investor.[10]

With provisions that provide state consent to arbitration, foreign investors can sue the state in international arbitration for alleged domestic law violations that would normally be dealt with in domestic courts. Essentially, once a state consents to international arbitration through its investment laws, it allows an international arbitration tribunal to interpret its domestic law in lieu of domestic courts. Like in the *SPP v. Egypt* case mentioned above, the tribunal determined that a sovereign state's interpretation of its own unilateral consent to the jurisdiction of an international tribunal is not binding on the tribunal or determinative of jurisdictional issues.[11]

Clauses that provide clear consent to international arbitration were more frequent in older investment codes that were enacted before 2010. This is as the result of advice from specialist units in international organizations, such as the World Bank, that advocated for countries to draft

[7] Georgia Law on the Investment Activity Promotion and Guarantees (1996), Article 16 (emphasis added).
[8] Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt, ICSID Case No. ARB/84/3.
[9] SPP v. Egypt, ICSID Case No. ARB/84/3. Decision on Jurisdiction.
[10] The country has since revised its investment law to remove consent to arbitration.
[11] Ibid., para. 60

their national investment laws with language similar to that contained in international investment agreements. A recent study[12] found that "receiving such advice on domestic law reform increased a country's likelihood of adopting a law with international arbitration by 650%. Of the 65 states that received such investment law advice, 30 subsequently included international arbitration in their law."[13]

Developing countries, including Togo, Egypt, El Salvador, and Côte d'Ivoire, are now removing consent in their most recent codes.[14] Meanwhile, some governments give exclusive jurisdiction to domestic courts, with no reference to ISDS in their investment laws.[15] National courts, by definition, are the natural forum to interpret and apply domestic law in each country. Other investment laws give jurisdiction to domestic courts, except where a subsequent agreement, such as a bilateral investment treaty (BIT) or contract, says otherwise. Such laws could read that disputes between the state and a foreign investor "may be submitted to arbitration in accordance with the following methods as may be mutually agreed by the parties."[16] This category of law does not contain any consent to ISDS that an investor can solely rely on to lodge an ISDS claim.

3. Why Is ISDS in Investment Laws a Cause For Concern?

An investment law (when it applies to foreign investors) covers virtually all foreign investors regardless of their home state and, therefore, broadens the scope of its applicability, increasing a country's risk of exposure to ISDS claims. By contrast, in treaties, the offer of consent is limited to foreign investors from the party states, and the scope is dependent on the definition of a foreign investor in the treaty[17] as well as the scope of the dispute settlement clause in the treaty. Investment contracts or permits similarly limit consent to investors who are party to the agreement. The scope and applicability of consent in investment laws are also broad because the law cannot be interpreted in isolation without considering other relevant domestic laws related to the investment. The interpretation of its provisions applies to a broader scope of issues, unlike in treaties, where the scope depends on the wording of the provisions contained in the agreement.

Beyond this broad applicability, other concerns about the ISDS mechanism include its lack of transparency, its unpredictability, and the costly and lengthy proceedings. Arbitral tribunals have also not been bound by case precedence in the past, leading to inconsistent and divergent outcomes even where identical material facts arose. Such inconsistencies could lead to a divergence with the domestic courts' interpretation of the law. Should this occur, a domestic investor who is unable to access international arbitration could have a different outcome from a foreign investor who has access to ISDS, creating a dichotomy in interpretation and application

[12] Berge, T. L., & St. John, T. (2020) Why do states consent to arbitration in national investment laws? *Investment Treaty News*. https://www.iisd.org/itn/2020/06/20/why-do-states-consent-to-arbitration-in-national-investment-laws-tarald-berge-taylor-john/

[13] Ibid.

[14] Kebe, M., Atteib, M., & Sangare, M. (2019, September 19). Ivory Coast's new investment code: Focus on issues related to sustainable development and dispute settlement. *Investment Treaty News*. https://www.iisd.org/itn/2019/09/19/ivory-coasts-new-investment-code-focus-on-issues-related-to-sustainable-development-and-dispute-settlement-mouhamed-kebe-mahamat-atteib-mouhamoud-sangare

[15] See South Africa Investment Act, 2015; Ethiopia Investment Proclamation, 2012; Namibia Investment Act 2016.

[16] Uganda Investment Act, 2019, article 25.2. See also, Algeria Investment Act 2016, article 23; Guinea Investment Code, 2015, article 43; and Rwanda Investment Act, 2015, article 9.

[17] Suzy Nikièma, "Definition of Investor", Best Practices Series, IISD, 2012. https://www.iisd.org/publications/best-practices-definition-investor

of the national investment law itself. Speculative claims through third-party funding[18] further exacerbate states' exposure to multiple ISDS claims that challenge similar measures.

