



# Columbia Center on Sustainable Investment

A JOINT CENTER OF COLUMBIA LAW SCHOOL  
AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

## CONCERN:

### FRIVOLOUS CLAIMS

**Frivolous claims – What are they? What are the problems they create? How can they be addressed?**

**Frivolous claims are difficult to identify – what are they?**

- In the area of investment law claims are difficult to characterize as frivolous:
  - Investment law is a system of “standards” as opposed to “rules”
    - Compare, for instance – **standards** of “fair and equitable treatment” (FET) or even content of newer treaties such as CETA that protect against manifest arbitrariness, with **rule-based** obligations such as speed limits, which make it relatively easy to determine whether there has been a violation
    - Costs of standards-based systems tend to fall on the party who seeks to align its behavior with them, which in ISDS is states
  - There is no system of precedent - issues can be re-argued
    - NOTE: this may be important for states (e.g., to continue arguing shareholder claims are not covered, or that FET does not protect legitimate expectations)
  - There is no appellate mechanism to provide greater consistency
  - Bases of law are often different – so arguments made/decisions issued under one treaty, or in connection with a parallel proceeding under the contract or domestic law, are not necessarily relevant for or applicable to a given treaty-based dispute, providing additional freedom regarding arguments that can be raised in any individual treaty dispute
- Tribunals rarely will declare a claim to be manifestly without legal merit, even if the claim is marginal, or pushing the boundaries of treaty-based standards
- **Illustration 1:**
  - The contract gave the state the right to terminate the contract with Company A if Company A transferred any rights or obligations under the contract without first seeking government authorization;
  - The domestic law gave the state the right to terminate the contract with Company A if Company transferred any rights or obligations under the contract without first seeking government authorization;
  - Company A transferred its rights under the contract to another party without first notifying the government or seeking government authorization. The government terminates the contract.
  - Company A sues the government for a violation of FET and seeks future lost profits under the contract.
  - **Q:** Is the claim:
    - A clear winner?
    - A likely winner?
    - A likely loser?
    - Frivolous?

- A: According to the tribunal: it is a winner (*Occidental v. Ecuador*)
- **Illustration 2:**
  - The claimant, a company of Country Z, did not have any business in the ‘home state’ Country A.
  - The host state, Country B, announced it would adopt a new legislative measure restricting the use of products produced by the claimant. When enacted, that legislation would harm the business interests of the claimant in Country B.
  - After Country B announced it would adopt the legislation, but before it adopted it, the claimant established an affiliate in Country A, and routed its investment from Country Z into Country B through Country A.
  - The claimant sues Country B on the ground that it violates the treaty between Country A and B.
  - Country B argues that the claimant is not a protected investor of Country A. It raises a preliminary objection arguing that the tribunal lacks jurisdiction.
  - Q: Is the claim:
    - A clear winner?
    - A likely winner?
    - A likely loser?
    - Frivolous?
  - A: According to the tribunal, the investor’s treaty shopping was an abuse of process (*Philip Morris v. Australia*)
    - But, that decision took
    - Roughly 4 years
    - Aus\$39 million
    - Thus – it is an abuse of process, but is it frivolous?
- **Illustration 3:**
  - The courts in Country A are common law courts – meaning that they have the power to create new law and revise existing law.
  - The Courts of Appeal in Country A adopted a new interpretation of patent law aiming to prevent abusive monopoly powers of patent holders; the losing party filed an appeal, but the Supreme Court denied leave to appeal.
  - There was no allegation that the procedures were defective, or the judges were biased or corrupt.
  - The investor filed an ISDS case challenging the courts’ new interpretation of patent law.
  - The underlying treaty is a multilateral treaty. **All three treaty parties** argued to the tribunal that ISDS tribunals are not courts of appeal, and are not authorized to sit in judgment of the merits of domestic court decisions unless the outcome is a travesty of justice or is grotesquely unjust.
  - Q: Is the claim:
    - A clear winner?
    - A likely winner?
    - A likely loser?
    - Frivolous?
  - A: “Although Claimant has not succeeded in this arbitration, its claims were not in any sense frivolous, and Claimant pursued them in good faith.” (*Eli Lilly v. Canada*) (para 455)

**How frivolous claims relate to other concerns about ISDS:**

- The ability to file frivolous claims increases costs incurred by states, and inability to secure quick dismissal results in **undue duration and costs**
  - States will need to argue (and reargue) ALL available defenses
- Even frivolous claims can generate **regulatory chill**

- The mere filing of an ISDS claim can potentially cause **reputational harm to the host state**
  - some studies have found that the filing of a claim can reduce inward FDI
- Decisions on what is/is not a “frivolous” claim may be **inconsistent** with states’ intent, and **incorrect** as judged by state parties to the relevant treaty

