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Toward arbitration between subnational units and foreign investors?

by
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The ICSID Convention has envisaged arbitration between subnational units and foreign investors since its inception in 1966: Article 25(1) allows a contracting state to designate its constituent subdivisions that may consent to arbitration by the International Centre for Settlement of Investment Disputes (ICSID) with a national of another contracting state. Their consent is conditioned by Article 25(3), requiring the approval of the contracting state on a case-by-case basis, unless this condition is waived. Because subnational units have extensive regulatory powers that can even be exclusive and constitutionally entrenched, as in the case of federated entities, the potential for investment disputes is not insignificant.

Australia is so far the only federal state to have designated all of its federated entities to ICSID. The other designations were made by the United Kingdom for the Isle of Man, the Channel Islands and the British Overseas Territories, and more recently by Indonesia for the Government of the Regency of East Kutai. None of these subnational units were ever party to ICSID arbitration.

The recent ratification of the ICSID Convention by Canada could, however, trigger the emergence of arbitration between subnational units and foreign investors. Claims are increasingly being brought under NAFTA Chapter 11 against measures adopted by Canadian provinces. After the amicable settlement in *AbitibiBowater Inc.* v. *Canada*,[1] Prime Minister Stephen Harper voiced his discontent over the federal government having to pay for unlawful provincial measures. If designation of Australian states was inconsequential, designation of Canadian provinces could bring international investment law into unchartered territory. There are good indications that Ottawa would be open to designate willing provinces, such as Quebec.

A few cases did involve undesignated subnational units, but they never proceeded to the merits. The sole conclusion to be drawn from them is that a clear designation to ICSID is vital for the arbitral tribunal to have jurisdiction. In *Cable Television of Nevis, Ltd.* v. *St. Kitts and Nevis,*[2] the claimant unsuccessfully attempted to bring a complaint against the Federation of St. Kitts and Nevis on the basis of an ICSID clause in the investment contract it had concluded with the Island of Nevis.

Therefore, most of the legal issues involved in arbitration between subnational units and foreign investors remain unexplored. This new type of dispute raises a complex nexus of consents to arbitration and legal obligations. First, the general rules of customary international law should remain fully applicable regarding the responsibility of the state for the acts of its subnational units. Designation of subnational units should not be construed as alleviating the international responsibility of the contracting state. Nor should it alter the consent of the contracting state to ICSID arbitration. Instead, it should be a means of adding new parties to ICSID arbitration.

Contract-based claims against subnational measures could now be opened to ICSID arbitration in cases where a contracting state cannot be held responsible in the absence of any treaty violation.[3] But designation also raises the question of whether ICSID arbitration would be opened to treaty-based claims directly against subnational units. Could the consent of subnational units to arbitration be derived from the treaty and their designation to ICSID? Could subnational units consent to treaty-based arbitration? Could separate claims be brought against a subnational unit and the contracting state to which it belongs? Could they be both party to the same arbitration? Similar questions were recently addressed in the new European Union (EU) regulation allocating procedural and financial responsibilities between the EU and member states in investment arbitration.[4]

Beyond these legal intricacies, arbitration between subnational units and foreign investors raises policy issues going to the heart of the international investment regime. On the one hand, it could be seen as a step too far in the fragmentation of international investment law. Contracting states would lose control of the settlement of investment disputes, and of the application of their treaties and customary international law. On the other hand, it would seem to be consistent with ICSID's overarching goal of depoliticizing investment disputes. It would put the foreign investor and the author of the impugned measure face-to-face. Damages and arbitration costs could be borne, at least in part, by the losing subnational unit. It would ensure greater accountability for subnational units regarding their breach of international law, which in turn could entail better implementation of investment treaties.

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[1] Consent Award (NAFTA Chap. 11 Trib. 2010), http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/abitibi-03.pdf.

[2] ICSID Case No. ARB/95/2, Award, ¶¶ 2.22-2. 33 (Jan. 13, 1997), 13 ICSID Rev. 328 (1998). *See also Province of East Kalimantan* v. *PT Kaltim Prima Coal*, ICSID Case No. ARB/07/3, Award on Jurisdiction, ¶¶ 191-202 (December 28, 2009).

[3] *See Salini Costruttori SpA* v. *Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, ¶¶ 60-62 (July 23, 2001), 6 ICSID Rep. 400 (2004).

[4] "Regulation (EU) No 912/2014 of the European Parliament and of the Council of 23 July 2014 establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party", *Official Journal of the European Union*, L 257, August 28, 2014, p. 121, available at http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2014:257:FULL&from=EN

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