

Prevention & Management of ISDS

Vee Vian Thien, Associate (Allen & Overy HK)

8th Meeting of the Asia-Pacific FDI Network, 26 September 2018

Agenda

1

Introduction to ISDS

2

Why is dispute prevention necessary?

3

Ways to prevent and manage ISDS

4

Procedural considerations

5

Concluding remarks

Introduction to ISDS

What is ISDS?

ISDS → Investor-State Dispute Settlement

Contained in many international investment agreements (IIAs)

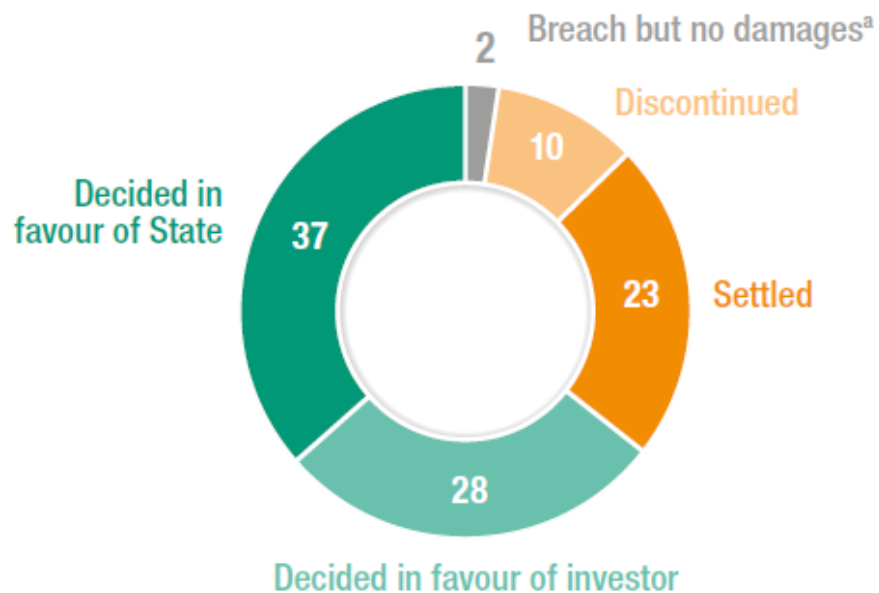
Mechanism which allows an investor from one country to sue the country in which it has invested for alleged discriminatory practices

In 2017, 65 new ISDS cases were initiated
– 80% of these were brought under BITs

Means of enforcing investment protection standards

50%+ decisions on jurisdictional issues were decided in favour of the State, whilst those on the merits were mostly decided in favour of the investor

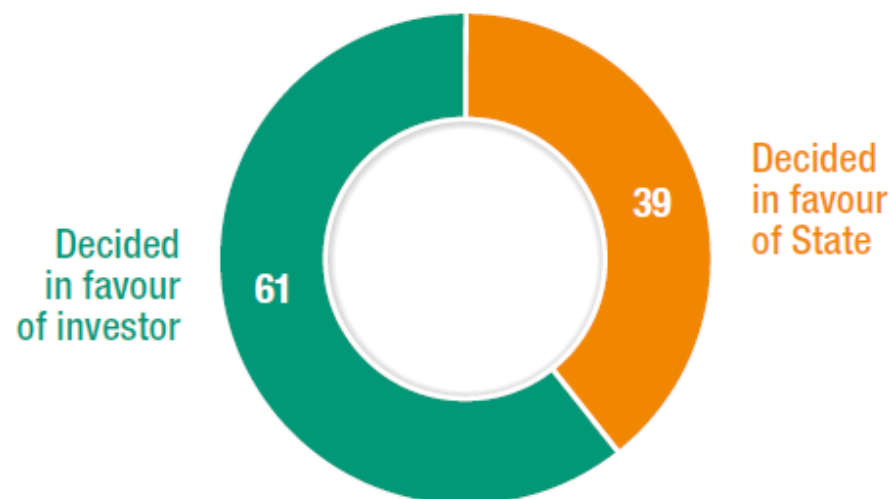
Results of concluded cases, 1987-2017 (%)



Source: UNCTAD, ISDS Navigator.

^a Decided in favour of neither party (liability found but no damages awarded).

