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Foreign Investment Disputes Settlement under ICSID and the Protection of FDI

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Abstract

Foreign Direct Investment (FDI) is of interest to both Investors and States. For individuals, it is an opportunity to enter new markets, expand their business portfolio and exploit favourable working conditions. For countries, FDI is a unique opportunity for economic development. FDI brings with it job creation, wealth redistribution, and advancement in technology among others. It is little wonder therefore that developing countries especially are keen on attracting foreign direct investment.

Before FDI can be considered, there are number of factors that need examination especially from the investor point of view. Protection of their investment, specifically legal protection, is very important. Are the legal processes in the host country transparent and fair? Do they provide adequate dispute settlement mechanisms? These are some questions that investors will seek to answer before deciding to invest in developing countries. It is therefore favourable for such countries to work towards achieving an improvement in these very processes. Such improvement can be achieved locally; however, if the legal framework is backed by an international organisation that can act as an alternative dispute resolution mechanism, it serves to provide advantages for both the host country and the investor.

Here we look at one such mechanism, International Centre for the Settlement of Investment Disputes (ICSID). The protection through this organization, we argue, is unique and yet flexible in many ways. The article focuses on the important aspects of the ICSID, and the ICSID Convention and critically analyses the sort of protection and the advantages that this mechanism brings to the investor and the host country.

Keywords: Foreign Investment; ICSID; FDI

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INTRODUCTION

International Investment Law has seen quick growth over the past few years. This has led to an increasing number of mutually enforced bilateral treaties as well as international investment contracts between those willing to invest and countries willing to be hosts for such investments. Majority of these contracts are based in the primary sector, used to exploit minerals, oil and gas extraction. Throughout the world, the number of bilateral treaties is increasing between economically under-developed countries and capital importing countries. This is in part due to bilateral treaties being seen as a way to increase flow of capital to the underdeveloped countries through foreign direct investments (FDI), technology transfer and human resources. Given the increasing number of treaties between countries, it was important for a system to be developed to pay attention to and facilitate any disputes that may arise.

Hence, from 1980's, countries exporting capital were happy to implement BITs that provided for arbitration mechanism between the host state and the investor. The International Centre for Settlement of Investment Disputes (ICSID) thus became a commonplace alternative dispute resolution mechanism offered by BITs.

The relationship between the investor and the host country is of special importance. This relationship requires understanding dynamic conditions for it to be successful. This has been the aim of a new generation of BITs, which have now pushed for a relationship between host state and investors to be based on several key factors such as transparency in authority decision making, impartiality of courts, effective remedies being made available for disputes, and an overall strong framework for international investment law. Attention to these factors means that host nations have to maintain strong regulatory and administrative frameworks, or risk losing out on FDI. It is no surprise that the demand for international laws that protect and govern such a relationship is increasing.

This paper will critically analyse one such mechanism, International Centre for the Settlement of Investment Disputes (ICSID), and will question the effectiveness of this mechanism. The paper uses systematic review methodology to answer this question.

The next section provides an overview of the methodology used and its associated advantages and disadvantages. Following this, the paper will provide a brief overview of the ICSID and highlight its importance. It will then analyse the strength of ICSID as an international dispute resolution mechanism, based on literature.

METHODOLOGY

This study uses systematic review as its methodology to ascertain the effectiveness of the ICSID as an international dispute mechanism system. A systematic review is a secondary study as it is based on the research that has already been carried out [1]. It allows researchers to identify, interpret and evaluate research that is available in the topic [1]. There are some distinct advantages of using systematic reviews. Through using this methodology, a particular topic can be studied from a wider range of perspective and empirical data present [1]. This is particularly true in terms of this paper, where it is important to gather information on the ICSID from a broad perspective in order to make a judgement as to its effectiveness.

In undertaking the systematic review, a number of search terms were used, for example Foreign Direct Investment, FDI, ICSID, international arbitration among others. All search terms were based on the initial reading on the topic. Various databases were utilised for search results, such as Westlaw, LexisNexis, Hein Online and JStore.

The search terms produced a number of results, not all of which were relevant to help in answering the research question. The abstracts of the papers searched were read and discarded if they did not include information on ICSID or international investment law.

THE ICSID CONVENTION

The main feature of the International Centre for the Settlement of Investment Disputes (ICSID) is to act as an arbitration organization. Setup in 1965, it is situated at the World Bank Head Quarters in Washington [2]. Its primary function is to simplify the process of disputes that parties have decided to present before ICSID. The ICSID arbitration rules are provided by the ICSID Convention, according to which arbitration will be based on the laws of the member state and the relevant international investment law. The Panama and New York Conventions on the other hand, provide otherwise. According to these conventions, ICSID awards can be enforced on countries that are signatories and that there will not be any need to review national courts. Experience of the ICSID awards in this regard has been very low [3].

The cancellation of the ICSID awards has been criticized by many as politically charged. Almost 100 countries have ratified the Convention, yet, until recently, a very small number of cases have actually been brought under the Convention [4].

