Seventh Columbia Internaitonal Investment Conference Report
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On November 14-15, 2012, the Seventh Columbia International Investment Conference, entitled "Reframing the Investor-State Relationship: From Criticism to Constructive Engagement," brought together 291 participants from 42 countries, reflecting a wide range of stakeholders, including high-level government officials, corporate executives, investors, academics, and civil society. The purpose of the conference was to advance practical solutions and strategies for improving the investor-state relationship and maximizing the impact of investment for sustainable development. The discussion was "Davos-style," in other words, without formal presentations, in order to foster a productive and dynamic discussion among all participants. The conference program sets out the detailed background and issues raised by each of the four panels. Some of the main points advanced and discussed at the conference are summarized below.

Session I: Is there a need to rebalance the investor-state relationship?

Session 1 panelists discussed the role of bilateral investment treaties (BITs) in the investor-state relationship and in advancing sustainable development. While recognizing that BITs have largely been promoted as a tool for attracting investment, empirical evidence suggests treaties may have failed to fill in function and it was even noted that there is little evidence showing that investors will invest in a host state because of the existence of BITs. Some panelists suggested that the failure of BITs to promote investment and sustainable development, has fed the current backlash against the investor-state system.

Is there a need to rebalance the investor-state relationship?

Most panelists and participants agreed that there is a need to rebalance the investor-state relationship, although not all agreed on the underlying causes of the imbalance. One area of discontent with the current "balance" arises from certain issues with treaty interpretation and application, an area where it was suggested that we may see tribunals self-correcting. Another driver behind the call for "rebalancing" arises from doubts that current BITs are economically beneficial for states and effectively protect investors' interests. While some have stated that states win a fair percentage of the investor-state disputes, it was noted that when claims are brought, governments, which are *always respondents* in the cases, have to spend resources defending the disputes and face reputational consequences. Thus, they never "win" even when an award is rendered in their favor; they might just not lose as much. But, it was noted that even investors might not be "winning." Indeed, some have argued that the current system does not promote either the interests of states or investors, but only the interest of the law firms representing the parties.

Some participants noted that the reference to a "rebalancing" of the relationship between the state and investor presupposes that there was balance in the first place. They argued that in actuality, some developing countries have had no bargaining power to begin with. This lack of bargaining power, in turn, has resulted both in the prevalence of these (allegedly imbalanced) treaties as well as imbalanced contracts directly with the investors, which are difficult to review and renegotiate.

<u>How can balancing the relationship between states and investors be achieved?</u>

Although many agreed that there is a need to rebalance the investor-state relationship, there is disagreement on how this can be achieved. Some contended that the current system may not survive as there is a growing recognition that it was undermining efforts to achieve sustainable investment in host countries. It was predicted that, over time, discontent would grow as host country governments will increasingly recognize the imbalance of BITs and the investment regime more generally. Others, however, argued that the system will likely survive because there are no better alternatives and abandonment of investor-state dispute settlement would take us back to "gunboat diplomacy." Even those who suggested that the current form of investor-state dispute settlement may be the best alternative conceded that that does not mean that the system does not need to be improved; it was suggested that those changes will come over time through tribunals' recalibrations.

In addition to tribunals' recalibration, other means of rebalancing were proposed, including requiring the exhaustion of domestic remedies; inserting provisions to re-assess and renegotiate treaties after a certain number of years; providing for greater host state rights in the agreements (by, e.g., allowing flexibility in the use of capital controls, especially when there are financial crises); introducing a sustainable investment requirement into the treaties; creating quasi-permanent appellate bodies; encouraging governments to cooperate and share information on investment promotion and investor conduct; and using treaties to ensure a forum in which to hold multinational enterprises (MNEs) accountable to host states and stakeholders by, for example, precluding the use of the *forum non conveniens* doctrine.

It was also noted that in addition to a rebalancing of rights as between investors and states, we may also be seeing and continue to see a recalibration between states and arbitral tribunals. As can be seen in US treaty practices, new agreements reflect an effort by states to take more control over decision-making authority.