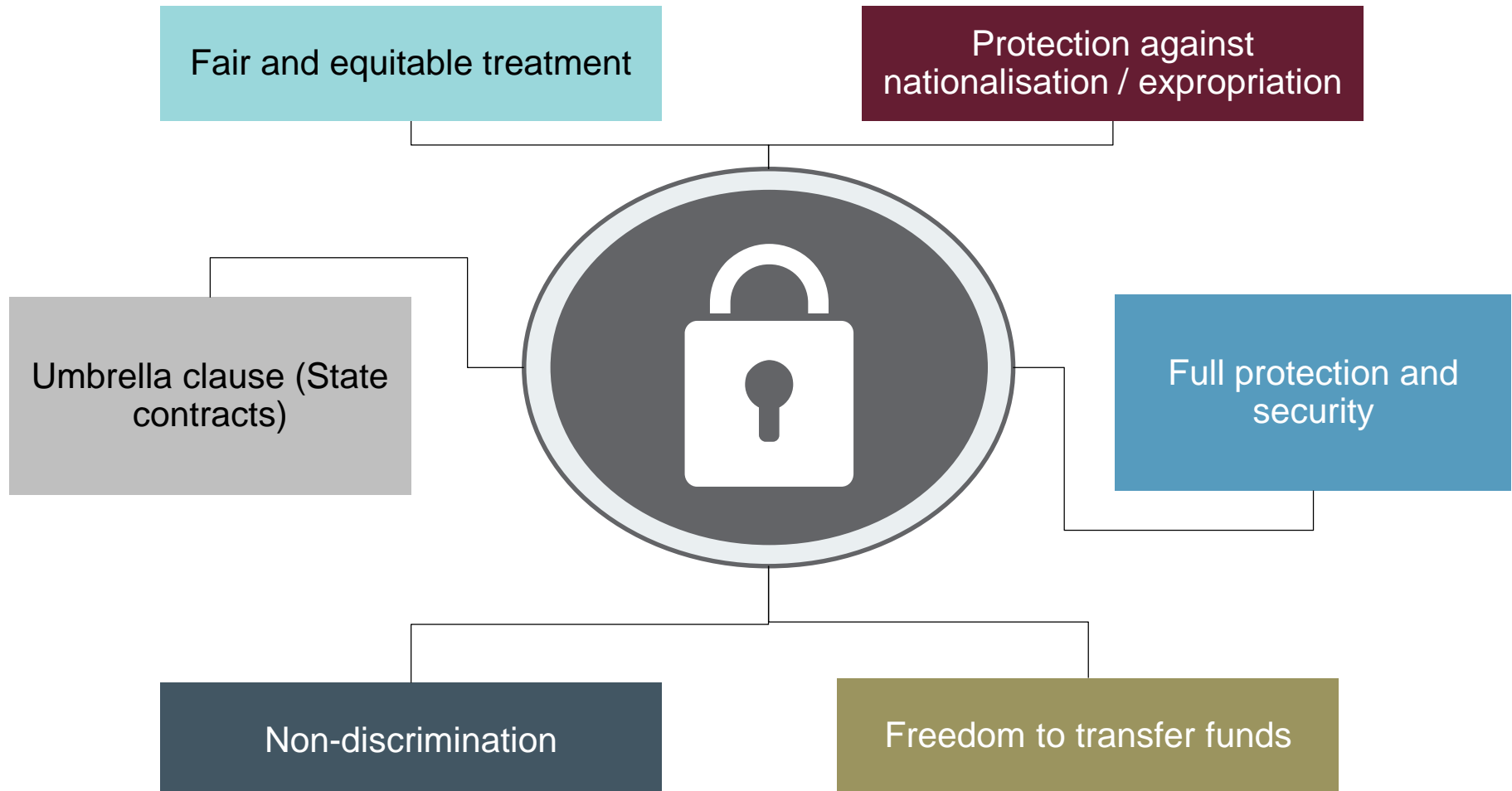
Results of decisions on the merits, 1987-2017 (%)



Source: UNCTAD, ISDS Navigator.

Note: Excluding cases (i) dismissed by tribunals for lack of jurisdiction, (ii) settled, (iii) discontinued for reasons other than settlement (or for unknown reasons) and (iv) decided in favour of neither party (liability found but no damages awarded).