Importance of ICSID convention

For developing countries, there is a greater need to attract FDI due to the economic

benefits it brings. Such benefits include but are not limited to efficient resource allocation and equal wealth distribution. It has been argued that the ICSID Convention was formed for this very purpose [5]. The importance of creating an environment of mutual trust between the investor and the host country must not be underestimated. It is in the scope of the convention to promote international investment; hence, it provides mechanisms to help in the resolution of cases related to such investments [6].

Since its inception, a number of different cases have been brought under the Convention. During the time period from 1993 to 1996, only 27 cases were resolved under the Convention. From 1998 onwards, case resolution was taking place on a monthly basis. A total of 118 cases have been resolved under the Convention by 2006 [7]. It is interesting here to examine the increase in the number of disputes brought under the Convention. As eluded earlier, upon reaching the stage of full function, those that drafted the treaty thought it wise to incorporate a dispute resolution mechanism that was simple and easy to follow [8]. Such BITs became a way for investors to completely protect their investments, using investment protection and arbitration clauses that were linked to the ICSID Convention. The number of BITs in existence currently also suggests that they appear to be the preferred protection mechanism by the investors. Over a decade ago, approximately 500 BITs existed, whereas currently, the number is closer to 2500, all with clauses that link to the ICSID Convention [9]. It is little surprise that given the number of BITs in existence; about 21 out of the 26 proceedings regarding arbitration by the ICSID were based on multilateral investment treaties. Including ICSID dispute resolution mechanism in these treaties only indicates the importance of a common forum for international investment disputes.

STRUCTURE OF ICSID

The ICSID is formed of the Secretariat and the Administrative Council, both of which serve an operational purpose. Chaired by the President of the World Bank, the Administrative Council oversees the operational activities of ICSID, hence maintain control over the work undertaken by the Secretariat. Member countries to the Council are allowed one vote each, and the representation of member countries is usually by their respective Finance Ministers. The Secretariat, which is a permanent body of the ICSID undertake the daily functions for the Centre. The Head of the Secretariat and the Deputy are both appointed by the Council [10]. The Secretariat has been given enforcement powers under the Additional Facility Rules. It will support the arbitration procedure of the ICSID through maintaining lists, providing consultations and drafting updated arbitration clauses for the Arbitration Tribunal. Hence, every Arbitration Tribunal will have an appointed Secretary in order for it to carry out its duties of organizing and arranging hearings effectively [11].

Member countries to the Convention are allowed to appoint up to four arbitrators of dispute in the Arbitration Centre. Article 14 (1) of the Arbitral Convention provides the skills required from arbitrators, which includes among others, being of high intellectual capabilities, sound mind, and highly competitive in the legal and financial industry. A

further 10 arbitrators can be appointed to the Centre by the Chairman of the ICSID [12]. There are three dispute resolution pathways under the Convention. The primary pathway is that of Ordinary ICSID arbitration, which is based on the Convention Rules. Secondly, ICSID also has arbitration rules based on the Additional Facility Rules; however, this process only applies in cases where one of the parties of the dispute is not a member of the ICSID [13]. It should be noted that the award created from both these pathways is binding. The third procedure, known as the conciliation process usually ends with a non-binding advice being provided to both parties in a dispute.

Consent: Written agreement: Consent is the key element of any dispute resolution case, and its importance has been established by Article 25 (1) of the ICSID Convention. Accordingly, the jurisdiction of the ICSID is based on the agreement of the parties to present the case to the ICSID and their willingness to declare this intentionally. In order to explicitly make clear that the parties would like their case to be presented and resolved through the ICSID, consent is very important and can be shown through the incorporation of arbitration clauses in the any contracts and treaties between the parties. Consent can be expressed in general terms so as to ensure that all forms of disputes are covered. In most cases under proper contractual agreements, consent by the investor and the host states is mutually agreed and written as part of the agreement.

Consent: Purpose: Parties in dispute have the autonomy to decide which resolution option they can be take. This can restrict the main purpose of the ICSID arbitration some agreements can limits its availability for various kinds of disputes [14]. In most cases, these limitations from countries will be based on national resources, for example, China informed the ICSID of its reservation that only nationalized expropriation were open to ICSID dispute settlement procedures [15].

Irrevocable consent: Consent provided for arbitration via the ICSID is not revocable. This forms the main protection for ICSID arbitration procedures. This provides a certain level of security for the investors as they can rely on the ICSID to resolve the issues without interference from any other mechanism [16].

Exclusive consent: Consent by the parties can also be of an exclusive nature. In line with the autonomy principle, countries can either provide full consent to the ICSID or exclusive consent, in that they can require that all local remedies be exhausted first before the matter is taken to the ICSID for arbitration [17].

Investment case matters: The presence of an investment case is a requirement to be able to bring ICSID Arbitration into force. An important point to note here is that ICSID will not hear ordinary commercial disputes, but only disputes that arise due to investments, however, the term investment itself is not defined by the Convention and hence, its application remains flexible [18].

In many tribunals, investment has been established as involving a high level of financial risk to and a high level of involvement from the investor [19].

