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Why States Should Have ISDS: the private sector perspective

This submission is a summary of my recent article published on SSRN as <http://ssrn.com/abstract=3730834>.

The purpose of the system of IIAs and the ISDS provisions thereof are to encourage industry to invest abroad, primarily for the benefit of the developing world.

The system was developed to protect the investments of foreign investors from acts by the host state government which could seriously injure those investments. The protections were clearly set out in these agreements, and were often seen as forming a “Rule of Law” that governed the relationship between the investor and the host state government, as often, the rule of law in developing states was very weak, putting the investor at risk to the whims of the government.

However, views of investors towards IIAs and ISDS and changes are not solicited, although they are the main beneficiaries thereof and their views matter. The perspectives of NGOs, IOs and governments are heard predominantly.

Investors realized from the outset that such protections would be quite illusory if there was no mechanism to enforce those protections in a legal forum against the host state. It is akin to a contract between two parties, but the contract is not enforceable in any court – a party would not enter into such a contract. Without legally binding decisions by arbitration tribunals to enforce IIA provisions, they are primarily aspirational.

Benefits to States of IIAs and ISDS

1. Better quality of investors to enter market. Without these protections, exploitative capital enters to the detriment of state - they are looking for short term super profits only.
2. Cost of capital to state reduces as international lenders see the state less risky so better credit risk.
3. Cost of capital to investors reduces as lenders see jurisdiction as more stable and mature. Pricing for infrastructure projects reduces for the benefit of the state. Investors will invest with lower projected ROI so it can focus on sustainability, not exploitation.

Investors are looking for improvements in ISDS provisions:

1. Current ISDS system takes years, and the investor has already lost their investment before it begins

2. Implementation of strong interim measures so that the actions of the state can be stopped by the arbitration tribunal before the complete damage is done to the investment.
3. Better communication with host state governments. Currently, governments tend to denigrate or ignore the concerns expressed by investors. They like to deal with other states, in a diplomatic manner, rather than companies who provide the investment and improvement to the state. Governments rarely negotiate and settle disputes with investors – they await arbitration award. If arbitration is removed from system and replaced with mediation, there will be even less willingness for states to settle via mediation.

Investors want states to stop downloading their human rights obligations to investors. Investors are told that they should build schools, engage in FIPC with Indigenous groups, provide health care, stop child labour. UN Guiding Principles refer to States' existing obligations to respect, protect and fulfil human rights under Pillar 1. State failure to comply results in investors being blamed and told to remedy the state failures.

Actions taken by states that result in ISDS claims by investors rarely are based upon best interests of the population. Most claims won by investors are based upon corruption, breaches of contract, refusal to comply with state obligations.

Conclusion

If a state wants to develop well for the benefit of its people, ISDS is a crucial element to instill confidence from quality investors.

If a state has a stable system, with ISDS, they are going to get more quality investment than a neighbouring state that does not.

Thus, a state that wants to act responsibly towards its citizens to promote the best quality of development will use an ISDS system to show that it is willing to live by the commitments it makes in BITs or FTAs.