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Investment Disputes, Sovereignty Costs, and the Strategies of States

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Abstract

The international investment framework has been particularly criticized for the investor-state dispute settlement mechanism as agreed upon in investment treaties. Host countries especially have argued that this mechanism has in effect restricted their right to regulate: they say it cost them part of their sovereignty. South American countries were the first to react against the international investment framework. In blaming international arbitration institutions and foreign investors, some countries in the region have terminated their treaties and abandoned the framework. Other strategies to avoid sovereignty costs have also been pursued. However, by taking into account all the concluded investment disputes in the South American region, a broader discussion on the strategies that countries in the region are taking can be presented. None of the existing strategies promises a good outcome for countries in the region, nor for other actors within the framework. Instead, what is hereby encouraged is a strategy for host countries which consists to actively participate in facilitating some of the changes of the international investment framework that are currently being proposed. Thus, to partake in the evolution of the international investment framework, for some of the proposed changes are aimed at diminishing sovereignty costs, and might benefit all actors much more in the long term.

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1. Introduction

The international investment framework, together with its investment treaties and conventions, was a real game changer in how states related to each other facing a foreign investment dispute. Its success can be seen in the fact that today investor-state dispute settlement mechanisms, originating in provisions of Bilateral Investment Treaties (BITs), are contained in most complex trade and investment agreements.[2] However, some of the main criticisms of the international investment framework concerned the *enforcement* of the treaties through the investor-state dispute settlement mechanisms, like those laid down by BITs, for restricting host countries in one of their primary rights as sovereigns, i.e. to regulate for the welfare of their citizens as the primary goal. In the area of the international investment framework sovereignty costs are normally associated to the restriction to regulate.[3] It is due to this restriction of host states that not only much of the scholarly literature has focused on this to criticize the framework,[4] but sovereignty costs have also been the explicit justification named by countries to choose the strategy of terminating their international investment treaties.

In the following, a discussion of this strategy and of three alternative strategies is presented, in light of an analysis of *all* investment disputes of a particular region of the globe. The case study is South America. The analysis discloses that in addition to the cases that have had the effect of restricting the right to regulate, there are also cases in which discriminatory actions were taken, and it is only due to the international investment treaty that actors could

[2] Most trade agreements that contain an investment chapter follow similar provisions of a BIT. For example, Free Trade Agreements (FTAs), Preferential Trade Agreements (PTAs), the Comprehensive Economic and Trade Agreement (CETA), etc.

[3] Locke defined the political power of a state as: “a right of making laws …. for the regulating and preserving of property, and of employing the force of the community, in the execution of such laws, and in the defence of the commonwealth from foreign injury; all this only for the public good.” Kelsen (1920) has long acclaimed "The concept of sovereignty, which the scholarship on modern constitutional law considers one of its most difficult and most solidly controversial concepts, has undergone a change of meaning. This has caused many disputes on how it is to be determined.” Krasner has defined, however, four types of sovereignty: international legal sovereignty, referring to international recognition of sovereign states; Westphalian sovereignty, referring to the exclusion of external authority from the territory controlled by the state; domestic sovereignty, referring to the organization of political authority and monopoly of enforcement within its territory; and interdependence sovereignty, referring to the ability of a state to regulate the flow of information, people, capital, etc, across its border. In the agreement of international treaties, there will always be sovereignty costs. Autonomy gets restricted for the simple fact that there is an agreement on rights but also obligations of one state to another. For the purpose of this article, I will refer to the terminology of sovereignty understood in terms of the restricted authority or capacity of a state to regulate within its own territory. Locke, John. Second Treatise of Government: An Essay Concerning the True Original, Extent and End of Civil Government (Crofts Classics, edited Cox, Richard. Wiley-Blackwell. 1982) p 2; Kelsen, H. Das Problem Der Souveranitat und die Theorie des Volkerrechts JCB Mohr (Paul Siebeck) Tubingen. 1920. p.1; Krasner, S Sovereignty: Organised Hypocrisy Princeton University Press 1999

[4] Gus Van Harten Investment Treaty Arbitration and Public Law (Oxford University Press 2007); Asha Kaushal ‘Revisiting History: How the Past Matters for the Present Backlash against the Foreign Investment Regime’ (2009) 50 Harvard International Law Journal 2; Lauge Paulsen ‘Bounded Rationality and the Diffusion of Modern Investment Treaties’ (2014) 58 International Studies Quaterly, 1-14; Lorenzo Cotula ‘Do investment treaties unduly constrain regulatory space?’ (2014) 9 Questions of International Law, 19-31; Jonathan Bonnitcha Substantive Protections under Investment Treaties: A Legal and Economic Analysis (Cambridge University Press 2014); Lise Johnson and Lisa Sachs ‘The Outsized Costs of Investor-State Dispute Settlement’ (2016) 16 Insights 1

achieve a remedy. This approach of taking all concluded disputes into account is important because it acknowledges the fact that even though investment disputes could derive from similar factual grounds, the outcome could differ. This is due to the non-precedent nature of cases settled pursuant to international law.[5] The question is thus how can the advantages of investment treaties be retained while getting rid of the acknowledged disadvantages that they have in their current form; this relates to the strategies that states are pursuing in regard to the international investment framework that we will discuss below.

As we shall see, further to the strategy of terminating the treaties, there are three more strategies that should be taken into account, two of which are already being followed by some state actors in the South American region. The second strategy that is being proposed is to create a regional arbitration institution to solve investor-state disputes and replace the existing institutions with it. The third strategy, tacitly implemented by host states in the region, is to keep the system as it is. Yet, in the conclusion there is a discussion about a fourth strategy, which promises to be not only less costly for host countries, but would also result in a more balanced outcome for all actors in the framework. This proposed strategy requires states to actively participate in implementing particular changes of the international investment framework, some of which are currently being proposed, and therefore contribute to the evolution of the international investment system.

[5] The decision of past cases are not binding for arbitration tribunals in the cases presented before them. Therefore, arguing to terminate treaties because of how one case was resolved does not provide legitimacy for states to pursue that strategy.

2. The Strategies of States relating to the International Investment Framework

The 'Treaty between two countries concerning the reciprocal Encouragement and Protection of Investment' (what we refer to by the short acronym of BITs), as its name implies, was intended to be used by the parties to encourage investment[6] and to be used as instruments of protection against discriminatory expropriations without compensation.[7] Focusing on this latter aim, it is important to distinguish that most investment treaties establish that neither state shall expropriate private property, *except* for reasons concerning: i) public purpose, ii) in a non-discriminatory manner, iii) upon payment of prompt, adequate and effective compensation and iv) in accordance to due process of law. There can be actions of a host state that constitute a direct expropriation (taking of property) or indirect expropriation, also called creeping expropriations, normally include regulations of a host state amounting to takings. In either event, however, if an expropriation takes place the four mentioned elements will determine the responsibility of the host state. It is from this understanding of states' right in regard to expropriation that the following can be said regarding investment disputes in the South American region.

The concluded investor-states disputes in the South American region[8] show that in some cases BITs have been used in ways that were clearly not intended by host countries when they agreed to them, in a way that restricted a state's freedom to regulate. This is the case resulting from the disputes that denote that what was at issue was the prime right of a sovereign state to react to an economic crisis,[9] to protect the environment[10] or the health of its citizens[11] by enacting laws.

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[6] The other aim pertaining to the encouragement of investment will not be dealt with here. For a discussion on different scholarly works on that topic see Gwynn 2016, p.128-135.

[7] Dolzer, R. and Stevens, M. *Bilateral Investment Treaties*. (Martinus Nijhoff Publishers. 1995); Jeswald Salacuse and Nicholas Sullivan 'Do BITs really work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46 Harvard International Law Journal 1, 67-130.

[8] Until March 2017, the ICSID Cases database reported 90 concluded cases and 51 pending, totalizing 141 cases in South America. The UNCTAD Investment cases database, which includes arbitration under UNCITRAL rules reported 107 concluded cases and 52 pending cases, totalizing 159 cases in South America.

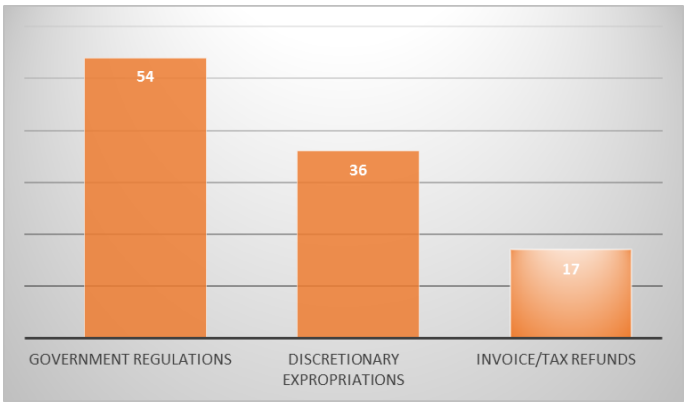
[9] For instance, in the cases brought against Argentina due to its 2001 financial crisis, in addition to dealing with the financial crisis, Argentina, the host country, also had to deal with a foreign investor who acted in its own interest rather than considering the interests of the citizens of the country affected by the crisis. Domestic companies, which were equally affected by the crisis, could not sue the state for how it reacted to the crisis. And yet, BITs allowed foreign investors to do just that.

[10] . In year 2003 and 2006 local communities in Peru and Ecuador had complained to the local authorities about the pollution caused by some foreign investments. The local authorities then reacted with measures to stop the problem, and as a result the investor ended up suing the host state. Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. (formerly Empresas Lucchetti, S.A. and Lucchetti Perú, S.A.) v. Republic of Peru (ICSID Case No. ARB/03/4). Decided in favour of State; Chevron Corporation and Texaco Petroleum Company v. The Republic of Ecuador (I) (PCA Case No. 34877). Decided in favour of Investor.

[11] Consider, for example, the Phillips Morris case against Uruguay. The country was implementing the Framework Convention on Tobacco Control of the WHO, which most countries had agreed to. Uruguay was regulating how big the health warnings on cigarette packages had to be, an action that many other countries in the world had already done, and one that clearly has the health of the countries' citizens at its heart. Yet because it had signed a BIT with Switzerland (the home state of

However, the latter are not the only investment disputes that exist in South America. The concluded cases show that there were also claims against governments' nationalisations in which the investors were not treated according to the provisions stated in the treaty nor to the minimum standards of international law. Of course, *this* is the kind of state action that the treaties were primarily designed to protect investors from. Cases where foreign investors were unjustifiably denied a remedy, or were unable to obtain them locally, still exist. In the case of some of the investment disputes in South America, it is also questionable whether such expropriations were done for the purpose of the public good, as in some cases citizens performed arrays of demonstrations and protests in the streets against those actions.[12] Yet, although the measures affected both domestic and foreign investors, it was through a BIT that foreign investors could submit their claims to international arbitration and have them settled in fair terms.