ISDS has come under scrutiny in recent years, and the United Nations Conference on International Trade Law (UNCITRAL) Working Group III is currently proposing its reform.[19] The current reforms are focused more on treaty-based ISDS. It is worth noting that the UNCITRAL Rules on Transparency[20] and the Mauritius Convention on Transparency,[21] which are aimed at promoting good governance in arbitration, only apply to treaty-based disputes and not those brought under domestic laws or investment contracts.

4. Can Investors Challenge COVID-19-Related Measures Under Investment Law-Based ISDS Clauses?

Along with trying to mitigate the health and economic effects of COVID-19, governments face the risk of ISDS claims arising from measures taken during and after the pandemic, including under contracts, treaties, or national laws. In this regard, law firms specializing in investment arbitration and arbitration newsletters are already foreshadowing COVID-19-related investor–state arbitration.[22]

On the one hand, there have not yet been any investment law-based COVID-19-related ISDS claims; however, several other ISDS cases have emanated from investment laws. By the end of April 2020, there were at least 30 known investment law-based cases,[23] of which a number lacked publicly available data on proceedings. In these cases, an investor relied solely on the law to make a claim without relying on another instrument, such as an investment treaty or an investment contract. For example, the Kyrgyz government has been the respondent to 14 known arbitration cases since the enactment of its 2003 investment law, which gave government consent to ISDS. At least five of the 14 cases claimed jurisdiction based on the investment law.[24]

Investment law-based ISDS cases are relatively low in comparison to the over 1,000 treaty-based ISDS claims.[25] But countries should not neglect the risks, especially given the uncertainties surrounding the COVID-19 landscape and the likelihood of foreign investors lodging claims to remedy losses. Coupled with the risk of speculative claims driven up by third-party funding and

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[18] Third-party funding could arise where a vulture fund or third party finances an investor to bring forth an ISDS claim in exchange for a return or other financial interest in the outcome of a dispute. For more info, see Garcia, F. (2018, July 30). The case against third-party funding in investment arbitration. *Investment Treaty News.* https://cf.iisd.net/itn/2018/07/30/the-case-against-third-party-funding-in-investment-arbitration-frank-garcia/

[19] Working Group III's ISDS reform work is available here: https://uncitral.un.org/en/working_groups/3/investor-state

[20] *UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration*. https://www.uncitral.org/pdf/english/texts/arbitration/rules-on-transparency/Rules-on-Transparency-E.pdf

[21] Ibid.

[22] Benedetteli, M. (2020). Could COVID-19 emergency measures give rise to investment claims? First reflections from Italy. *Global Arbitration Review*. https://globalarbitrationreview.com/article/1222354/could-covid-19-emergency-measures-give-rise-to-investment-claims-first-reflections-from-italy; Aceris Law LLC. (2020). *The COVID-19 pandemic and investment arbitration*. https://www.acerislaw.com/the-covid-19-pandemic-and-investment-arbitration/; Herbert Smith Freehills. (2020). *COVID-19: Pressure points: A balance of obligations: The response to the pandemic and investment treaty protections (global)*. https://www.herbertsmithfreehills.com/latest-thinking/covid-19-pressure-points-a-balance-of-obligations-the-response-to-the-pandemic-and

[23] https://www.italaw.com/

[24] Berge, T. L., & St. John, T. (2020, June 20), Why do states consent to arbitration (See footnote 11).

[25] UNCTAD Investment Dispute Settlement Navigator https://investmentpolicy.unctad.org/investment-dispute-settlement

contingency fees, it is worthwhile for countries to revisit their investment laws to ensure that the provisions contained therein allow for adequate policy space to respond comprehensively to the effects of the pandemic—as a general precautionary measure.

5. Can Combining Consent to ISDS With BIT Standards in Investment Laws Increase Exposure to Costly Arbitration Claims?

Risks to governments can be exacerbated when provisions giving consent to ISDS in investment laws are coupled with substantive provisions imported from old-style investment treaties. Controversial provisions include fair and equitable treatment (FET) or indirect expropriation. Some recent investment laws have indeed incorporated these two concepts.[26]

FET[27] is a highly controversial "catch-all" provision that allows investors to challenge legal or regulatory changes made by governments, most times alleging impingement on their "legitimate expectations." This provision is vague and expansive and is especially used where all other claims have failed.

Indirect expropriation[28] is yet another controversial provision that has led to ISDS claims, especially when it comes to governments regulating public health or intervening in times of economic crises.[29] According to some investors, regulatory measures curtail the use or enjoyment of their investment rights, therefore constituting a breach of states' obligations under investment agreements.

The main concern with such provisions is that they set up parallel standards to those available under a country's constitutional and administrative laws. For example, while domestic laws typically include the concept of "expropriation," they do not typically adhere to the concept of "indirect expropriation." Moreover, the calculation of damages for expropriation differs between the domestic law, as interpreted by the domestic courts, and international law standards, as interpreted by arbitral tribunals, which often resort to exorbitant amounts.[30]

ISDS has indeed resulted in hefty awards made against states, in part due to the wide-ranging interpretation of some of these clauses by arbitral tribunals. Tribunals are also not bound by case precedence in their decision-making process. Outcomes can therefore vary widely, even where cases may have similar material facts and defences.