### **Solution 1 – Early dismissal provisions**

- **Arbitration rule-based** – e.g., ICSID Rule 41(5);
- **Treaty-based**, e.g.,
  - US-Panama FTA - Includes two options for early dismissal of frivolous claims
    - Option 1: for claims manifestly without legal merit based on facts as pled:
      - Provides for a preliminary decision on the respondent’s objection that “as a matter of law, a claim submitted is not a claim for which an award in favor of the claimant may be made.”
      - “In deciding an objection under this paragraph, the tribunal shall assume to be true claimant’s factual allegations in support of any claim in the notice of arbitration (or any amendment thereof) and, in disputes brought under the UNCITRAL Arbitration Rules, the statement of claim referred to in Article 18 of the UNCITRAL Arbitration Rules. The tribunal may also consider any relevant facts not in dispute. (10.20(4)(c))
    - Option 2: Respondent may make an argument that there is no jurisdiction – no competence – which is also to be decided on a preliminary basis. (10.20(5))
    - The respondent can pursue the first option, then the second option; and failure on the first doesn’t prejudice subsequent argumentation focusing on competence or based on additional evidence/discovery
  - CETA
    - Article 8.32 (provides mechanism for early dismissal of claimant’s claims that are “manifestly without legal merit”)
    - Article 8.33 (provides mechanism for early dismissal of claimant’s claims (or parts thereof) that are “unfounded as a matter of law”)
    - *What is the difference?*
- **Rationale for early dismissal provisions:** provide a rule- or treaty-based mechanism to identify and secure quick dismissal of frivolous/meritless claims, or claims where jurisdiction is relatively clearly lacking
- **Limits of early dismissal provisions:**
  - Such provisions seem to have had limited effect to-date (partly due to tribunal reluctance to declare claims frivolous or manifestly lacking in legal merit)
  - For example, ICSID Rule 41(5):
    - Adopted in 2006
    - Rule 41(5) has been raised in 27 cases<sup>1</sup> (as of this report)
    - In only 3 cases the tribunal upheld the objections in full and disposed of the case (in only 2 was the respondent awarded costs)
    - Some tribunals upheld objections in part
    - Some mechanisms for early dismissal still require discovery/evidence exchange, and full mini-hearings before a decision on whether the claim is frivolous, lacks merit, or lacks jurisdiction will be heard. Thus, it is not necessarily a quick or inexpensive process

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<sup>1</sup> This data is from the ICSID report available at <https://icsid.worldbank.org/en/Pages/process/Decisions-on-Manifest-Lack-of-Legal-Merit.aspx>.

- What states deem frivolous or manifestly lacking legal merit is not necessarily the same as what tribunals or other adjudicators will
- **Downsides/disadvantages of early dismissal mechanisms:**
  - If these mechanisms were combined with proposals for dismissal of frivolous defenses or frivolous counterclaims it could impact states' ability to argue their cases, assert the intent of the treaty, and/or create customary international law through state representations
  - Expanding use of these provisions by adding them to arbitration rules or a supervening treaty won't necessarily improve their effectiveness unless it is made clear that their current interpretation/application has not been satisfactory and strategies are developed to make them more meaningful.
- **Options for combining it with other reform proposals?**
- **Questions?**

### **Solution 2 – Pleading standards**

- **What:** Require particularized pleading of facts and law for claims to be brought, which will raise the bar for filing notices of claim/arbitration. Mandate dismissal if pleading standards are not met.
- **Rationale:**
  - By placing a greater burden on investors to, up front, articulate the legal and factual bases of claims, it can be easier to identify and dismiss them as frivolous/meritless cases
- **Downsides/disadvantages**
  - Effectiveness depends on standards adopted and how adjudicators interpret and apply them
- **Options for combining it with other reform proposals**
- **Questions?**

### **Solution 3 – attorney certification and sanctions procedures**

- **What:** Place attorneys/law firms on the hook for pleading arguments in law or fact that are not adequately grounded
- **Rationale:**
  - Increase the cost of/risk to attorneys for filing baseless claims used to threaten governments
  - Require increased due diligence by claimants' counsel
- **Downsides/disadvantages:**
- **Options for combining it with other reform proposals**
  - Could, e.g., be combined with heightened pleading standards

### **Solution 4 - state-to-state mechanism (as pre-ISDS filter/first rights of decision or sole means of dispute settlement)**

- **What:** Shift from ISDS to state-to-state dispute settlement for:
  - All claims (ie, all cases must be pursued through state-to-state dispute settlement (SSDS)); or
  - Some claims (e.g., investors can only directly bring claims for direct expropriation, transfer restrictions, and/or nationality-based discrimination); or
  - Initial filters (investors can only bring all or some claims if the state parties affirmatively agree, or decline to halt the case)
- **Rationale:**
  - Require states (which, in contrast to investors likely have an interest in maintaining correct and balanced interpretations of their treaties) to filter claims, likely narrowing the range of cases being brought and arguments being raised (including with respect to damages), and avoiding frivolous or egregious claims.

- Will result in fewer claims being brought; claims for damages will also likely be less/narrower.
- **Downsides/disadvantages**
  - States may fear repoliticization. However:
    - it is unclear that ISDS actually does depoliticize disputes, and
    - state-to-state dispute resolution can be legalized, decided based on law rather than power; treaties with dispute settlement mechanisms can enable this
  - Depends on whose perspective (e.g., individual investors likely want to keep the extraordinary power to have complete control over decisions regarding when/why/for what to sue)
  - Depends on the formula adopted (since the role of state parties filtering claims or having sole authority to bring claims can sit along a spectrum from absolute control over all claims, to the option to exercise control over some claims; the degree of politicization also depends on the mechanism set up in the treaty and underlying domestic law to guide discretion on state decisions to bring claims).