Table 1. All Concluded Investment Disputes against South American Countries based on Subject Matter



Source: Listing of disputes at the ICSID disputes database, UNCTAD Investment disputes database, and Host Countries' Institutions database. March 2017

The sovereignty costs in the form of restriction to regulate make it understandable that some type of reaction would follow from South American countries against these practices, but considering that empirical evidence shows that some discriminatory practices still persist some questions remain: Is it justified to abandon the existing framework or to blame actors like foreign investors or international arbitration tribunals for the sovereignty costs? Are host countries really not gaining 'anything' from international investment treaties? Bearing these questions in mind, we shall turn to the discussion of some of the strategies that have been pursued to face these challenges.

Phillip Morris), Uruguay was sued for protecting the health of its citizens, something that Switzerland itself did not even have to fear when they introduced the same kind of law for cigarette packages sold in Switzerland.

[12] For example in cases against Venezuela and Bolivia. Anatoly Kurmanaev and Juan Forero. 'Commerce Strike to Protest Venezuelan Regime Fizzles Out' *Wall Street Journal (*October 28, 2016); Lapper, Richard 'Venezuela and the Rise of Chavez: A background Discussion paper' Council on Foreign Relations. (Nov 22, 2005); 'Expropriations in Bolivia. Just when you thought it was safe' *The Economist* (May 5 2012)

Strategy 1: Termination of the Agreements

South American host states have stated that the restriction of their right to regulate, alongside the fact that international tribunals pass judgement upon their policies, constitute sovereignty costs, and that these sovereignty costs were caused by BITs and the main international arbitration institution that settles investor-state disputes: the International Centre for the Settlement of Investment Disputes (ICSID).

As a result, Bolivia denounced the ICSID Convention and was excluded from it in 2007 and subsequently terminated 8 of its BITs.[13] Ecuador denounced ICSID in July 2009 and terminated 9 BITs,[14] though the total number of BITs the Ecuadorian President asked to be terminated in that year was 13.[15] In 2012, Venezuela also denounced and terminated the ICSID Convention and its BIT with the Netherlands.[16] Argentina, the South American country against which most investment disputes were submitted to international arbitration, has in fact only paid five of the awards related to its economic crisis of year 2001.[17] In March 2012, Argentina submitted a draft of law in Congress that states the termination of the ICSID Convention.[18] In 2013 Argentina terminated its BIT with India, in 2014 with Bolivia, and in 2016 terminated its BIT with Indonesia.[19] Chile terminated its BITs with Korea and Peru.[20] Brazil, on the other hand, remains reluctant until today to become part of the framework for

[13] Bolivia terminated its BITs with the Netherlands (2009), United States (2012), Spain (2012), Austria (2013), France (2013), Germany (2013), Sweden (2013), Argentina (2014). UNCTAD; Organization of American States.

[14] Ecuador terminated its BITs with the Dominican Republic (2008), El Salvador (2008), Nicaragua (2008), Paraguay (2008), Romania(2008), Finland(2010), Germany (2010), UK (2010), France (2011). See UNCTAD; also Ecuador's Official Registry No. 632. July 13, 2009; see also 2011 Investment Climate Statement Report.

US Bureau of Economic, Energy and Business Affairs. March 2011, <http://www.state.gov/e/eb/rls/othr/ics/2011/157270.htm> (last visited Nov 21, 2016); Mena Erazo, P. "Ecuador pone fin a los tratados bilaterales de inversión"BBC News report (September 16, 2010); Ecuador's Legislative Brief No. 179 submitted by the "Comisión de Soberanía, Integración, Relaciones Internacionales, y Seguridad Integral de la Asamblea Nacional" discussed in the sessions dated September 9 and 14, 2010; see also UNCTAD, Denunciation of the ICSID Convention and BITS: Impact on the Investor-State Claims. IIA Issue note No. 2. December, 2010.

[15]A request for termination of the BITs with the US and Spain is pending at the Ecuadorian Congress. Author's translation from the report by Carlos Juliá of the IV Americas Social Forum, on August 12, 2010, <http://www.bilaterals.org/spip.php?article17879>; see also Article 422, 2008 National Constitution of Ecuador.

[16] Venezuela denounced the ICSID Convention on January 24, 2012. List of contracting States and Other Signatories of the Convention (as of April 12, 2016) International Centre for Settlement of Investment Disputes.

[17] Ezequiel Vetulli and Emmanuel Kaufman 'Is Argentina looking for reconciliation with ISDS?' Kluwerarbitrationblog.com (October 13, 2016); Recently, however, Argentina offered to pay some of these awards in the form of government bonds at a discounted rate. See Calvert, Julia 'State Strategies for the Defence of Domestic Interests in Investor-State Arbitration' *Investment Treaty News* International Institute for Sustainable Development (Feb 29, 2016)

[18] Argentina's Draft of Law. File No. 1311-D-2012. H. Camara de Diputados de la Nacion. March 21, 2012. The Parliamentary process seeking the termination is still ongoing in the Argentinean Congress. See Submission of the Lower Chamber of Congress on March, 30 2016. Parliamentary Process 20/2016; Also Senator's Chamber. Communication 134, No.3646 of the year 2016.

[19] UNCTAD Investment Policy Hub.

[20] Chile terminated its BIT with Korea in 2004 and with Peru in 2009 but replaced them with new treaties. This is also the case for Peru's BITs with Korea and Singapore.

international investments: it still has not signed the ICSID Convention, nor any modern versions of BITs with industrialised countries.[21]

The decision to implement this strategy has come after some South American countries were sued for enacting and implementing regulations. In other words, it was due to the unintended consequences resulting from the BITs, in which their right to regulate was restricted.[22] Vandevelde (2005) had long pointed out that "developing countries may come to see the agreements as poor bargains in which states surrender portions of their sovereignty and subject themselves to costly arbitration with investors, without having gained appreciable new investment as a result."[23] Allee and Peinhard (2011), referring to the dispute settlement clauses, stated that BITs had 'teeth'.[24]

However, even though it is true that the treaties have resulted in a restriction to regulate for host countries, these consequences result from the enforcement of particular clauses. Rather than terminating the treaty as a whole, host states might consider working towards amending these clauses, thus avoiding or at least substantially reducing sovereignty costs without compromising the effective obligations and protections that the treaty brings about through other clauses. The termination of the treaties terminates all rights and obligations of the parties. This will certainly have effects for the host state. As I will elaborate in the following, the host state may realize that there would be yet other adverse effects if they terminate the treaties.

The first problem that the host state might face is that the submission of investment disputes to international arbitration will not end after terminating the treaties or the ICSID Convention. Bilateral Investment Treaties have sunset clauses. Sunset clauses are devised such that the rights and obligations of the treaty remain in force for a certain number of years after the treaty was terminated; the term varies from 15 to 20 years.[25]

This is aligned with the protection granted by international law against government measures that might terminate a treaty and give a justifiable way for that government to breach international law. The International Law Commission's Articles on State Responsibility for Internationally Wrongful Acts states in its commentary that "once responsibility has accrued as a result of an internationally wrongful act, it is not affected by the subsequent termination of the obligation, whether as a result of the termination of the treaty which has been breached…"[26] By the same token, the Vienna Convention on the Law of treaties also states that "the termination of a treaty under its provisions or in accordance with the present Convention…does not affect any right, obligation or legal situation of the

[21] Brazil has signed and ratified a treaty with investment provisions with Paraguay in the 1957 and in 1975. See below Itaipu Dam case.

[22] All countries that terminated their treaties have given the sovereignty costs as a justification for such action. See further comments given by these countries in section 2.2

[23] Kenneth Vandevelde 'A Brief History of International Investment Agreements' (2005) 12 University of California at Davis Journal of International Law and Policy, 157-194, p. 186

[24] Todd Allee and Clint Peinhardt 'Contingent Credibility: The Reputational Effects of Investment Treaty Disputes on Foreign Direct Investment' (2011) 65 International Organization 3, p 21

[25] Tania Voon and Andrew Mitchell 'Denunciation, Termination and Survival' The Interplay of Treaty Law and International Investment Law' (2016) 31 ICSID Review 2: 413-433

[26] Commentary to Article 13. See Nick Gallus *The Temporal Scope of Investment Protection Treaties* (British Institute of International and Comparative Law 2008)

parties created through the execution of the treaty prior to its termination".[27] Venezuela for example terminated the ICSID convention in 2012, and yet investment disputes concerning Venezuela are still submitted to ICSID.[28] There are also cases in which the host country's own legal system allows for disputes to continue to be submitted to ICSID. (See section 1.3).

The second problem has to do with the fact that when terminating the treaties, the dispute settlement clause, and recourse to international arbitration, are also terminated. This is a two-fold problem because it would affect the foreign investors, who are also actors of the international investment framework, as well as the host state. The termination strategy would adversely affect the actors of this framework because the protective part of the treaty against expropriations through unfair discriminatory actions will also be terminated. Discriminatory actions and disregard for the rule of law normally happen in authoritarian systems, in which the domestic courts are equally constrained by authoritative impositions. In such settings, a fair assessment of a dispute is not guaranteed by domestic courts, and thus both aliens and nationals risk abuses or breaches of due process and judicial procedure. Although international law provides protection against such practices,[29] investment treaties make it easier and more straight forward for foreign investors to submit such claims to international arbitration. Concluded investment disputes in South America show that cases in which discretionary actions were taken to expropriate without proper compensation still exist. Though the latter is primarily a concern for foreign investors, terminating the protective part of the treaty becomes a problem for the host country if it leads investors to stay away from that country because of fear of expropriations.[30]

As for the host state, the most important problem of the strategy of a state to terminate its BITs in order to rid itself of the sovereignty costs brought about by these treaties is that doing so may actually bring about higher sovereignty costs. This statement seems to argue something different from the direction that the scholarship on this topic is taking: due to the sovereignty costs that host states experienced, theories that disfavour international arbitration started to arise. It is argued that the investment disputes continue to be politicized (because investors involve their home states in such disputes), a situation that international arbitration was supposed to decrease.[31] It is also argued that states should return to diplomacy and 'replace' international arbitration,[32] because the home state intervenes in the host state anyway.[33] Johnson and Sachs (2016) also concluded that having investor-state

[27] Vienna Convention on the Law of Treaties, Article 70(1)

[28] Venezuela has ten pending investment disputes that have been submitted to ICSID after 2012.