It is not enough, however, to assess the balance or imbalance of the investor-state relationship through the lens of treaties and dispute resolution, as the relationship between states and investors is much more complex. For instance, from an economic perspective, some states are stuck with old contracts that need to be reviewed in light of changing circumstances; this is mostly true with infrastructure or extractive industry contracts.

Some panelists noted that there is currently a guide to help countries negotiate treaties from a sustainable investment perspective, but the same does not exist for negotiating good and stable contracts, and in any event, there's a question about whether governments will be able to implement such guidance in actual negotiations.

<u>Session II: Predictability and flexibility in the investor-state relationship: striking the right balance</u>

The need for investors to achieve stability over the duration of long-term agreements may conflict with the interest of the state in retaining flexibility to develop and implement their policy goals.

Sources of stress in contracts include sharp increases in raw materials prices; monetary or financial crises in host countries; changes in environment or health regulations and standards that are resisted by investors; the allocation of resources between local and federal governments; and corruption or incompetence on the part of state negotiators that leads to agreements that are intolerable to subsequent governments; among others.

<u>Why can investors and states not create better contracts? Why are dollar-denominations, stabilization clauses and non-progressive taxes insisted upon by investors?</u>

First, the shifting political pressures faced by governments over the course of agreements were noted. Several contracts were negotiated at a time of relatively low commodity prices by under-resourced governments that were facing high unemployment and low level of infrastructure development. Exceptional contracts may also have been designed for ‘first movers,’ companies which enter into high-risk markets, and therefore, require higher rates of return. These deals may become unpalatable to the population, especially when prices rise and circumstances change. When oil prices rose in 2003, there was interest by governments to renegotiate oil contracts, even when the original contracts may have taken into account price volatility.

Second, it was noted that governments may want to renegotiate a contract that was negotiated by an earlier administration. Two examples of such political shifts given were in Russia and the populist governments in Latin America.

From the perspective of the investor, it was noted that companies have an interest in resolving conflicts with states amicably and avoiding arbitration. The most successful agreement from the standpoint of the investor is one in which the initial agreement is considered fair for both parties. While companies require predictability in agreements, frequently negotiated for 30 to 40 year periods in order to recover the capital investment and to provide shareholder return, the importance of sustainable investment was also emphasized as important. The shift in investor attitudes over the past 10 years in favor of ‘creative solutions’ was suggested in response to the observation that companies may insist on inflexible terms, including stabilization clauses and non-progressive fiscal terms, despite the interest for the state to have flexible arrangements in long-term contracts. Similarly, it was also observed that companies have been revising the standards that are considered ‘normal’ in favor of higher standards with regards to protection of the environment and health. One proposal for ensuring stability for the investor and flexibility for the state was to understand predictability with regards to procedures and to increase transparency in legislation.

<u>What leads companies to different positions in their willingness to renegotiate?</u>

It was noted that different companies appear to have different policies regarding how to handle requests to reasonably renegotiate contracts. How a company handles those requests, it was emphasized, can have a reputational impact that may influence host countries’ decisions regarding whether to contract with that company. From the investor’s perspective, deciding whether to agree to renegotiate or to try and enforce contract rights entails a cost-benefit analysis that includes consideration of the value of the relationship and the value of the claim. This calculation can vary dramatically among industries.

It was pointed out that requests for renegotiations should not be seen as only arising from states. While there has been a lot of publicity regarding governments’ attempts to renegotiate contracts, companies also frequently request a renegotiation of contracts, for example, in Latin American infrastructure agreements.

The weakness of low capacity of governments has been an issue since at least the 1970s; has the capacity situation evolved?

It was noted that the issue of low negotiation capacity of developing governments has been an issue at least since the 1970s; the impact of the disparity of negotiation capacity is most pronounced in low-income, resource-rich countries that negotiate extractive industry contracts. Over the past several decades, however, there has been an increase in capacity building and negotiation assistance initiatives. Some panelists noted that states have difficulty retaining knowledge among government officials, who frequently move among different government posts and from the public to the private sector.

Are governments constrained by the worst treaty that they have negotiated? Do they have the opportunity to benefit from learning?