IIAs provide investors with valuable protections



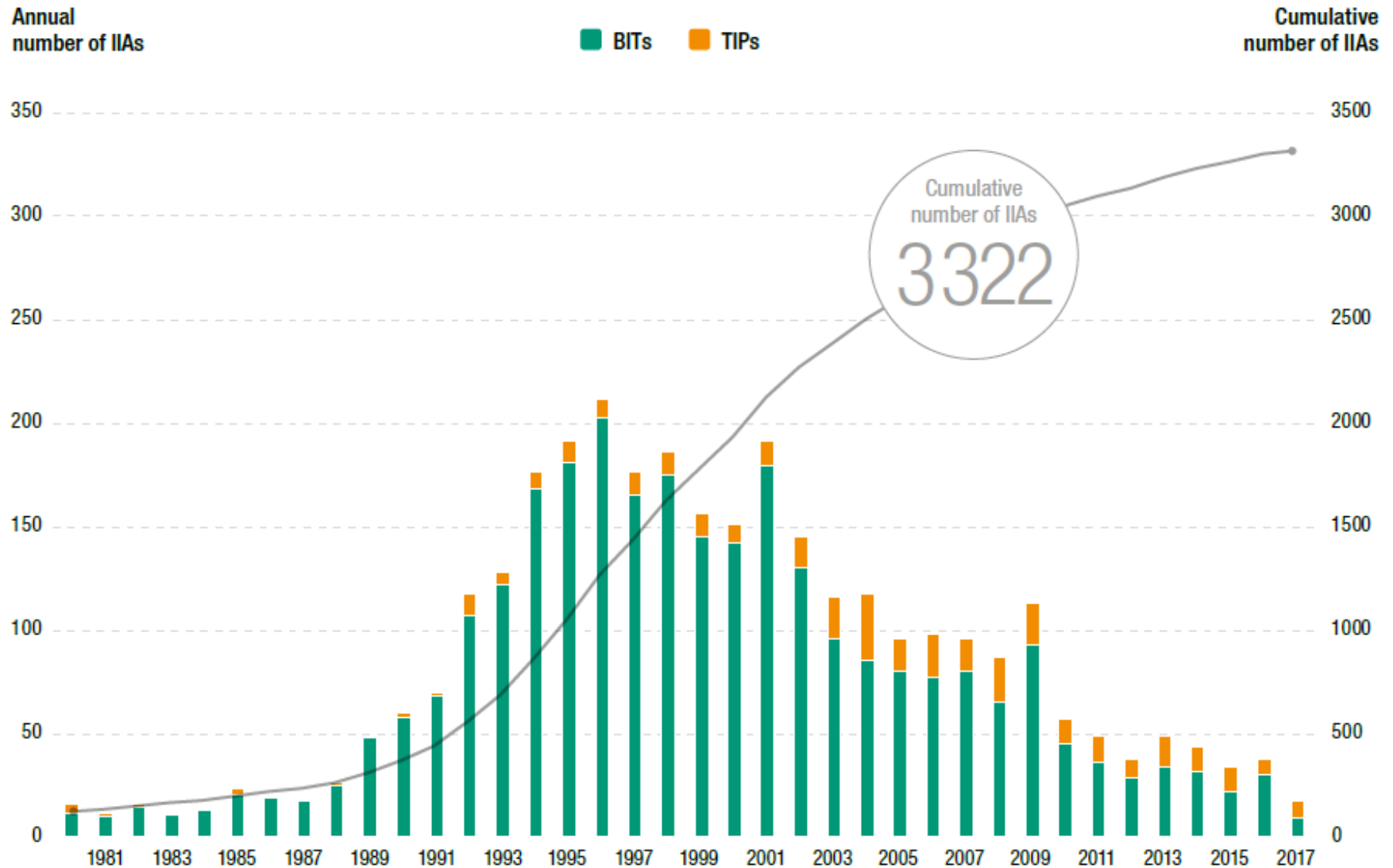
What may lead to a dispute?

- Nationalisation/expropriation
- Revocation of/refusal to renew a licence
- Price controls/alteration on agreed tariffs

**State measures
which may trigger
breach of contract
or breach of
investment treaty**

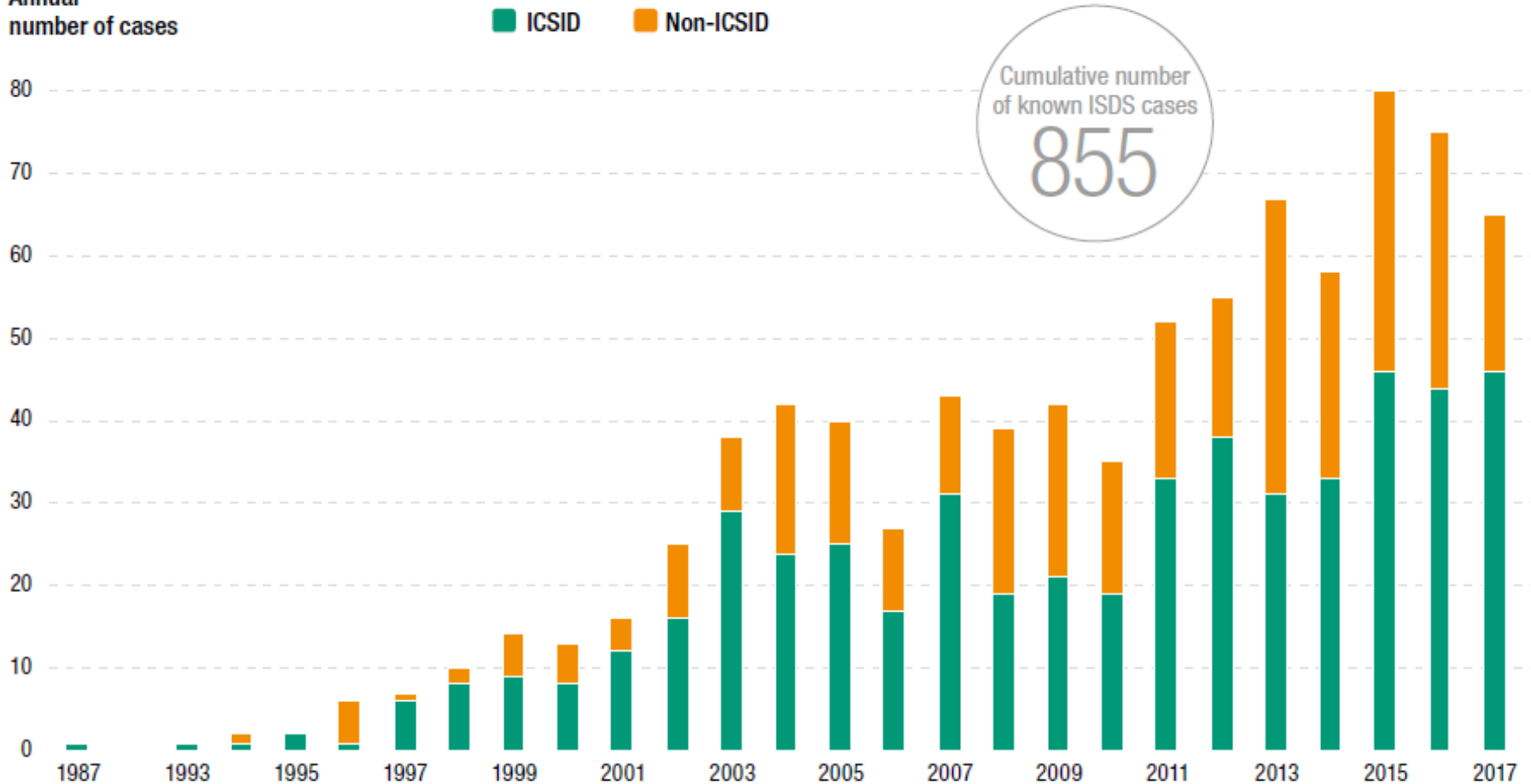
- Change in law/new regulations rendering a business unviable
- Changes to tax laws
- Discrimination against foreign investors
- Ordinary breaches of contract