[29] *Barcelona Traction, Light and Power Co., Ltd. (Belg. v. Spain)*, 1970 I.C.J. 3, 155-56; Jan Paulsson *Denial of Justice in International Law* (Cambridge University Press 2005)

[30] Though Brazil is a country in the region which if often cited as the exception as it has no BITs and yet has the highest FDI in the region; but Brazil still maintains the rule of law in their treatment to citizens and foreign investors. This is not a case with Venezuela for example, which with its government not respecting the rule of law have indeed made that country a less attractive destination for foreign investments.

[31] Catherine Rogers *The Future of Investment Arbitration* (Oxford University Press 2009); Lauge Poulsen, L *Bounded Rationality and Economic Diplomacy* (Cambridge University Press 2015)

[32] Jandhyala has argued that a return to diplomatic intervention of home countries in host countries was preferable, alleging that the former would be more favourable than having a dispute settlement mechanism like that of international arbitration to settle investment disputes. In Srividya Jandhyala 'Why Do Countries Commit to ISDS for Disputes with Foreign Investors?' 16 Insights 1.

[33] Jandhyala, S., Gertz, G and Poulsen, L. 2015 Legalization and Diplomacy: Evidence from the investment regime. Working Paper. This conclusion is reached without a crucial analysis and

dispute settlement mechanism in treaties has more costs than benefits for host countries and that that this mechanism is not effective.[34]

These theoretical approaches, however, disregard historical developments, the *ratio legis* of the dispute settlement clauses, and the consequences of asymmetrical power relationships that may affect the host state. For as it would be shown below, without the dispute settlement mechanism guaranteed by international investment treaties, smaller and weaker nations are much more at the mercy of bigger and powerful nations than they are with the existence of such a mechanism. Before making this argument, let us step back and take note of the historical development of the peaceful settlement of international disputes; it will help us see the importance of a third party capable of enforcing the terms of a treaty especially in the arena of international investments.

Terminating the treaties and, therefore, the international arbitration as a dispute settlement mechanism is a retreat from all the historical efforts to achieve a peaceful mechanism to solve international disputes. The Hague Peace Conference of 1899 adopted a Convention on the Pacific Settlement of International Disputes, which recommended different stages to solve a dispute: good offices and mediation, commissions of inquiry, and international arbitration. This convention established the Permanent Court of Arbitration (PCA). In 1907, a second Peace Conference improved the latter convention through another draft. In the belief that peace could be achieved through cooperation, US President Woodrow Wilson proposed the establishment of the League of Nations. This forum created the Permanent Court of International Justice, for which the 1907 draft convention of the Hague Peace Conference was used to draft the PCIJ Statute. Later this institution, with the creation of the United Nations, turned into the International Court of Justice. Prime international conventions relating to the peaceful settlement of disputes thereafter, like the United Nations Charter (Chapter VI) and the OAS Convention on the Pacific Settlement of Disputes[35] mention stages to solve international disputes, which normally include amicable means, negotiation or conciliation, judicialization and international arbitration.[36] This is a practice that is aligned with that of dispute settlement mechanism of investment treaties, most of which have investment dispute settlement clauses that mention these stages.[37] In 1962 the PCA Rules of Arbitration and Conciliation for Settlement of Investment disputes between two parties of which only one is a state was established, but as Parra (2012) has described the PCA was established by treaty but not its arbitration rules.[38] The 1965 ICSID Convention, on the other

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assessment of disputes at different official institutions that have acted to settle disputes; instead these scholars focus on informal diplomatic communications obtained through Wikileaks as its data source.

[34] Lise Johnson and Lisa Sachs 'The Outsized Costs of Investor-State Dispute Settlement' (2016) 16 Insights 1

[35] Charter of the United Nations. Chapter VI. Article 33 (1); American Treaty on Pacific Settlement (Pact of Bogota 1949); see also 1975 OAS Inter-American Convention on International Commercial Arbitration (Panama Convention).

[36] The investor in its own right can inform their home state of such disputes, it is entirely up to the party to do this, with or without a treaty. Should the home state in furtherance of goodwill choose to try and mediate the dispute -some clauses of investment treaties do not prevent this as there are amicable or negotiation stages to solve the disputes in which there is no restriction as to whom the parties appoint to do this- such practices should be welcome if they contribute to solving a dispute at an earlier stage.

[37] Gwynn 2016

[38] The only way to make the state be part of and consent to arbitration was if international law was breached Parra, A. *The History of ICSID* Oxford University Press. 2012. p.17

hand, was a multilateral treaty and it also references that a state may require the exhaustion of remedies (stages) before submitting a dispute to international arbitration at their centre.[39]

Every international dispute entails political and legal aspects. Having stages in the dispute settlement clauses represent an awareness of this, but there are crucial differences among the initial stages like negotiation, mediation, inquiry and conciliation (where due to political decisions the resolution of a dispute rests on the parties), and the later stages like domestic courts or arbitration (where there is adjudication by an impartial third party body).

No party wants to be sued but if it happens, settling the dispute as soon as possible is the most desirable outcome. Trying to mitigate disputes at earlier stages have always been common practices established in peaceful mechanisms of international disputes settlement and it has the advantage of reducing the costs for the parties.[40] However, if the dispute does not get solved through the previous stages (such as amicable/diplomatic means, negotiation or conciliation or at domestic courts), having the recourse to submit the dispute to international arbitration, the next stage, is a very important guarantee.

The institution of arbitration in investment treaties arose to prevent uses of force by the home state to solve investment disputes and was indeed a success in this regard.[41] International arbitration replaced practices of gun-boat diplomacy. There are scholars that stated that gun-boat diplomacy was replaced by gun-boat arbitration[42] but these referred only to the cases based upon the restriction of a state's authority to regulate. Such argument does not hold for cases in which expropriation was made in a discriminatory manner and without proper compensation. For such cases, the recourse to international arbitration was an effective remedy that allows a party to submit a claim against violations of international law.

The ICSID Convention does not prevent and expressly state the possibility of facilitating the settlement of a dispute through informal diplomatic exchanges.[43] Though, a host state might find itself in the situation where this early stages mechanism are not effective to solve the dispute either because what is proposed is not in the best interest of the host country, or because the asymmetry of the relationship becomes too great. In this spirit, long pointed out by the Convention on the Pacific Settlement of International Disputes, Article 16: "in questions of a legal nature, and especially in the interpretation or application of Intentional Conventions" arbitration is "the most effective, and at the same time the most equitable means of settling disputes *which diplomacy has failed to settle*."[44] Even from practical accounts, no state would want another state to get involved by asking it to defend the legitimacy of its action, for this would go against the basic principle of sovereignty. This was

[39] ICSID Convention. Article 26.

[40] In fact, even in the draft constitutive agreement of the Dispute Settlement at UNASUR, there is a reinforcement for the parties to use the previous stages before arbitration to solve the dispute, which is no different from the dispute settlement clauses in investment treaties.

[41] See for example the interesting contrast with Calvo doctrine in Horacio Grigera Naon 'Arbitration and Latin America: Progress and Setbacks' (2005) 21 Arbitration International 2.

[42] Jose Alvarez and Kathryn Khamsi 'The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime" (2009) Yearbook of International Investment Law and Policy. (Karl P. Sauvant, ed) p 73

[43] ICSID Convention, Article 27 (2).

[44] Convention for the Pacific Settlement of International Disputes, established at The Hague in 1899 during the first Hague Peace Conference. Art 16. My highlights.

mentioned by the established US Act of State doctrine, and continues to be mentioned in practical implications concerning disputes resulting from IIAs.[45]

Furthermore, the existence of an arbitration tribunal balances the relationship especially after bilateral efforts between the parties were futile. Allowing intervention by other home state's parties would bring power issues to the fore and undermines the whole historical development of the investment regime to counteract power asymmetries. Different interests could taint the decision of the home states to get involved, interests that might be alien to the dispute and yet might be used to influence the parties. International arbitration as an institution is important and in this regard, liberal theories have emphasized the role of institutions.[46] In the international investment framework, there are actors other than states, and it has been precisely due to arbitration tribunals that undue intervention that would mark an asymmetrical influence in deciding the cases has been prevented in some investment disputes. For instance, in some investment disputes that concerned member states of the European Union, the members states tried to justify breaches of their contracts with investors with European legislation and indeed the European Commission, not a party to the cases, tried to intervene in most of them; the arbitral tribunal rejected such petitions in some cases or regulated the degree of allowing for the submission as amicus curiae reports.[47] This situation might soon change, as the Treaty of Lisbon gives the EU competence to enter into these treaties and therefore allow it to be a party to such disputes. But the fact remains that without an international arbitration system, there would be no institution that would control the degree of involvement of third parties in the dispute. This would not only affect legal issues of privity, they could also affect the consent given by the parties, which is key to be subjected to this kind of jurisdiction.

Terminating the treaties terminates the investment dispute settlement clause. With no investment dispute settlement clause, the obligations in the treaty would not be enforceable anymore. While from a legal perspective this is crucial, it is equally so from a political and economic perspective. Schelling, when speaking about commitments (key to bargains) says that they have to be enforceable because that is the essential element for preventing an adversary or partner to release himself from the commitment. He further argues that the former is in effect a commitment to a third party,[48] stating that: "Agreements must be in enforceable terms and involve enforceable types of behaviour. Enforcement depends on at

[45] US Act of State doctrine: "Every sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in judgement of the acts of the government of another, done within its own territory." Chief Justice Fuller in Underhill v Hernandez. 168 US 250, 18S. Ct. 83, 42 L. Ed. 456 (1897); Jan Paulsson 'Arbitration without privity' ICSID Review Foreign Investment Law Journal 10 (2) (1995), 256; Sir Geoffrey Palmer 'Perspectives on International Dispute Settlement from a Participant' Lecture Series. Audiovisual Library of International Law. United Nations.