6. Why is Consent to International Arbitration Incorporated in National Laws?

One may ask why certain governments, particularly those from developing countries, would give consent to ISDS in their national laws or incorporate controversial treaty provisions such as FET. These clauses pose very high risks to states and are open to vague interpretations by arbitral

[26] See, for example, Burkina Faso 2018 investment code, articles 8 and 9.
[27] For a discussion of this controversy, see: https://uncitral.un.org/en/working_groups/3/investor-state
[28] For a definition of indirect expropriation, see: https://www.iisd.org/publications/best-practices-indirect-expropriation
[29] Bernasconi-Osterwalder et al. (2020), Protecting against investor–state claims (see footnote 1).
[30] Bonnitcha, J., & Brewin, S. (2019). *Compensation under investment treaties*. IISD. https://www.iisd.org/sites/default/files/publications/compensation-treaties-best-practicies-en.pdf

tribunals, potentially leading to damages in the millions or billions of dollars.

A recent study[31] finds that developing countries incorporate such provisions because they are deemed "international best practice" by specialist units in international organizations, such as the World Bank. In its 2010 investment law reform handbook for development practitioners, the World Bank recommended that developing countries "include in the investment law an arbitration provision with an explicit consent to arbitration that could give investors more comfort."[32] Such advice led some governments to amend their laws with the intention of mirroring problematic investment treaty language.[33] It is indeed questionable for international organizations to advocate for developing countries to include advance consent to international arbitration or controversial standards in their national laws, despite the increasing evidence and recognition of its flaws at the global level.

7. How Can Governments Mitigate the Risk of Investment Law-Based ISDS Claims Arising From COVID-19-Related Measures?

Governments can consider different action steps to mitigate against the risk of ISDS claims arising from COVID-19-related measures. These steps should be appropriate to the country's legal framework, particularly the language contained in its investment law and its domestic constitutional system. Measures should also be commensurate to the level of exposure to ISDS claims arising from COVID-19-related measures. Precautionary efforts would not bar access to justice for foreign investors in domestic processes or other applicable international processes in force, including state–state processes, which could be clearly communicated to the investor community and institutional partners.[34]

From the outset, governments should have clarity on the scope of the reform measures they wish to undertake and whether these should be interim or permanent. For example, the government could decide to suspend ISDS provisions as an interim measure, with a more holistic and in-depth revision of the law at a later stage. Unlike treaties, investment laws can be amended without the agreement of another government. Another issue to consider is whether ISDS under the investment law should be suspended across the board or only with respect to COVID-19-related measures and how long an ISDS suspension should last if it is not permanent. There may also be opportunities or processes to develop clarifications on ISDS and/or substantive provisions as they relate to the COVID-19 pandemic to clarify the rights of the government during states of emergency.

[31] Berge, T. L. & St John, T. (2019, August 30). Asymmetric diffusion: World Bank 'best practice' and the spread of arbitration in national investment laws. *Review of International Political Economy*. https://ssrn.com/abstract=3447365 or http://dx.doi.org/10.2139/ssrn.3447365

[32] World Bank Group. (2010). *Investment law reform: A handbook for development practitioners* (p. 64). https://openknowledge.worldbank.org/handle/10986/25206 License: CC BY 3.0 IGO

[33] Ibid.

[34] Bernasconi-Osterwalder et al. (2020), Protecting against investor–state claims (see footnote 1).

Conclusion

Not all government COVID-19-related measures will constitute a breach that is enforceable under ISDS. However, states' public interest measures—be they health, trade, or finance related—can come under challenge from investors, especially in times of severe national crises. Each country will need to choose the appropriate instrument or process that will effectively minimize its risk of ISDS claims. In addition, this might be a good time to begin to undertake an overall assessment of governments' investment codes and/or related sectoral laws that should be amended concurrently.

Investment laws have been instrumental in establishing institutional frameworks and decision-making processes for investments, and this is possible without creating a parallel set of investment protections already incorporated in a country's domestic legal system.[35] Considering the likely risk of ISDS claims arising from investment laws, countries should assess the need, role, and value addition of ISDS provisions in their investment laws during and after the COVID-19 pandemic.

[35] Bonnitcha, J. (2017, December). *Investment laws of ASEAN countries: A comparative review*. IISD. https://www.iisd.org/sites/default/files/publications/investment-laws-asean-countries.pdf

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Head Office

111 Lombard Avenue, Suite 325
Winnipeg, Manitoba
Canada R3B 0T4

Tel: +1 (204) 958-7700
Website: www.iisd.org
Twitter: @IISD_news

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