Why is dispute prevention necessary?



Source: UNCTAD, IIA Navigator.

Note: The cumulative number of all signed IIAs, independently of whether they have entered into force, is 3,322. IIAs for which termination has entered into effect are not included.

Annual
number of cases

Source: UNCTAD, ISDS Navigator.

Note: Information has been compiled on the basis of public sources, including specialized reporting services. UNCTAD's statistics do not cover investor-State cases that are based exclusively on investment contracts (State contracts) or national investment laws, or cases in which a party has signalled its intention to submit a claim to ISDS but has not commenced the arbitration. Annual and cumulative case numbers are continuously adjusted as a result of verification processes and may not match case numbers reported in previous years.

Issues with the increase in ISDS cases

1

Implications on a country's right to regulate

2

Implications on perceived legitimate public policy objectives

3

Large sums claimed by investors and the large sums awarded

4

High cost of the arbitration process itself

5

Length of the proceedings

6

Possibility of frivolous claims

*Ways to prevent and manage ISDS:
1. Treaty Structuring*

Strategic treaty structuring

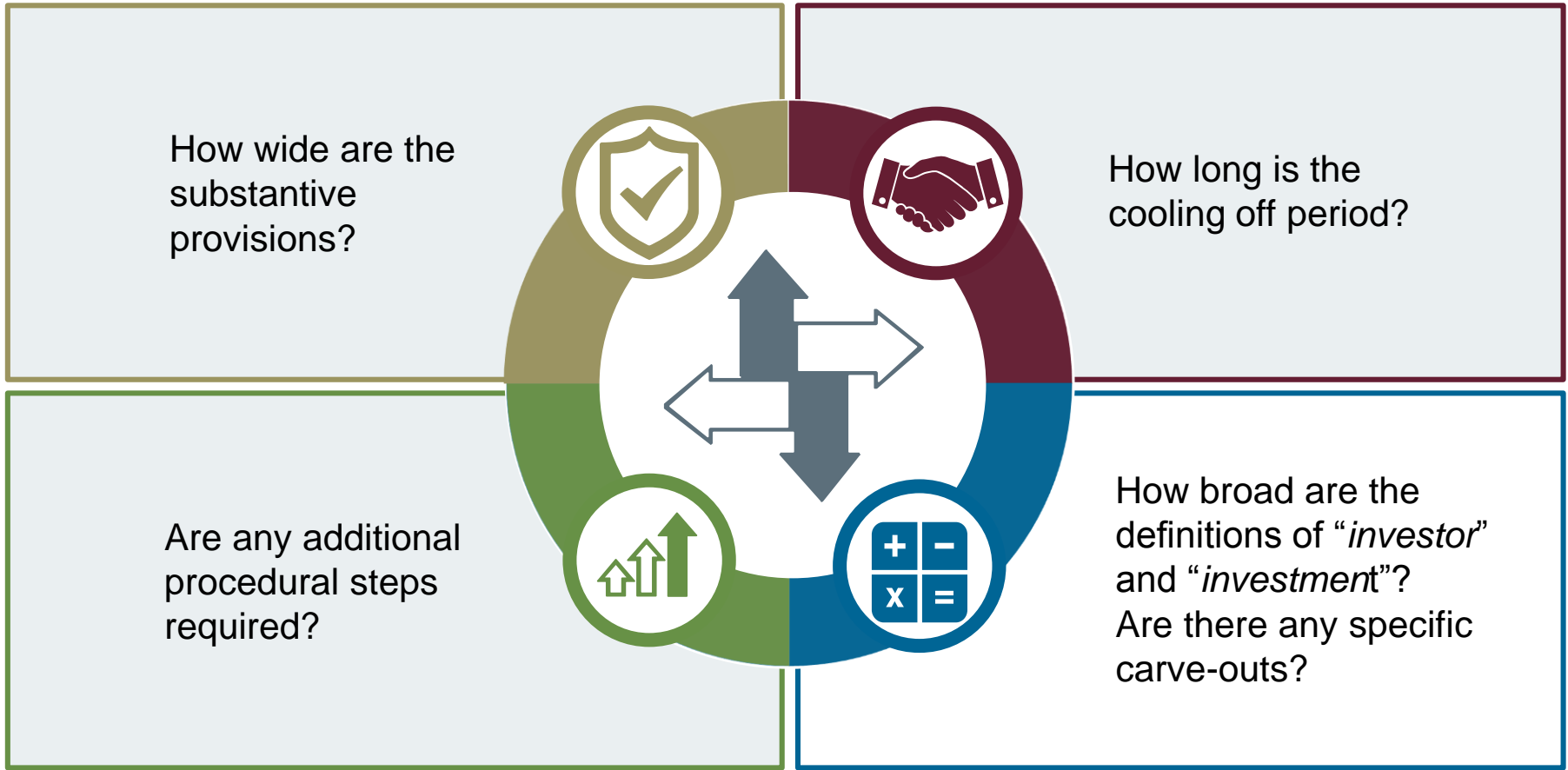
- Various preventative measures:
 1. Exception provisions → denying arbitrability
 2. Limiting most-favoured nation clauses
 3. Restriction of jurisdictional coverage