[46] Andrew Moravscsik 'Liberal Theories of International Law' in *Interdisciplinary Perspectives on International Law and International Relations*, eds Jeffrey Dunoff and Mark Pollack. (Cambridge University Press 2013). See also Robert Keohane, Andrew Moravcsik and Anne-Marie Slaughter 'Legalized Dispute Resolution: Interstate and Transnational' *International Organization* 54, 3 (2000); 457-488

[47] In the Eastern Sugar case, the involvement was rejected. Eastern Sugar B.V. v. The Czech Republic (SCC Case No. 088/2004). See also Andrea Bjorklund 'The participation of sub-national government units as amici curiae in international investment disputes' in *Evolution in Investment Treaty law* and Arbitration eds Chester Brown and Kate Miles Cambridge University Press 2011 pp 312-313

[48] Thomas C. Schelling The Strategy of Conflict (Harvard University Press 1960), 43

least two things –some authority somewhere to punish or coerce and an ability to discern whether punishment or coercion is called for."[49] Schelling, in other words, describes the importance of a third party neutral that can enforce the obligations that two parties agreed to.

The legalization approach in International Political Economy, when treating legalization as a form of institutionalization also remarks delegation as one of its key components.[50] Hart, the 2016 Nobel laureate for Economics, in his theory of incomplete contracts and the theory of the firm, has stated that it was thought that parties enter into contracts to specify all the obligations about the events that could happen in the future. However, that is not possible, in fact the norm is that a contract will always be incomplete and 'it would have gaps or missing provisions'. This is because the parties will not always be able to specify everything. In such cases "the parties may sometimes disagree about what the contract really means; disputes may occur and *third parties* may be brought in to resolve them."[51]

If we applied this to contemporary world politics, courts or international arbitration institutions fulfil this enforcement role. Yet, though the division of power in a state should make domestic courts effectively a third party, this is not the case where a division is not fully respected, for example as it is seen in authoritarian regimes. As for the early stages of solving disputes -negotiation (diplomatic means), mediation, conciliation- and the decision thereof, such mechanisms do not provide that capacity because their decisions are not enforceable. The decisions emanating from international arbitration tribunals on the other hand, due to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) that most countries in the world have ratified, make arbitral awards enforceable in most jurisdictions around the world.[52]

Thus, the most important problem with the strategy of terminating the existing BIT framework justified in the sovereignty costs it brought about, is a *caveat status* (state's beware), that terminating it may well bring about yet higher sovereignty costs. Maurer (2013), in a historical analysis of the investment regime, points out that the removal of the arbitration system in investment relationships could be seen as an 'Empire Trap' that could restrict host countries even further within their public policy space.[53]

The smaller and weaker a party, the more it would want to rely on legal, fair and impartial institutions in a system that counteracts asymmetric relationships. These type of structures generate capabilities for them.[54] Further to the aforementioned theoretical arguments, I will illustrate this point with an empirical scenario. I will use an investment scenario in the same South American region. In this scenario there is no arbitration mechanism as those contemplated in investment treaties. This lack of an enforcement mechanism has caused

[49] Schelling 131

[50] Obligation, precision and delegation. In Kenneth W. Abbott, Robert O. Keohane, Andrew Moravscik, Anne-Marie Slaughter, and Duncan Snidal 'The Concept of Legalization' (2000) 54 *International Organization* 3: 401-419

[51] Oliver D. Hart 'Incomplete Contracts and the Theory of the Firm' Journal of Law, Economics, & Organization, Vol. 4, No. 1 (Spring, 1988), pp. 119-139 p123. My highlights.

[52] Also refer to as the New York

Convention. See status of ratification at
http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html

[53] Noel Maurer *The Empire Trap* (Princeton University Press 2013)

[54] Maria A.Gwynn 'Structural Power and International Regimes' GLF Working paper (under review).

more sovereignty costs to the weaker party; the scenario concerns Brazil and its neighbouring country Paraguay.

Case Study: the Treaty establishing the Itaipu Dam and the Use of Renewable Energy

An investment endeavour was carried out by Brazil and Paraguay to build a dam in their bordering Parana river and economically profit from the renewable hydroelectric energy it would provide.[55] Prior to the building of the dam in 1973, Brazil, a country who until today refuses to ratify investment treaties with industrialised states due to sovereignty implications, did in fact sign and ratify a treaty that concerned investment issues with Paraguay before this major investment in the region. The 'General Treaty of Trade and Investment between the Republic of the United States of Brazil and the Republic of Paraguay' was ratified by the parties in 1957.[56] This and other agreements between the parties led them to ratify the Itaipu Treaty in 1973. With the Itaipu Treaty the construction of the dam began and a bi-national company was created, Itaipu. This bi-national company is in charge of managing and redistributing all the hydro-electrical energy that the dam provides. The treaty establishes that everything will be equally shared by the parties. Since Paraguay did not have the financial resources to contribute in equal part to the building of the dam, Brazil gave the loans to Paraguay and the treaty stated long term commitments for the repayment of the debt back to Brazil.[57] In particular, the treaty established that the unused energy of the share that belonged to Paraguay has to be sold solely to Brazil, and at a very low price when compared to that of the market. More recently, there is high demand to purchase this unused energy by other countries in the region who are offering a much higher price, but the

[55] Both countries agreed on the profitable economic use of the bordering rivers through the Foz do Iguazu Declaration signed in 1966. They then established the Paraguayan-Brazilian Technical Commission to study the technical details. In 1973, with the results of such study, the Itaipu Treaty was signed and ratified by Paraguay and Brazil and the construction of dam began in that same year.

[56] General Treaty of Trade and Investment between Brazil and Paraguay signed on October 27, 1956 and entered into force on September 6, 1957. See Brazil's Ministerio Das Relacoes Exteriores, SCI Sistema Atos Internacionais. Sistema Consular Integrado. Last accessed Nov, 30, 2016. This treaty expressly covers areas common to *BITs inter alia* investments, national treatment, most favoured nation, transfer of capital clauses and it expressly states about entrepreneurship activities that have the objective of developing electric energy (Article XII paragraph 2). Such investment treaty also makes reference to a dispute settlement clause but it is limited to amicable solutions, as its article XXIV states that upon objections raised by one of the parties, the other party shall take them into consideration and upon exchange of ideas, the parties should provide satisfactory solutions pursuant to common interests. (Article XXIV. For all other investment matters, the treaty delegates to the Mixed Permanent Commissions that were established by exchange of notes between the two states. Article XXV. However, it is closer to the type of FNC treaties rather than modern BITs because it lacks an expropriation clause; Brazil and Paraguay also ratified a Friendship and Cooperation Treaty in 1975, which also regards investments.

[57] The debt was for the construction of the dam and the incorporation of the entity. The outrageously high interest rates of the debt, which in excess exceed the amount of the debt, have prevented the debt to be fully paid, even after almost half a century. Itaipu Binacional 'General Balance Sheet to December 31, Year 2015 and 2014. Net Passive Assets' 2016; Paraguayan General Controller Office 'Report of the Financial Reports of the Ministry of Finance fiscal year 2013' August 2014. pp432-436; Jeffrey Sachs, Lisa Sachs, Perrine Toledano and Nicolas Maennling "Leveraging Paraguay's Hydropower for Sustainable Economic Development" Vale Columbia Center on sustainable International Investment. November 2013; Ricardo Canese *La Deuda Ilicita de Itaipu* (Editorial Generacion 1999).

Itaipu treaty restricts Paraguay from selling its unused energy to any other party but Brazil.[58] There have been economic technical reports that state how much income Paraguay loses for this restriction caused by the treaty, among the one that discloses the minimum loss, states it to be about US$748.6 million per year.[59] It is also worth pointing out that Paraguay has so much unused energy because there is a lack of infrastructure to transmit that electricity to some areas within Paraguay. The budget of the country is not enough to get the transmission lines or improve the existing ones.[60] Related to this, despite co-owning one of the biggest hydroelectric power plants in the world, the whole country suffers from common blackouts throughout the year because of the defective power lines and electrical infrastructure.

Paraguay could use the profit it would gain from either getting a fair price for its energy or being allowed to sell their energy to other countries than Brazil to improve their infrastructure deficiencies, but it is restricted from doing so by the Itaipu treaty. Paraguayan officials and directors of the binational company have raised some concerns in this regard but since the treaty provides no mechanism for resolving disputes by a third neutral party, such conflicts remain entirely political, bilateral and in a negotiation scenario that is very asymmetrical due to Brazil being more powerful in every respect. While it is true that institutions like the International Court of Justice (ICJ) could always be the last resort, the complexities of the asymmetrical interdependencies and politics, and the asymmetrical position of Paraguay in every aspect vis a vis Brazil in this case is a severe disadvantage.[61]

In conclusion the Itaipu Treaty brought about severe sovereignty costs to Paraguay, despite the fact that there is no international arbitration institution as a dispute settlement mechanism in the treaty. Indeed, I would argue that sovereignty costs are higher due to the absence of a mechanism that would allow to involve such an arbitrator, for a third party arbitrating a dispute regarding, say, Paraguay's wish to sell their part of the Itaipu energy to other countries than Brazil could help mitigate at least some of the imbalances between Paraguay and Brazil.

This is just one example that shows that the current system of investment treaties involving international arbitration as a possible mechanism is not necessarily detrimental to host

[58] Itaipu Treaty, Article XIII; See also Juan Carlos Wasmosy, *Archivo Itaipu. Memorias y Documentos ineditos*. Eds Teresa Goossen Martens (Grafica Latina SRL 2008); Enzo Debernardi *Apuntes para la Historia Politica de Itaipu* (Editorial Grafica Continua SA 1996); Kohlhepp, Gerd *Itaipu* Deutsche Gesellschaft fur Technische Zusammenarbeit GTZ Gmbh. (Friedr Vieweg and Sohn 1987); Soares de Lima, Maria Regina *The Political Economy of Brazilian Foreign Policy. Nuclear Energy, Trade and Itaipu* (FUNAG, Brasilia 2013)

[59] Jeffrey Sachs, Lisa Sachs, Perrine Toledano and Nicolas Maennling "Leveraging Paraguay's Hydropower for Sustainable Economic Development" Vale Columbia Center on sustainable International Investment. November 2013.

[60] The annual budget of the Paraguayan Ministry of Public Works for example is less than half of Paraguay's loss for this restriction.