While governments may learn from past negotiations of BITs and have the capacity to negotiate improved investment treaties subsequently, countries may be tied to the earliest agreements that they concluded due to treaty shopping by investors. One example given was that of Exxon Mobil, which utilized a more favorable BIT between the Netherlands and Venezuela, through a small Dutch subsidiary, to protect its investments in Venezuela. The ability for a government to modify or clarify its treaty obligations may, therefore, be effectively constrained.

Session III: Mitigating and managing disputes: Are new mechanisms needed?

Are there ways relationships can be managed to avoid disputes leading to international arbitration?

With the investment of significant amounts of foreign investment abroad, disputes may be inevitable. Concerns have been raised, however, that the international system established to resolve those disputes, while not necessarily collapsing, appears to be spinning out of control.

A number of the panelists and participants noted that part of the problem may be that attention to the issue of avoiding and resolving disputes has not been adequately or correctly focused. For one, a number of speakers indicated that deal formation and due diligence phases were crucial for impacting and assessing whether future disputes would arise, particularly in long-term and high-value investments. It was noted, for instance, that an investor's actual ties to and relationships in the country, and its investment in the "social contract" appeared important to the success of its project. Where investors and attorneys relied exclusively on a formal linkage through a legal contract, cases illustrated that there was an increased likelihood that the contract would fail. It was also said that research, such as that done by the IMF, indicated that it was possible to predict where disputes might arise based on the features of various projects, which can be used to identify how to avoid or resolve disputes. Broad stakeholder involvement in project planning stages and the perceived fairness of the deal were factors that were noted as being key for success.

States likewise can and have been taking steps to avoid treaty disputes by, for example, advising sub-national authorities about their obligations under the investment treaties; Mexico was cited as an example. UNCTAD has similarly been working with countries to help identify when there might be a dispute and try to address the conflict before it escalates to arbitration. The challenge, however, is that it is difficult to convince governments to put resources into proactively mitigating disputes, rather than allocating resources to fight a case once the dispute has arisen.

Panelists cited work by the IFC and Professor Ruggie on the elements of a solid dispute resolution process that could be used to improve national systems; it was also highlighted that there was a need to do more research in alternative dispute resolution. More knowledge and analysis regarding issues such as when and under what circumstances settlements are taking place and what parties can do when they think there might be an early dispute could help parties make informed decisions about how to proceed. It was further said that in order to facilitate such informal or alternative resolution of disputes, there needed to be, at a minimum, a carve-out of time or a "cooling off" period for negotiations.

<u>How might the international arbitration system be improved to better manage disputes?</u>

During the discussion, a number of concerns were raised regarding the current investor-state arbitration system, including that there was a pro-investor culture, a burden on states to constantly "recalibrate" treaties to respond to expansive interpretations, and a mismatch between the traditional rationales for arbitration (speed, finality, and confidentiality) and the needs of an investor-state system where other factors, such as fairness and justice, are of more importance.

As a solution the possibility of an appellate mechanism or other standing body was discussed. It was said that there are many advantages for the creation of such a mechanism, among which are that it can bring greater consistency to the law, improve the quality of the awards, heighten the accountability of arbitrators and increase the perceived fairness and legitimacy of the system. It was also noted, however, that creation of a new mechanism could create a number of difficulties and issues. Several questions would have to be determined, including what would be the ground for review (i.e., error of law?), how to ensure the quality of a standing body or new institution would inspire confidence among the systems' users, and whether the states would exercise too much control over the decision-makers.

It was also said that perhaps the key issue to focus on was how to create and strengthen national dispute resolution systems (rather than how to fix the international system by, e.g., adding another layer to it). If there is a constant shift from a national to an international forum, then the domestic process is not strengthened nor pushed to grow and improve. And, while it has been said that the investor-state arbitration system is young and merely needs time to work out its kinks, the same point can be said for host countries' legal systems as well. It was thus questioned whether emphasis should be on building more layers at the international level, or redirected to focus on dispute resolution issues at the domestic level.