- See e.g. UAE-Vietnam BIT and China-Russia BIT
- Naturally filters the disputes which can be submitted to arbitration
- Other methods include: (i) notice given to the host State; (ii) cooling-off periods; and (iii) exhaustion of local remedies



Investment planning – IIAs from the investor's perspective



Investors and Investments

Investors

- Natural persons (must have nationality of a Contracting State)
- Companies
 - Must have the nationality of a Contracting State
 - Most commonly required nexus: “place of incorporation” or “seat”
 - Some treaties require more substantial nexus (e.g. genuine economic activities)
- Scope for multiple arbitrations/claimants
 - Multiple arbitrations (e.g. *Lauder cases*)
 - Multiple entities from same corporate chain (*Vatennfall v Germany*)
 - Class actions (*Abaclat v Argentina*; *PV Investors v Spain*)

Investments

- Typically a broad definition including:
 - Interests in local companies (including indirect and minority stakes)
 - Debt, financial products and loans (but not short term loans)
 - Contractual rights
 - Tangible and real property
 - Intellectual property: copyrights, trademarks, patents and trade secrets
 - NOT pre-investment expenditures or ordinary sales contracts

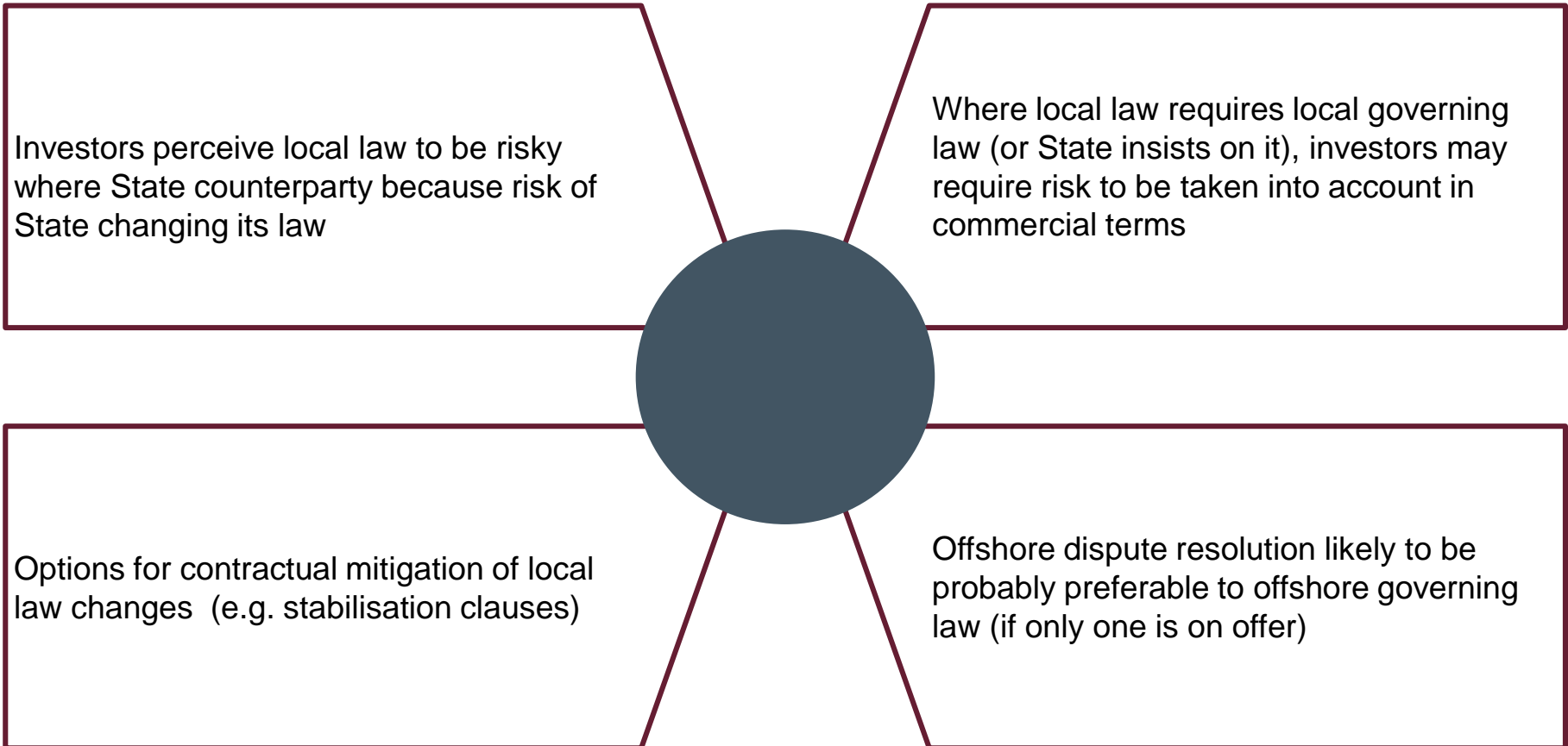
*Ways to prevent and manage ISDS:
2. Contractual Provisions*