[61] Paraguay has raised some concerns about this and the importance of modifying the treaty in this regard, but the discussion of the topic of amendment or renegotiation was never officially in the bi-national agenda. In 2009, the Paraguayan government raised considerable criticism, and threatened with the ICJ, but Brazil only gave a one time higher settlement for revenues, after which the topic was again dropped. From this Maurer (2013) has written "In July 2009, Brazil signed a generous settlement with Paraguay regarding revenues from the Itaipu Dam, shared between the two countries. The reason was not Paraguayan pressure but a Brazilian desire to shore up its southern neighbor: giving it a greater share of the dam revenues was easier than voting a foreign aid program." Noel Maurer *The Empire Trap* (Princeton University Press 2013) p.447.

countries. On the contrary, depending on the circumstances, not having a dispute settlement mechanism like international arbitration might leave countries in a worse position, in terms of sovereignty costs, and that can affect them for a longer time.

Strategy 2: Replacing the International Arbitration Institution with a Regional Institution

Case Study: the treaty draft attempting to establish an UNASUR Arbitration Center

UNASUR is a regional South American organization which was created with the aim of integrating regional processes developed by the Mercosur and the Andean Community. It was agreed in 2008 and entered into force in 2011.[62] Its member states are working on a proposal to create an UNASUR Centre for Settlement of Investment Disputes. The main aim of this proposition is for the UNASUR Centre for Settlement of Investment Disputes to replace the main existing International Centre for the Settlement of Investment Disputes (ICSID), which is dependent of the World Bank.

Although contested multilateralism could be a theoretical explanation for this phenomenon, as it points out that "[f]requently, multilateral institutions are challenged through the use of other multilateral institutions, either without resort to unilateralism or bilateralism or in conjunction with those strategies",[63] the developments of how the proposition came about suggest that it is not really a contestation but rather self-interest strategies of particular actors.

South American countries, whether developing or emerging markets, have the same goals as any other state. Krasner (1985) stated: "Third World states want power and control as much as wealth. One strategy for achieving this objective is to change the rules of the game."[64] However, when the aim is to change the rules, it is very unlikely that any one developing country can achieve this on its own. Immediately after Ecuador terminated its investment treaties and the ICSID convention, Ecuador's then Foreign Affairs Minister stated that foreign investments will be in danger if Ecuador does not find a new mechanism for dispute settlement.[65] Indeed, in the year following of its ICSID termination, Ecuador submitted a proposal to the recently created South American regional organization, UNASUR, to create a new arbitration centre.

Leadership is defined as "providing solutions to common problems or offering ideas about how to accomplish collective purposes, and mobilizing the energies of others to follow these courses of action."[66] Until the proposal of the new centre, it was only Bolivia which had terminated the ICSID Convention in 2007. Ecuador denounced and terminated the ICSID Convention in 2009, and Venezuela denounced ICSID in 2012.

[62] UNASUR has 'the aim of integrating regional processes developed by the Mercosur and the Andean Community.' UNASUR, History.

[63] Julia Morse and Robert Keohane 'Contested multilateralism' (2014) Review International Organization 9:385-412. p.386

[64] See Stephen Krasner *Structural Conflict* (University of California Press 1985) p.3

[65] Interview with Manuel Chiriboga, former Foreign Affairs Minister. Mena Erazo, P. "Ecuador pone fin a los tratados bilaterales de inversión"BBC News report (September 16, 2010)

[66] Nannerl Keonane *Thinking about Leadership*. (Princeton University Press 2010) p. 19

After these terminations, these host countries made statements putting the blame for the sovereignty costs derived from the investment disputes on particular institutions like ICSID. One of Ecuador's members of Congress stated: "we are defending the sovereignty of our jurisdiction. We want to acknowledge the possibility that our State has to settle disputes at an instance in which it has confidence. In the case of ICSID our data reveal that its awards have been mainly favourable to the foreign companies"[67] and the speaker of the Ecuadorian Government further said: "ICSID works as a tool for exploitation, pressure and destabilization of our countries."[68] Similarly, in Venezuela, the Energy and Oil Minister, reportedly stated: "We will pull out of ICSID. It is not a mechanism to settle differences and for that reason we will get out of it."[69] In the case of Brazil, at the time the ICSID Convention draft in 1964, the Brazil's representative stated that the draft raised constitutional problems.[70] Since Brazil changed its constitution and has adhered to the 1950 OAS Convention on the Peaceful Settlement of International Disputes (Bogota Pact) and the later 1975 Convention on International Commercial Arbitration (Panama Convention), both of which cover international arbitration as a mechanism to solve disputes. Brazil, however, to date rejects the ratification of the ICSID Convention.[71]

Once the current institutional structure, and ICSID's role in particular, was perceived as common problems for more countries in the region, the solution that was proposed was the creation of a regional UNASUR arbitration institution to replace the existing international arbitration institution, ICSID.[72] In this way, UNASUR provided a common forum to propose new rules and other countries in the region supported the work on the draft to create the UNASUR Centre for the Settlement of Investment Disputes.[73]

The agreement on the goal to change the rules by replacing the existing arbitration institution and the mobilization of others to support that goal was achieved. In 2012 the first draft of a Constitutive Agreement of the Centre for the Settlement of Investment Disputes of

[67] Interview with Linda Machuca, Vice-President of the International Relations Commission of the Ecuadorian Congress. Mena Erazo, P. "Ecuador pone fin a los tratados bilaterales de inversión"BBC News report (September 16, 2010)

[68] The justification for the termination of these treaties was that they were against the Ecuadorian Constitution. The National Constitution of Ecuador states that the government cannot give away sovereignty when signing international treaties and based on that article Ecuador denounced the treaties. The speaker of Government was Pedro Páez. In the report by Carlos Juliá of the IV Americas Social Forum, on August 12, 2010, <http://www.bilaterals.org/spip.php?article17879> (Author's translation).

[69] Statement of Rafael Ramirez, Venezuela's Energy and Oil Minister. *Agencia Venezolana de Noticias (AVN)* (January 15, 2012).

[70] Jean Kalicki and Suzana Medeiros 'Investment Arbitration in Brazil. Revisiting Brazil's Traditional Reluctance Towards ICSID, BITs and Investor-State Arbitration' Arbitration International, Vol 24, No 3. 2008. pp432

[71] It is opposed by Parliamentarians. See Investment Arbitration Reporter 2008. Vol 1, No. 9

[72]Though it would also affect some of the UNCITRAL arbitration. For the details of the proposition see Katya Fach and Catherine Titi 'Unasur Centre for the Settlement of Investment Disputes: Comments on the Draft Constitutive Agreement' *Investment Treaty News* (August 10, 2016). https://www.iisd.org/itn/2016/08/10/unasur-centre-for-the-settlement-of-investment-disputes-comments-on-the-draft-constitutive-agreement-katia-fach-gomez-catharine-titi/

[73] Silvia Fiezzoni 'UNASUR arbitration centre: The present situation and the principal characteristics of Ecuador's proposal' (2012) Investment Treaty News, 2(2), 6–7. <http://www.iisd.org/pdf/2012/iisd_itn_january_2012_en.pdf>

UNASUR was finished; a new version of the draft was presented in 2014.[74] However, it is not yet enforced as there is still no consensus on many matters relating to the creation of such Centre.[75]

There are some aspects relating to the content of the Draft Constitutive Agreement of the UNASUR Centre for the Settlement of Investment Disputes that we should reflect upon.[76] If the draft were to reduce the sovereignty costs for host states while continuing the protection to foreign investment from discriminatory state measures, it would be an improvement. However, as it stands in its current form, it does not fulfil these purposes. First, the draft starts by stating that the agreement 'shall not affect the applicability of investment disputes settlement mechanism and other obligations contained in international agreements'.[77] This means that even if the draft is agreed upon, there is not going to be any difference in how disputes are handled if they do not modify or terminate their existing agreements. As mentioned before, that action of terminating the treaties has its disadvantages as well.[78] Second, the draft states that each party can accept to not submit certain disputes and to exhaust local remedies before a dispute is submitted to the centre. There is no difference from what article 26 of the ICSID Convention states in this regard. Third, consultations and negotiations through diplomatic channels are going to be maximized, intending arbitration to only be the last resort. Again, almost all bilateral investment treaties have the same stages. Interestingly, the draft expressly states the increased effort in using diplomatic channels, which as explained before is in accordance with the existing investment treaties. Furthermore, according to the draft, each member state can object to an arbitrator proposed by the other party, and the objection will prevail over nomination of the candidate.[79] There have been propositions to establish a Permanent Tribunal but only to deal with annulments, and there is no consensus on the matter. Although there are certain differences among the rules, compared to that of ICSID, the UNCITRAL rules or the investment treaties, some of the most prominent features of the current system are kept. Furthermore, in the proposition, the draft keeps some of the rules that actors were dissatisfied with which can cause the same effects of the deficient rules of the current framework, such as those resulting in restrictions to regulate. Thus, adopting the latter version of the draft does not improve the current system.

The choice of using a regional organization rather than a multilateral one to improve the system could be questioned. In the investment regime, the UN has contributed with work in the area relating to investment regulations. It has two specialised bodies, UNCTAD and UNCITRAL. Most recently UNICTRAL has created a treaty, which adds transparency to the investor-state dispute settlement mechanism and it is applied retroactively to modify the

[74] UNASUR VIII Reunion of the Working Group on Investment Dispute Settlement.

[75] UNASUR VIII Reunion of the Working Group on Investment Dispute Settlement. March, 2014; Maria A. Gwynn 'South American Countries' Bilateral Investment Treaties: A Structuralist Perspective' (2015) 6 Journal of International Dispute Settlement 1, 97-117.

[76] Katya Fach and Catherine Titi 'Unasur Centre for the Settlement of Investment Disputes: Comments on the Draft Constitutive Agreement' Investment Treaty News (August 10, 2016).

[77] Draft Constitutive Agreement of the Centre for the Settlement of Investment Disputes of the UNASUR, Article 2.

[78] The draft in its current form does not disarm all the disadvantages that a termination of the ICSID Convention would bring about, which I mentioned in the previous section.

[79] Draft Constitutive Agreement of the Centre for the Settlement of Investment Disputes of the UNASUR, Article 34.

existing treaties (see section 2). The lack of transparency in investor-state disputes was one of the main criticisms by developing countries and academics. This treaty, which now adds transparency to all investment disputes, is open to ratification but to date, only one developing country has signed this treaty.