A number of other "fixes" to the current investor-state dispute settlement system were also discussed. One was to prohibit arbitrators from representing parties in other arbitration cases. Other possibilities raised were to rely more on state-state mechanisms to resolve all or parts of disputes, or to have home-states filter claims.

The issue of confidentiality and transparency was also addressed. It was said that although privacy has been a feature of commercial arbitration, there is a need for more transparency in investor-state arbitration because of the public interest aspects of the disputes and the large amounts of money involved in these cases. It was also said that transparency can help improve the quality of awards. Concerns have been raised, however, that too much transparency might allow the disclosure of strategy and/or will be embarrassing for the state. Current work on the issue of transparency is underway in UNCITRAL, but this effort, it was noted, may simply be taking attention away from and delaying the broader and more systematic fixes to the system that are needed.

Session IV: Taking a broader view: Maximizing the outcomes of the investor-state relationship for sustainable development

How can it be known that investment contributes to sustainable development?

After a shift away from the idea that *more* foreign direct investment is always desirable, the means by which investment contributes to sustainable development is still debated. It was noted that the identification in legal frameworks of the need for foreign investors to make sustainable investments is important even though how an investment contributes to sustainable development may not always be defined. The Investment Policy Framework for Sustainable Development published by UNCTAD promotes four key objectives in drafting international treaties that promote sustainable investments: concrete commitments and mechanisms to promote sustainable development, a balanced relationship between the investor and the state, regulatory space in the public interest, and a guard against high administrative costs for firms.

What should be expected from a project that is intended to contribute to sustainable development?

While investments in extractive industries are not sustainable due to the finite nature of natural resources, the linkages made by investing the rents, by contrast, can be sustainable. Five linkages, important to sustainable development, were presented: human and physical infrastructure, backwards linkages through the utilization of local content, forward linkages by promoting refined products, knowledge linkages in STEM skills (science, technology, engineering and mathematics) and technology development, and spatial linkages that allow communities to benefit from open infrastructure. The movement by companies towards 'core competencies'–solely focusing on resource rents due to the higher rate of return—rather than towards vertical integration, may be at odds with sustainable development because long term linkages are not promoted. It was also noted that foreign investors may not be as cognizant of building these linkages when compared with domestic investors, and foreign investors are more likely to engage in transfer pricing, sourcing labor and supplies globally to lower costs as opposed to locally, exporting raw materials to refineries abroad rather than processing domestically, and not building excess capacity in infrastructure investments.

What is the role of local content in sustainable development?

One area cited where a specific measure for promoting local economic development is currently included in contracts is that of local content. A focus on the sub-national level may encourage the use of local involvement and local content in labor and infrastructure. Failing to source local content or to hire local labor due to standard operating procedures of the company where local suppliers and labor are available may create a poor public image of the company. Investment promotion agencies were suggested as a means of promoting these linkages. A panelist described how in Peru, foreign employees of a mining company, who earned a multiple of the local salaries, created inflationary pressures in the economy and other social instability, and contributed to a negative image of the company and of the industry.

How can the private sector be encouraged to contribute to sustainable development?

It was emphasized that sustainability should be commercially viable or reflect good economics—not simply imposed by the state, but rather through a partnership with incentives for the private sector to choose sustainable solutions. There are areas where the interests of the state and investor are aligned, for instance, using local labor and supplies that may lower expenses.

What global framework is in place that addresses the goals of sustainable development? What are the responsibilities of key stakeholders?

Four dimensions of sustainable development were presented as having been established at Rio +20: economic development, social inclusion, environmental sustainability, and good governance. There can be a conflict between existing strict legal frameworks and investment treaties, which are focused on protecting FDI, and the achievement of these goals.

The role of stakeholders was also assessed as an alternative to addressing sustainable development solely through the international legal framework and investment treaties. Stakeholders include the company, the host government, the home government, and international bodies. The company has a responsibility to see that investors earn a 'normal' rate of return and that local companies' interests are being attuned to. The host government has an interest in promoting transparency and sustainable development. The home government responsibility is to not tie foreign policy to the relationship between investors from the home country and the host country.