Whose conduct can bind the State?



Article 4.1, ILC Articles: “*The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State.*”

Governing law considerations



Dispute resolution



- Offshore dispute resolution often regarded (rightly) as critical
- Arbitration likely to be chosen:
 - States rarely submit to foreign courts
 - Enforcement reach of New York Convention
 - Arbitration provides implied (but partial) waiver of state immunity
- Consider ICSID arbitration clause
- Some States now require local dispute resolution
- Again, risk of local dispute resolution would usually be factored into commercial terms

Stabilisation clauses to reduce risk of local law changes to investors



Types of stabilisation clauses

- “Freezing clauses”
- “Economic equilibrium clauses”
- “Renegotiation clauses”



Scope of clause

- Often covers only the fiscal regime
- No reason in principle why broader regulatory regime cannot be covered



Practice

- Rarely seen in contracts with OECD countries
- Practice varies by sector and region



Drafting

- Governing law relevant to effectiveness: national or international law
- Consider the appropriate counterparty to a stabilisation clause
- Waiver of sovereign immunity may also be required

Waiver of sovereign immunity

The Protections

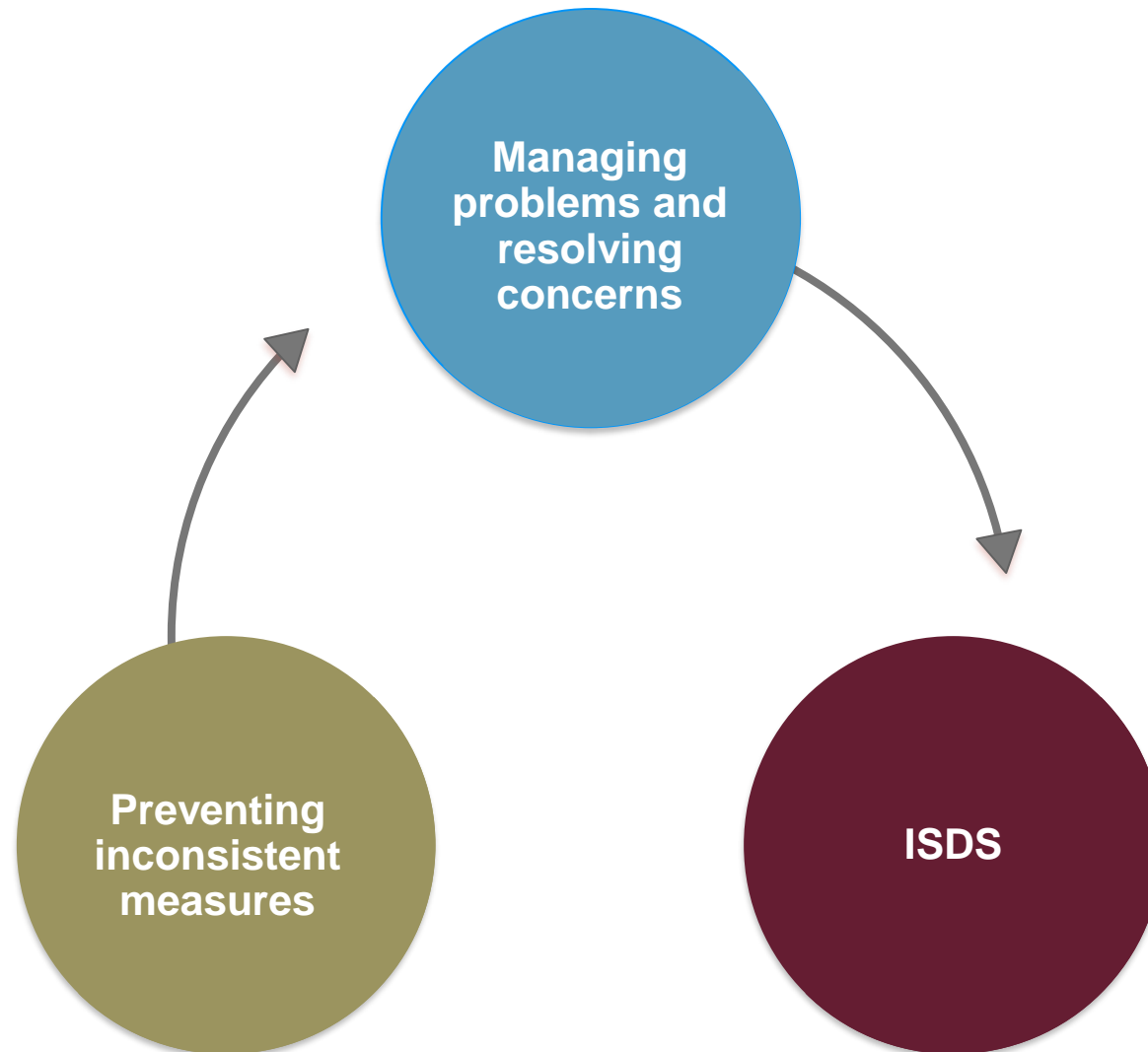
- Immunity from suit
- Immunity from recognition and enforcement
- Immunity from execution