DISCUSSION: FUTURE OF INTERNATIONAL INVESTMENT

As eluded earlier, there is a strong link between FDI and economic development. This in part is due to the access FDI offers to economic resources, technological development, share capital and other such resources. It is little surprise then that the monetary transfer in FDI outweighs many forms of multilateral and bilateral public development [20]. In addition, access to global markets and worldwide distribution networks is also made possible through foreign investment activities. A good example of this are the Latin American economies, where rapid increased in economic growth were attributed to foreign investment in various industries such as telecom and infrastructure. Such examples have served as a stepping stone for other developing economies to be more open to the idea of foreign investment. However, it must be noted that the investment climate in different countries is dependent on a set of factors, such as politics, socio-economics, production costs, taxes, infrastructure, corruption, and the overall stability of the legal system [21,22].

Settlement of disputes in the local legal system is an important factor in protection for foreign investors. This is because in the absence of any alternative, any disputes arising between the host country and the foreign investor will be dealt with by the local courts. It is important therefore, for the investors to feel secure that the local legal system is robust enough to undertake a fair consideration of all issues being presented to it. Nonetheless, this does not present an attractive choice for the investors perhaps because in the past, local courts have shown less flexibility in similar situations, and have based decisions on the local laws, which do not include sufficient protection for foreign investors [23]. Local courts may also be seen as lacking the expertise required to resolve complex international investment cases, whereas the courts of the investors home country will normally lack the jurisdiction to get involved in such cases on the investors behalf especially due to the principles of sovereign immunity [24]. An alternative to this is the Diplomatic protection for the foreign investor; however, this has its own disadvantages. It is argued that Diplomatic protection does not provide full protection to foreign investors. It is not considered as a popular solution, mainly because it can lead to political tensions between countries [25].

Preference is therefore given to direct arbitration mechanisms between the host state and the foreign investors for dispute settlement. An effective alternative is that of International Arbitration which offers dispute resolution mechanism through the national courts. In this procedure, the parties are asked to choose arbitrators that they feel will be lead to an overall successful case and handle the issues in a highly effective manner.

Investment Arbitration is important for both states and the foreign investors. Being brought before the International Arbitration Tribunal may be inconvenient for states, it is still in the best interest of the state to protect the investments [26]. Hence, it sheds some light on why the ICSID Convention was developed under the framework of the

World Bank [27]. In its very first statement, the Convention refers to the importance of international cooperation in fostering economic growth. Having an international investment arbitration mechanism is advantageous to foreign investors as it assures them of legal security when making investment decisions [28].

The advantages also extend to the host country, the most important one being an improvement in the overall investment climate. Through the provision of arbitration opportunities, host countries make themselves better prospective recipients of investment. It was clear from the case of *Amco v Indonesia* [29] that protecting investments encourages development, especially in the case of developing countries. Additionally, allowance on international arbitration also serves to protect the host country from international litigation and political pressure [28].

International investment arbitration is a commonplace in the international investment law at present. Where in the past it was mainly used as a remedy for unfair treatment, it is now included in almost all investment treaties. Of course the success of international arbitration has not been without any critics. Countries that usually find themselves at the end of claims from foreign investors have shown some concern regarding this and routinely establish ways in which to bypass international investment arbitration [30]. Furthermore, complains regarding the international arbitration system has led to debates on its appropriateness in the future. Some critics feel that international arbitration may need to be abolished all together.

CONCLUSION

The ICSID regime is a uniquely powerful tool for international enforcement mechanism. It provides many flexible ways for dispute resolution such as exhaustion of local remedies, enforceability of awards and no interference from domestic courts once matters are brought to the ICSID. Its uniqueness also lies in that it is not setup of one large multilateral treaty, but of a number of small bi and multilateral agreements. In the past, attempts to establish big multilateral agreements, especially by OECD and WTO have seen failure [31].

This paper has presented a case as to why protection of investment is better under the ICSID regime. Developing countries favor attracting FDI due to the economic benefits that it brings. Hence, for such countries, the ICSID, which in its core promotes the idea of economic development through FDI, has been successful [32]. Thus it can be argued that ICSID Convention, through its dispute resolution mechanism, is bringing about global improvement in the process of FDI and economic growth of developing countries. It is important however to look at some systemic weaknesses in the process and provide recommendations for its improvement. Firstly, it is felt that the law relating to investment needs further development in that it should include an obligation on foreign investors to comply with the host countries social and environmental criteria [33]. There is also a scope for the introduction of conflict clauses, which recognize that there is public conflict of interest, and that these need to be considered and balanced when

making investment decisions.

The requirement of exhausting local remedies before admitting the case to ICSID, it is felt, should be made compulsory; however, exceptions can be added to this, especially in situation where serious abuse of legal rights by authorities is evident [34].

Lastly, there is a greater need for understanding the complex relationship between the investor and the host country. It is selfevident that both the investor and the host country will seek to protect themselves against the other, and hence, largely their objectives in the international investment scenario remain different. Investors would favour investment protectionism, whereas as host countries, in the interest of sovereignty, will favour local protectionism. It is important to reconcile the two objective in the international investment Laws as so long as the interest of the host state and the investors remain largely different, even a large network of BITs will not help in the creation of customary international law for this purpose.

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