Thus, an alternative explanation for this strategy might be connected to the interest of some countries in advancing their hegemonic role in the region. In 2000, the first summit of South American Presidents took place in Brasilia upon the invitation of the Brazilian President Fernando Henrique Cardoso. In 2004, at the third summit of South American Presidents that took place in Peru, the South American Community Organization (SACO) was established. The President of Argentina at the time did not participate in this summit, as a sign of objection claiming that such proposition was mainly promoted by the Brazilian government.[80] In 2007, at the next summit that also dealt with energy issues, the Bolivian President Evo Morales proposed to rename SACO as UNASUR.[81] Brazil is also a member of MERCOSUR, and Mercosur also has treaties regarding the promotion and protection of investments, which also allows for international arbitration. Country members of Mercosur have ratified these treaties; Brazil has not.[82] Now with the recent creation of UNASUR whose headquarters is in Ecuador and its Parliament is in Bolivia, both countries have contested the current international investment framework. Considering the likely developments even if an agreement is reached, it is very unlikely that Brazil would ratify such a new treaty. Furthermore, in its short life as a regional organization, the UNASUR was used as a mechanism of involvement in domestic politics of other countries in the region.[83] Thus, the asymmetrical differences among member countries and the leadership role of the ones with more capacity to assert a hegemonic position do play a role in such a setting.[84] As what regards to the draft to create the new arbitration centre, these political issues and the proposition of allowing a member state's objection to prevail over the nomination of an arbitrator proposed by another state should be considered with caution.[85] This gives a lot of discretion to a member state to exert their influence in the constitution of the tribunal and it may also unnecessarily delay the process of constituting the tribunal.

[80] Reported by the ARgentinean newspaper la Nacion. In "Union de Naciones Suramericanas-UNASUR" Correo Sindical Latino-Americano Boletin Tematico Ano III No.2 June 2008. UNESCO Uruguay. p.6

[81] The proposition was made in Cochabamba. Although the Argentinean President during (2003-2007) did not participate of the original summits for claiming that the initiative to create UNASUR was promoted solely by Lula Da Silva, President of Brazil.

[82] Jean Kalicki and Suzana Medeiros 'Investment Arbitration in Brazil. Revisiting Brazil's Traditional Reluctance Towards ICSID, BITs and Investor-State Arbitration' Arbitration International, Vol 24, No 3. 2008. pp434

[83] The suspension of Paraguay from its membership in 2012 because the Paraguayan Parliament impeached the then President Lugo, after the latter support for rebels' violence and confiscation of private property.

[84] See for example some early examples of Brazil's hegemonic role in the region since the Itaipu case. Soares de Lima, Maria Regina The Political Economy of Brazilian Foreign Policy. Nuclear Energy, Trade and Itaipu (FUNAG, Brasilia 2013)

[85] Draft Constitutive Agreement of the Centre for the Settlement of Investment Disputes of the UNASUR, Article 34.

Moreover, blaming the international arbitration institutions[86] or foreign investors for the sovereignty costs, and therefore, using that as the justification for a regional institution can also be questioned. The sovereignty costs derive from the enforcement of the rules. If there were different rules, the outcomes would have been different. The actors who agreed on the rules are not the foreign investors nor the international arbitration institution but the states themselves agreed to these rules, ergo the blame can be said to be misplaced. Also, the blame lacks foundation when one considers cases of investment scenarios in which these actors are not present and which result in worse sovereignty costs for the host countries, as the *Itaipu* case previously discussed has shown.

This strategy does not solve the existing problems which South American countries have complained about and for which they have criticised the existing system. The proposed rules make for a weak case of contestation. Replacing the system with another which would only differ in that it establishes a regional enforcement institution and still lacks agreement on key provisions would be a step backwards in the attempt to improve the system as a whole.[87] Furthermore, other factors such as the lack of infrastructure, monitoring, and as mentioned before, influence of political will of stronger countries *vis a vis* smaller countries in the region, might constrain the countries and fail to provide the legal certainty or fairness required for such a system. The caveat is laid upon the intention of states to have more control over the process, which is exactly what the system of international arbitration aimed to avoid.

Strategy 3: Keeping the System as It Is

Not all South American countries have followed the action of terminating the treaties or the ICSID convention, and despite being members of institutions like UNASUR, there are some South American countries that are keeping the system such as it is. Moreover, some South American countries continue to promote their countries and provide foreign investors with many incentives to engage in investments in their countries.[88]

Many of the countries in the region not only have the current international legal framework supporting foreign investments but they also have domestic laws that protect foreign investments, even in their National Constitutions.[89] In many of these investment laws international arbitration is granted as a mechanism to solve disputes. Thus, disputes can be submitted to international arbitration based on domestic investment laws or particular contracts. This has been the case for Ecuador, Peru and Venezuela; countries with cases at different international arbitration institutions based on their investment laws or contracts.[90]

[86] Furthermore, ICSID is the main institution that settles investment disputes but it is not the only one. The International Chamber of Commerce, the London Court of International Arbitration, the Stockholm Chamber of Commerce, among others have also settled investor-states disputes.

[87] See for example cases of actors in other policy areas, Chen Zheng (2016) 'Exist, Voice, and "Daobi": China's Mixed Strategies for International Financial Institutions Reform' GLF Working Paper.

[88] See for example the use of Investment Promotion agencies: for example, Red de Importadores y Exportadores (REDIEX) in Paraguay and the ProColombia Centre in Colombia and the one recently created in Chile under their Framework Law for Foreign Invetment. For global trends of countries' investment promotion agencies see UNCTAD, 'Investment Laws: A Widespread Tool for the Promotion and Regulation of Foreign Investment' Investment Policy Monitor (22 November 2016) p.9

[89] See for example the National Constitution of Paraguay, which guarantees equality of treatment between foreign and national investors.

[90] See UNCTAD Investment Policy Hub.

These facts are compatible with global trends. The information of a 2016 UNCTAD report finds "that at least 108 countries have an investment law as a core instrument to govern investment, almost all of which are either a developing country or an economy in transition" and that such laws "often cover the same issues as IIAs and more than half of the laws provide access to international arbitration."[91]

The explanation for this strategy of keeping and promoting the international investment system as it is can also be analysed from different perspectives. One could think that countries that keep the system as it is are doing so because they were not yet affected as much by the disputes; contrary to countries that have taken some form of action like Argentina, Bolivia, Ecuador or Venezuela. However, this view cannot be upheld since almost all countries in the region have experienced investment disputes,[92] and furthermore, as the previous sections showed, they were well aware of the problems, of which they were informed at their regional institutions, like UNASUR.

On a different perspective, Gruber (2000) has claimed that countries will acquiesce to regimes because they know that otherwise the system will proceed without them.[93] However, this is not the only way for states to act and it is proven by the existence of the strategy of replacing the system with other institutions subject to the host countries' regional organization.

Therefore, an alternative explanation of why countries follow this strategy might have to do with the financial dimension of structural power as interpreted by Strange (1988). The ability of controlling the supply and distribution of credit takes part in shaping outcomes.[94] Evidence of these sort of interactions have been present since the creation of the framework for international investments and continues to be a factor in the present. Many of the credits from international financial institutions to host countries are coupled to promoting investment policies in those host countries.[95] This explains how this situation would affect the host country decision towards preferring such a strategy as it is a source of revenue.

Reflecting on this strategy, keeping things as they are, we find that whether the claims are submitted pursuant to a treaty, a contract or a law to an international arbitration tribunal, the tribunal is bound to consider the international investment treaty between the parties as an applicable law. Not changing the crucial provisions in such treaties does not mitigate the risk of future frivolous disputes that, as the South American concluded investment disputes showed, have ended up in international arbitration and resulted in having the effect of restricting the ability to regulate for host states (see section 1).

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[91] UNCTAD, 'Investment Laws: A Widespread Tool for the Promotion and Regulation of Foreign Investment' *Investment Policy Monitor* (22 November 2016)

[92] The two exception are Brazil and Suriname. See UNCTAD Investment Disputes database and ICSID cases database.

[93] Lloyd Gruber *Ruling the World: Power Politics and the Rise of Supranational Institutions* (Princeton University Press 2000)

[94] Strange 1988

[95] Baccini and Urpelainen (2015) pointed out the "2003 IMF approved a standby agreement worth us$2.1 billion intended to bolster Colombia's economic program until 2004"that created the climate for FTAs. Leonardo Baccini and Johannes Urpelainen Cutting the Gordian Knot of Economic Reform When and How International Institutions Help (Oxford University Press 2015) p210; see also Maria A. Gwynn 'South American Countries' Bilateral Investment Treaties: A Structuralist Perspective' (2015) 6 Journal of International Dispute Settlement 1, 97-117.

The rules contained in investment treaties, most of which were signed in the 1990s, do not prevent frivolous claims to be submitted to international arbitration. If these rules are left unchanged, countries risk having the same kind of disputes, as it is the same kind of rights and obligations that are going to be enforced. The Philips Morris case against Uruguay, for establishing a health warning, is a recent case that shows that these risks persist.

3. A Fourth Strategy: Active Participation in the Changes and Evolution of the current International Investment System

The current international investment framework has fulfilled its protective aim for which the rules were designed for: it guarded investors from discriminatory actions regarding expropriations. However, the enforcement of the early versions of investment treaties also show that there have been unintended effects that result in sovereignty costs for host states in the form of restrictions to regulate. In order to diminish these sovereignty costs, what has to change are the rules.

Considering that none of the aforementioned strategies involves an action that effectively modifies the deficient rules of the investment treaties, i.e. those that have caused a restriction to regulate, and considering that protection against discriminatory actions is still needed, I shall put forward a fourth strategy. The strategy is to *actively participate in the evolving trend of changing and improving the existing rules.*

Currently, the rules of the investment framework are indeed changing: the European Commission comments on the dispute settlement mechanism of investor-state disputes and states that frivolous claims should be avoided by modifying the provisions of their agreements.[96] In many of the negotiations of modern investment treaties, the most important changes are pertaining to the two main clauses of investment treaties: expropriations and the dispute settlement mechanism. If we compare the investment treaties that South American countries have signed in the 1990s and early 2000s to newer versions of international investment agreements, one can see how these rules are changing.

Let us take a closer look at the expropriation provision first. BITs established in the 1990s did not contain exclusions on the expropriation clause. As early as 2012 exclusions of regulatory activities from what constitutes expropriation start to appear. For example in the latest 2012 US BIT model, it is specifically mentioned that state activities protecting the 'legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations'. In 2016, the EU-Canada Comprehensive Economic Trade Agreement (CETA), explicitly established an article for the right to regulate in the areas of public health, safety, the environment, public morals, social or consumer protection or the promotion and protection of cultural diversity. It further explicitly excluded from the concept of expropriations non-discriminatory measures that are applied to protect legitimate public welfare objectives. Similarly, these same exclusions from the concept of indirect expropriation were recommended to be included in the investment chapter of the Transatlantic Trade and Investment Partnership (TTIP) under negotiation between the US and the EU. (See Appendix A for the evolution of expropriations clauses). If these provisions had been in place in the BITs that South American countries had signed in the 1990s and 2000s, then many of the problematic cases that led South American countries to react

[96] European Commission "Investment Protection and Investor-to State Dispute Settlement in EU agreements' 2013; Also, recent suggestions in how to amend the system have introduced changes to allow the host state to counter sue the investor that violates investing in a sustainable manner in the host state. Views expressed in J. Anthony Van Duzer, Penelope Simons and Graham Mayeda Integrating Sustainable Development into International Investment Agreements. A Guide for Developing Country Negotiators (Commonwealth Secretariat 2013)

against the investment regime could not have been brought to arbitration by foreign investors.[97]

A similar development has taken place in the evolution of dispute settlement clauses: In the 1990s, Most Favoured Nation (MFN) was applicable to dispute settlement clauses.[98] Due to this, such clauses were named 'Frankenstein' treaties, because dispute settlement clauses agreed in third party treaties could be used in a dispute with another party.[99] In the 2012 US BIT Model, the MFN was excluded from use in dispute settlement clauses. It also included transparency provisions in investor-state dispute settlement clauses. The inclusion of transparency provisions in the arbitral process was pursued at different levels.[100] In 2016, CETA excluded the application of MFN treatment from dispute settlement clauses. It introduces a Permanent Tribunal with an Appeal mechanism, transparency, a conduct of proceeding and a code of conduct for arbitrators, and a fast track system for rejecting unfounded or frivolous claims. Also, in CETA the parties had agreed to pursue…"the establishment of a multilateral investment tribunal" (Art 8.29).[101] Similarly, in the negotiations between the EU and the US, the negotiators proposed to create an 'Investment Court' to make the dispute settlement mechanism evolve much further.[102] This would involve an appeal mechanism and non-state parties would have better access to the dispute settlement mechanism. (See Appendix A for the evolution of dispute settlement clauses).

Another very important change is the work of UNCITRAL, a UN body that introduced the UNCITRAL Transparency Rules in Investor State disputes in 2014.[103] The Mauritius Convention, another effort of the UNCITRAL's arbitration working group, is even more important.[104] The Mauritius Convention establishes that the latter transparency rules will be applied retroactively to all the investment treaties. In this way, the Mauritius convention acts as a meta-treaty to modify the existing treaties. Signing it is an easy and costless way for a state to modify the provisions of the existing treaties, so as to include transparency provisions in investor state arbitrations.[105]

[97] For example, a clear South American case that would not have reached the stage of international arbitration if such provisions were in place is the Phillip Morris case.

[98] Applied when for the same kind of relation indicated in the same kind of treaty, one country has an advantage, more preference or is placed in a more favourable situation as compared to other countries, then the country that is less favourable can claim MFN and benefit from the rights entitled to other countries under those same circumstances.

[99] Daniel Price 'Chapter 11-Private Party vs Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve' (2000) Can- US Law Journal 26: 107

[100] See UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration.

[101] A similar provision was also included in the EU-Vietnam- FTA.

[102] Sornarajah (2016), however, claims that an investment court will not cure the illegitimacy of investor-state dispute settlement. He stated that "The establishment of an Investment Court would dissociate that Court from democratic control" See Sornarajah, M. 'An International Investment Court: panacea or purgatory?' (2016) Columbia FDI Perspectives No. 180.

[103] UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration.

[104] Mauritius Convention or United Nations Convention on Transparency in Treaty-based Investor-State Arbitration. UN General Assembly Resolution 69/116.

[105] Mauritius Convention or United Nations Convention on Transparency in Treaty-based Investor-State Arbitration. UN General Assembly Resolution 69/116.

The changes mentioned here are not an exhaustive list of all that could be changed that affect actors in the framework[106] but they are a first step. Not every aspect of the investment treaty needs to be changed, just the parts that restrict host countries in their right to regulate. The effects of changing the rules in the aforementioned way are aimed at *diminishing* the sovereignty costs that result in the restriction to regulate for the country hosting the investment. This is done by specifically excluding the state's regulatory activities from what constitutes expropriation, by excluding MFN from the dispute settlement clause, by adding transparency in the arbitration process, and by proposing an improved system to solve disputes. When such rules containing these specific wordings are enforced, host states will no longer experience the degree of sovereignty costs that were derived from the enforcement of the earlier rules.

Thus, the fourth strategy a state could take is to actively participate in these changes, and to lend its support to them. It promises to be the best course of action because:

***It acknowledges historical developments of the international investment framework*:** Historically, the development of the rules of the international investment framework consisted of a dynamical and complex interaction that involved transnational relationships with many interests and many actors: states, corporations, international institutions, banks, communities.[107] What is important is that the initial rules agreed upon when the framework for international investment was formed *did not* envisage provisions promoting public interests, like health, environmental, security, financial; nor did they exclude state's regulations in these areas from the concept of expropriation in those treaties. It is these treaties that contained rules which lacked the inclusion of public interests in the rules that are being enforced. The enforcement of rules which reflect only one party's interests will irremediably have the consequence of resulting in unintended sovereignty costs for the other party, which in the cases of the area of investment disputes were reflected in the restriction to regulate for the host state. The economic shifts produce situations in which investors from emerging markets also invest in industrialised countries, and so it is no longer the case that only host countries from developing countries will be burdened with sovereignty costs in the form of restriction to regulate if the rules remain unchanged. [108]

[106] There is no mention for example of tax revenues and the role of international institutions in that regard, nor is there a contemplation about the impact of advances of technology (automatization) in this area.

[107] Before the rules were established in the current framework, on the one hand, there were private parties such as investors and bankers that were seeking more property protection and as these actors were mostly from industrialized countries, such countries supported those interests. The advancement of these interests in the rules were reflected in the propositions to establish the Hull principle as the principle to follow in cases of expropriation, and the detachment of disputes from domestic courts by the use of international arbitration. On the other hand, newly constituted countries and host countries to such investments were adamant in protecting their sovereignty and as such wanted to have their laws to govern foreign investments and disputes be resolved by their courts. Not only states, but also international institutions were involved in aiding the pursuit of these interests, but it was only states who could sign treaties, so the different interests were compacted under the state's interests. In this debated scenario, states reached an agreement and established the current rules in a bilateral rather than a multilateral way.

[108] This awareness is important, for "those who don't know history are doomed to repeat it" Quote by Edmund Burke (1729-1797)

The changes that are being proposed in new versions of Treaties with Investment Provisions (TIPs) reflect a more balanced approach to the interests of actors in the framework. They prioritize public interests, which is important for any country, powerful or weak. This is also why rather than restricting actions to regional efforts, cooperation on these issues could be achieved through multilateral institutional efforts.

***It considers interests of all actors of the international investment framework*:** All these changes are beneficial not only for host states but to every actor in the system. This is because the changes are only targeted at the provisions that have had the effect of restricting the right of a host state to regulate; the protective part is kept. Foreign investors can invest in a sustainable manner in host countries while relying on the fact that in case of discriminatory expropriations without compensation a neutral system to settle such disputes exists. Regional integration zones like the European Union and MERCOSUR can equally participate as entities in the framework. Host countries will no longer be prevented from regulating on matters that advance their policies towards the welfare of its people, and communities can also be reassured that, as a consequence, their interests are protected.

***It shows positive effects of aligning policies to that of the international system*:** Not all the investment disputes have caused sovereignty costs, many cases were settled.[109] This might point to situations in which the host government admits certain behaviour towards foreign investors in which their treatment was not guaranteed as stated in the treaty. Having an international treaty in place provides international standards which are necessary for actors that interact in a framework. Actors in their relation with one another can expect a certain practice and this provides certainty, which is crucial for establishing long term relationships that result from those interactions.

There are adjustments that might involve costs for actors, but countries might decide that the resulting benefits of the investment framework are worth the costs.[110] There are for example non-commercial spill-over effects of foreign practices that improve the host countries' domestic policies. For example, foreign investors have to comply with anti-corrupt domestic laws of their home state even when investing abroad. In the US, the Foreign Corrupt Practices Act or in the UK, the Bribery Act, form part of the compliance mechanism for foreign investors. When foreign firms conduct their businesses according to these laws, the domestic institutions of the host country emulate these practices in order to prevent corrupt practices. There is also another example in which an investment treaty was used to overcome corrupt practices. In an investment dispute against Peru, it was thanks to the investment treaty that the arbitral tribunal favoured the host state's action of terminating the contract with a foreign investor, after obtaining evidence that the investor had previously bribed the domestic court to continue with an activity that polluted the environment. In such

[109] For instance, in 13 nationalization cases against Bolivia, Bolivia settled 12 claims. Similarly, in its 17 nationalization cases against Venezuela, Venezuela settled 12 claims. See Maria A. Gwynn 'Investor-State Disputes in South America' GLF Working Paper

[110] Even though there might be different ways of analysing economic results, Baccini and Urpelainen (2015) for example claim that treaties like Preferential Trade Agreements actually promote positive policies in developing countries, and the respective countries may appreciate these more than the associated costs. Leonardo Baccini and Johannes Urpelainen Cutting the Gordian Knot of Economic Reform When and How International Institutions Help (Oxford University Press 2015)

way, the submission of such dispute to international arbitration benefited the welfare of the citizens in the host country.[111]

The same applies for labour conditions. For example, some modern versions of TIPs or BITs state in their preamble that they aim to 'promote respect for internationally recognized worker rights'. Any contrary practice, thus, was prohibited.[112] Bolivia, in spite of having ratified all of the International Labour Organization fundamental conventions, during the Presidency of Evo Morales in 2012, terminated many BITs, some of which stated those aims in its preamble. Bolivia then enacted laws authorizing child labour with parental permission.[113] It is now a common practice in that country for children as young as 10 years old to work and be part of the labour force in some industries. Terminating treaties with these obligations not only fail to restrain the use of such labour but it also makes Bolivia the only country in the world that has implemented such a practice in a Code for Children, a situation that goes against standards of the international labour community.[114] These issues should also be a red flag for states when encouraged to agree to treaties that do not contain the minimum international standards.[115]

***It promotes Institutional Cooperation*:** Gruber (2000) refers to winners and losers in the international system and has stated that the losers cooperate because they do not want to be left out of the game, even though they dislike this cooperation. However, we have to consider the new capabilities that the structures of the international regimes give to actors. International institutions as well as international treaties are part of these structures and have embedded in them the values belonging to the actors that created such structures. As structures in their own right they generate capabilities for any actor. Therefore, actors of an international system continue to seek actions at international institutions because they benefit from them. Thus there is an incentive to do so.[116] Some examples of how these structures have benefited actors can be seen in what was discussed by Krasner (1985). By analysing north-south relations of industrial and developing countries at the UN during the

[111] The case concerned a pasta factory owned by a Chilean investor, which was polluting an environmentally protected zone. In spite of the Peruvian's Environmental Protection Agency demands to the investor to stop its polluting activity which were in breach of the environmental impact analysis, the investor disputed such measure at the domestic court, where allegedly through bribery, obtained a measure to continue their production activity but that meant a continuance of polluting the zone. The state authorities in evidence of the pollution terminated the contract with the investor. The investor then sued the host state submitting the claim to international arbitration. The arbitration tribunal, due to the bribery evidence presented, issued an award in favour of the host state in the matter. Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. (formerly Empresas Lucchetti, S.A. and Lucchetti Perú, S.A.) v. Republic of Peru (ICSID Case No. ARB/03/4).

[112] See for example the US BITs with Argentina, Bolivia and Ecuador. See Maria A. Gwynn *Power in the International Investment Framework* (Palgrave Macmillan 2016) p 98

[113] The age for children allowed to work starts at 10 years old. Code for Children and Adolescents, Law No. 548, of 17 July 2014 published in the Official Gazette of the Government of Bolivia on 23 July 2014, deals with the "Right to protection of the child and adolescent at work" (Chapter VI).

[114] The International Labour Organization and Human Rights activists have requested a revision of such measure. See ILO's statement issued on July, 28, 2014 at http://www.ilo.org/ipec/news/WCMS_250366/lang--en/index.htm (Last accessed 12 Dec, 2016)

[115] China, for example, seeks relationships with developing countries and use of their resources but their agreements do not include any diffuse interests like labour, environment, etc. Although China sells this as advantageous in their competition to agreements of the US or the EU because it focuses just on the financial dimension, one should be cautious as these are not advancing development while the resources are exploited.

[116] Maria A. Gwynn 'Structural Power and International Regimes' GLF Working Paper

1970s, Krasner points out how institutional settings such as the UN provided meta-power to some actors (specifically third world countries) that allowed them not only to counteract asymmetries when compared to industrialised countries but also for giving them the ability to change the rules.[117] Davis (2006), looking at the WTO setting, has also argued that the institutional context levels the playing field for developing countries.[118] Similarly, by analysing the attempts to regulate foreign investment rules at the UN and WTO it was concluded that a multilateral setting will be more advantageous for establishing investment rules.[119] Furthermore, it is worth considering the capabilities that are generated by institutional and legal structures especially at times of global development that involve the rise of constitutional autocrats. Actors of the international system might face an increased demand for, and reliance on, an international treaty and its enforcement mechanism, which conforms to international standards and solves disputes under fair terms by an impartial transnational dispute resolution institution.

The proposed changes involve an alternation of behaviour but in the attempts made by actors to adjust their policies to each others' objectives there is cooperation; and in this process, regimes 'facilitate further efforts to coordinate policies'.[120] This does not mean that cooperation will go smoothly; indeed cooperation can be conflictual, as Keohane (1984) emphasized. But it is precisely the ability of a state to adjust to altering conditions one of the things that characterizes the evolving international system.[121] Thus, if this strategy of actively participating in changing the rules is pursued successfully, then those who cooperate with each other to bring it about will be the winners. Better yet, the system in this policy issue area has the potential to overcome the entire dialectic that there have to be winners and losers.

[117] Stephen Krasner *Structural Conflict. The third World Against Global Liberalism* (University of California Press 1985)

[118] Christina Davis 'Do WTO Rules Create a Level Playing Field for Developing Countries? Lessons From Peru and Vietnam' In John Odell ed. *Negotiating Trade: Developing Countries in the WTO and NAFTA* (Cambridge University Press, 2006)

[119] Maria A. Gwynn Power in the International Investment Framework (Palgrave Macmillan 2016)

[120] Robert Keohane After Hegemony Princeton (Princeton University Press 1984); p52-57

[121] John W. Burton *International Relations. A General Theory* (Cambridge University Press 1965)

4. Conclusion

In sum, I discussed the strategies currently employed by South American states in reacting to the current system of international investment. These strategies have been to abandon the system entirely, to keep the system as it is, or to replace it by something much more regional. I argued that none of these strategies will lead to the best possible outcome, especially for South American states. Instead, they should take part in and cooperate towards bringing about the changes currently under discussion.

All these changes need *active* participation to be implemented. Most changes are applied in new versions of International Investment Agreements (IIAs), and for them to have an effect on earlier versions of BITs in force, state action will still be required to pursue and adapt the changes that improve the system. The current developments at UNCITRAL, especially with the Mauritius Convention, show how improving changes can be implemented.[122] Countries must actively participate and ratify such treaties, or entertain the possibility of agreeing on something multilaterally that follow these changes. It is an easy and costless way for a state to modify the provisions of the existing treaties, as it is for them to improve provisions in investor state arbitrations, avoid the unintended effects and participate in the evolution of the system into something much more balanced, inclusive and with an investment arbitration system that is in accordance with sustainable development.

The worst scenario is that industrialized countries sign improved IIAs with one another, benefit from mutual investments without suffering from sovereignty costs, while South American countries are left behind because they decided to go for one of the first three strategies. Instead, they should join the forefront of countries aiming at changing the investment regime, so as to keep all the advantages of the old treaties, but severely reduce the disadvantages, sovereignty costs in particular. The changes, once implemented, can provide certainty and security for international commercial relations, which will entail a relationship that is likely to have more beneficial long term effects, and as such will be more propitious for *all* the actors in the framework.

[122] UN, 'Settlement of commercial disputes: presentation of a research paper on the Mauritius Convention on Transparency in Treaty-based Investor-State Arbitration as a possible model for further reforms of investor-state dispute settlement' Submitted by the Secretariat on 24 May 2016 for the Commission on International Trade Law Forty-ninth session New York, 27 June-15 July 2016. A/CN.9/890

Appendix A. Foreign Investment Provisions' Evolution in Expropriations and ISDS clauses

EXPROPRIATION AND COMPENSATION (extracts from the provisions)	
SA BITS with the US (dated around the 1990s)	Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization ('expropriation-) except for a public purpose; in a non-discriminatory manner; **upon payment of prompt, adequate and effective compensation**
2012 Latest US BIT model	1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) **on payment of prompt, adequate, and effective compensation** and (d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment](1) through (3). **ADDED:** -Clarification for fair market value; excludes compulsory licenses granted in relation to intellectual property rights. -[Expropriation] shall be interpreted in accordance with Annexes A and B. Annex B:… **non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.** -Separate articles on Investment and Environment and Labour
CETA	A Party shall not nationalise or expropriate a covered investment either directly, or indirectly through measures having an effect equivalent to nationalisation or expropriation ("expropriation"), except: (a) for a public purpose; (b) under due process of law; (c) in a non-discriminatory manner; and (d) **on payment of prompt, adequate and effective compensation**. **ADDED:** -Clarification for fair market value; excludes compulsory licenses granted in relation to intellectual property rights; -Affected investor shall have the right, **under the law of the expropriating Party**, to a prompt review of its claim, by a judicial or other independent authority. - the revocation, limitation or creation of intellectual property rights to the extent that these measures are consistent with TRIPS, do not constitute expropriation. - Article 8.9 **right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity.** - Annex 8-A: For greater certainty, except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, **non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations.**
TPP propositions (2016)	No Party shall expropriate or nationalise a covered investment either directly or indirectly through measures equivalent to expropriation or nationalisation (expropriation), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on **payment of prompt, adequate and effective compensation** and (d) in accordance with due process of law **ADDED:** -Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner **sensitive to environmental, health or other regulatory** objectives.

TTIP propositions (2016)	Neither Party shall nationalize or expropriate a covered investment either directly or indirectly through measures having an effect equivalent to nationalisation or expropriation (hereinafter referred to as 'expropriation') except: (a) for a public purpose; (b) under due process of law; (c) in a non-discriminatory manner; and (d) **against payment of prompt, adequate and effective compensation.** **ADDED:** -Clarification for fair market value; excludes compulsory licenses granted in relation to intellectual property rights; - the revocation, limitation or creation of intellectual property rights to the extent that these measures are consistent with TRIPS and Chapter X (Intellectual Property) of this Agreement, **do not constitute expropriation.** -ANNEX I: Expropriation …. **non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity do not constitute indirect expropriations.**

INVESTOR-STATE DISPUTE SETTLEMENT MECHANISM	
SA BITS with the US (dated around the 1990s)	1. Amicably, 2. Consultation or Negotiation, 3. Local Courts, or 4. International Arbitration (ICSID or UNCITRAL) Allowed use of MFN for IDS clause.
2012 Latest US BIT model	1.Consultation and Negotiation, 2. Arbitration (ICSID or UNCITRAL). Clarifies on standards for consent, selection and conduct of arbitrators. Excluded: Local Courts, MFN from IDS; Added: Transparency
CETA	1.Consultation 2.Mediation 3.Permanent Investment Tribunal: 15 member nominated by the EU and Canada. ICSID, UNCTIRAL rules. Support of ICSID Secretariat. 4. Appellate Tribunal Excluded: MFN for IDS clause; claims if the investment has been made through fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process; parallel proceedings at domestic courts and the tribunal. **ADDED** -The Parties shall pursue with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes. -Rules on the conduct of investment dispute settlement proceedings and Code of Conduct for Arbitrators and -Mediators -Transparency -Fast track system for rejecting unfounded or frivolous claims
TPP propositions (2016)	1.Consultation and Negotiation 2.Arbitration (ICSID or UNCITRAL) Excluded: MFN from the dispute settlement mechanism **ADDED** -Transparency
TTIP propositions (2016)	1. Investment Court System. 15 judges (5 each nationality, 5 third party) Appeal mechanism with 6 panellists.

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