The Waiver

- Scope of immunity and effectiveness of waiver depends on relevant national law.
- Immunity is absolute (i.e. cannot be waived) in some important jurisdictions – e.g. China (including Hong Kong)
- Where waiver is possible, each immunity must be individually waived
- Alternatives to waiver: arbitration agreement; recognition state is acting in commercial capacity

*Ways to prevent and manage ISDS:
3. Minimising issues before the dispute*

Country Policies



Procedural considerations:
1. Rule 41(5)

2006 Amendments to ICSID Rules – Rule 41(5)

Introduced by ICSID in 2006 following Discussion Paper (October 2004) and Working Paper (May 2005)

In response to growing caseload and feedback from states

Note also limitations of Article 36(3) of ICSID Convention

(5) Unless the parties have agreed to another expedited procedure for making preliminary objections, a party may, no later than 30 days after the constitution of the Tribunal, and in any event before the first session of the Tribunal, file **an objection that a claim is manifestly without legal merit**. The party shall specify as precisely as possible the basis for the objection. The Tribunal, after giving the parties the opportunity to present their observations on the objection, shall, at its first session or promptly thereafter, notify the parties of its decision on the objection. The decision of the Tribunal shall be without prejudice to the right of a party to file an objection pursuant to paragraph (1) or to object, in the course of the proceeding, that a claim lacks legal merit.

Standard of review: "manifestly without legal merit"

<p>"Manifestly"</p>	<ul style="list-style-type: none"> - <i>Trans-Global</i>: "ordinary meaning of the word requires the respondent to establish its objection clearly and obviously, with relative ease and despatch. The standard is thus set high." - <i>MOL</i>: partly approved of <i>Trans-Global</i> except for "[t]he exercise may thus be complicated; but it should never be difficult". <i>MOL</i> Tribunal prefers that it should be "clear" or "certain" rather than susceptible to argument one way or another, or require elaboration / further analyses
<p>Without legal merit</p>	<ul style="list-style-type: none"> - Rule 41(5) does not provide guidance - Case law treats this as a 2nd step, after analysing theory of objection and follows existing practice
<p>Jurisdiction vs. merits</p>	<ul style="list-style-type: none"> - Text of Rule 41(5) silent on this, reference only to "legal merits" - Commentary and policy supports inclusion - Case law (<i>Brandes</i>, <i>Global & Globex</i>, <i>Emmis</i>, <i>Accession Capital</i>, <i>PNG</i>, <i>MOL</i>) confirm - <i>RSM</i> – new bases? Collateral estoppel
<p>What other materials?</p>	<ul style="list-style-type: none"> - <i>Global & Globex</i> tribunal added Q: What other materials might either Party (specifically the Claimants) bring to bear if the question at issue were to be postponed until a later stage in the proceedings?

Procedural considerations:
2. Jurisdiction

Abuse of rights objection

“Nationality planning”

Any measures undertaken by an investor with the sole purpose of changing their nationality.

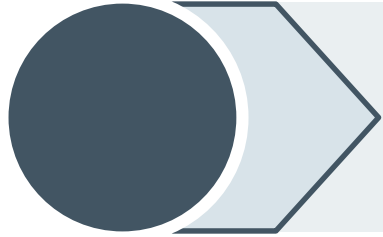
ICSID tribunals: *Salini* test (Article 25(1) ICSID Convention)

UNCITRAL tribunals: definition embedded in the relevant BIT

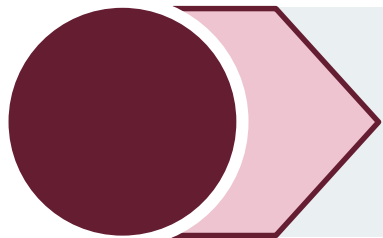
“Treaty / forum shopping”

The process of routing an investment so as to gain access to a BIT where one did not previously exist or for gaining access to a more favorable BIT protection.

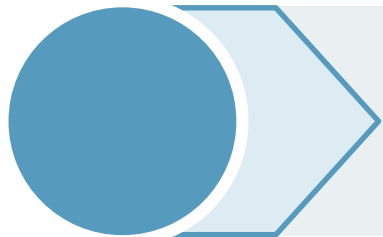
Rationae temporis objection



Whether a claimant made its investment **before** the date on which the alleged breach of the investment treaty occurred



If a tribunal considers that the actions of the host State which breached its obligations pursuant to the investment treaty have **already occurred**, then the host State will be likely to successfully argue that the tribunal lacks jurisdiction *rationae temporis*



Specific to the timing and context of the breach in question

Procedural considerations:
3. Bifurcation

Bifurcation

The separation of jurisdictional issues from the merits of the proceedings:

“

a separate jurisdictional phase to consider the jurisdictional and admissibility of objections raised by the respondent

”

The tribunal must consider factors such as:

1. the merit of the objection;
2. whether bifurcation would materially reduce time and costs; and
3. whether jurisdiction and merits **are so intertwined** as to make bifurcation impractical.

Procedural considerations:
4. Third party funding

Third party funding

Party Costs (i.e. fees and expenses of counsel, experts and witnesses)

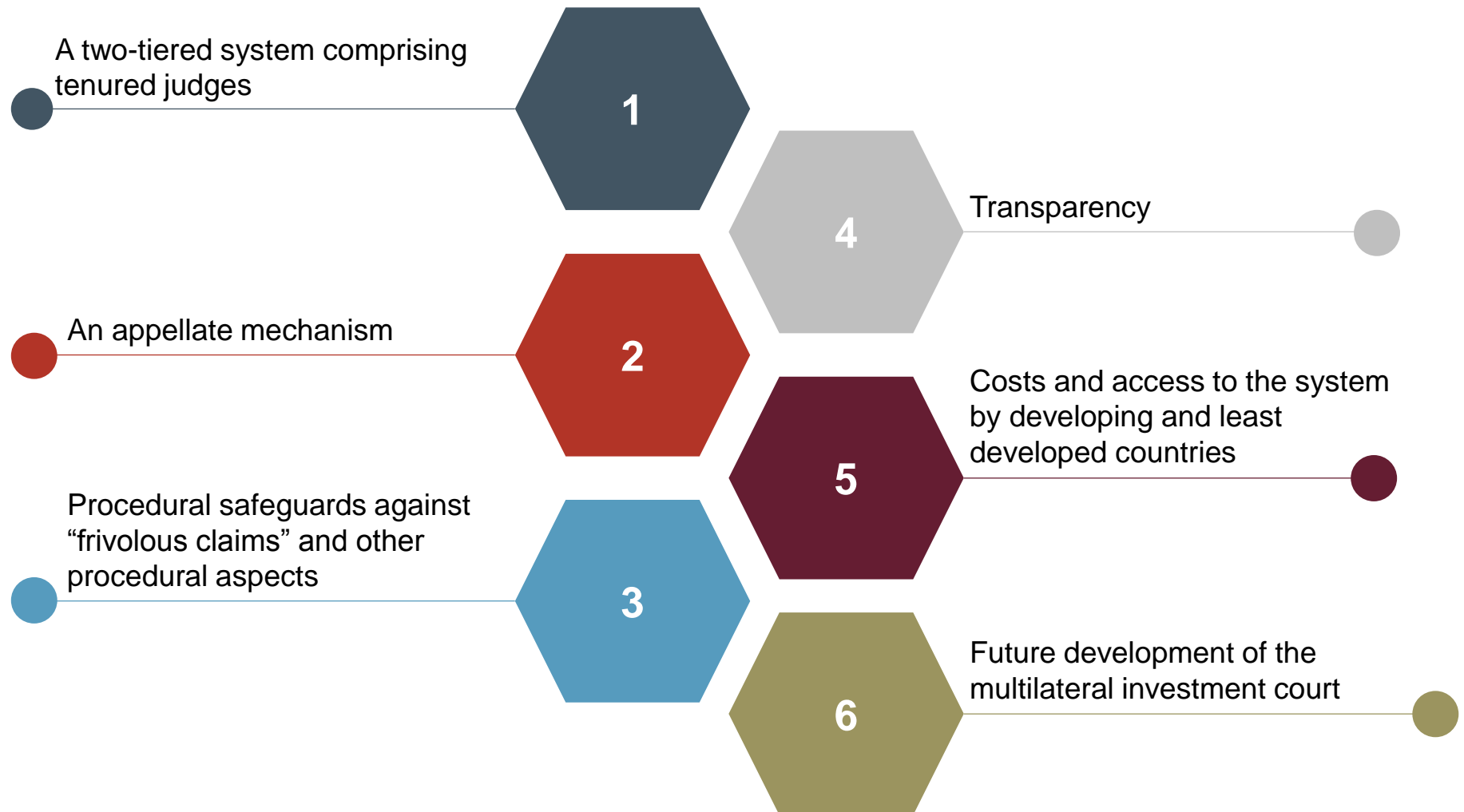
- Average claimant costs: USD 6,019,000 (**USD 4,437,000**)
- Average respondent costs: USD 4,855,000 (**USD 4,559,000**)

Tribunal Costs (i.e. arbitrators' fees/expenses and institutional charges)

- Average costs: USD 933,000 (**USD 746,000**)
- Average ICSID costs: USD 920,000 (**USD 769,000**)
- Average UNCITRAL costs: USD 1,089,000 (**USD 853,000**)

Concluding remarks

Arguments for reform



Questions?

These are presentation slides only. The information within these slides does not constitute definitive advice and should not be used as the basis for giving definitive advice without checking the primary sources.

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. The term partner is used to refer to a member of Allen & Overy LLP or an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings.