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INVESTOR-STATE DISPUTE SETTLEMENT: BACK TO THE BASICS

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I. INTRODUCTION

Investor-state dispute settlement ("ISDS") clauses are a current staple of many international investment treaties between states.[1] ISDS clause are a "procedural mechanism that allows an investor from one country to bring arbitral proceedings directly against the country in which it has invested."[2] The initial purpose of these clauses was to provide protections to foreign investors from discrimination or expropriation by host state governments.[3] Ideally, such protections would incentivize capital investment in foreign states, especially in developing nations or economies that want to attract foreign investment.[4] But in recent years, ISDS provisions have become controversial because corporations are arguably misusing them for unjustifiable multimillion-dollar government payouts.[5]

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[1] Valentina Vadi, *Inter-Civilizational Approaches to Investor-State Dispute Settlement*, 42 U. PA. J. INT'L. L. 737, 740 (2021). Countries are commonly referred to as "states" in the international context, and this Comment follows that convention.

[2] PRAC. L. GLOSSARY, THOMSON REUTERS, INVESTOR-STATE DISPUTE SETTLEMENT (ISDS) (2022), Westlaw 0-624-6147.

[3] *See id.*; *The Arbitration Game*, ECONOMIST, Oct. 11, 2014, https://www.economist.com/finance-and-economics/2014/10/11/the-arbitration-game.

[4] David R. Sedlak, Comment, *ICSID's Resurgence in International Investment Arbitration: Can the Momentum Hold?*, 23 PENN. ST. INT'L. L. REV. 147, 148–49 (2004).

[5] *See, e.g.*, SHINEY VARGHESE, INVESTOR-STATE DISPUTE SETTLEMENT: MILESTONE AROUND THE RIGHT TO WATER? 5 (2017), https://www.iatp.org/sites/default/files/2017-12/2017_12_11_ISDSWaterRights_SV_f_0.pdf. In an ISDS proceeding brought against Ecuador, the American company Occidental Oil Corporation received one of the largest payouts to date in the sum of $2.4 billion dollars, despite the fact that Occidental breached the oil contract with the Ecuadorian government. Lori Wallach & Ben Beachy, Occidental v. Ecuador *Award Spotlights Perils of Investor-State System*, PUB. CITIZEN (Nov. 21, 2012), https://www.citizen.org/wp-content/uploads/oxy-v-ecuador-memo.pdf. Another example involves the German government's decision to quickly shut down its nuclear power industry after the 2011 Fukushima disaster in Japan. Subsequently, Vattenfall, a Swedish utility, filed an ISDS proceeding against Germany demanding compensation for $4.7 billion dollars for lost revenues because Vattenfall operated two nuclear plants in Germany. *The Arbitration Game*, *supra* note 3. According to the United Nations' Investment Dispute Settlement Navigator, Germany was able to settle the ISDS case for $1.7 billion. *Vattenfall v. Germany (II)*, UNCTAD INVEST. POL'Y HUB, https://investmentpolicy.unctad.org/investment-dispute-settlement/cases/467/vattenfall-v-germany-ii- (last visited Apr. 15, 2022). This settlement was in addition to Vattenfall winning its domestic case brought in German courts as well. *Vattenfall Wins Case Against German Nuclear Phaseout*, DEUTSCHE WELLE (Nov. 12, 2020), https://www.dw.com/en/vattenfall-wins-case-against-german-nuclear-phaseout/a-55572736. These two examples illustrate the controversy of the ISDS system allowing massive payouts from governments to private companies in the wake of government

Generally, foreign corporations invoke arbitration under ISDS provisions in response to routine legislation or regulations by the host government.[6] This invocation gives foreign investors the opportunity to intrude on host governments' sovereignty.[7] Under the North American Free Trade Agreement ("NAFTA"), which has been replaced with the United States-Mexico-Canada Agreement ("USMCA"), foreign corporations frequently challenged environmental, safety, and health laws—a significant reason why ISDS provisions are so controversial.[8] Foreign investors usually obtain multimillion-dollar judgments against host governments when they win ISDS challenges.[9] However, even when claims are dismissed or host governments win disputes, host governments still foot the bill for defending themselves in ISDS actions.[10]

Why ISDS is controversial is not complicated: large international corporations effectively have the power to challenge environmental, safety, and health laws that are in the public interest as decided by elected officials.[11] Most of the time, corporations will choose to file ISDS challenges because newly implemented laws will cost the corporation more money than they originally planned to spend in the foreign state in order to comply with the new laws.[12] Although ISDS clauses are common amongst international agreements, they create a unique set of circumstances because domestic companies cannot

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action. For additional discussion on the practical problems presented by ISDS, see Elizabeth Warren, *The Trans-Pacific Partnership Clause Everyone Should Oppose*, WASH. POST: OP. (Feb. 25, 2015), https://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html, as well as Danielle Kurtzleben, *Why Elizabeth Warren is Declaring War on an Obscure Trade Policy*, VOX (Feb. 28, 2015), https://www.vox.com/2015/2/28/8124057/investor-state-dispute-settlement-elizabeth-warren.

[6] Nikesh Patel, Note, *An Emerging Trend in International Trade: A Shift to Safeguard Against ISDS Abuses and Protect Host-State Sovereignty*, 26 MINN. J. INT'L L. 273, 279–80 (2017).

[7] *Id.*

[8] PUB. CITIZEN, TABLE OF FOREIGN INVESTOR-STATE CASES AND CLAIMS UNDER NAFTA AND OTHER U.S. "TRADE" DEALS 2 (2018), https://mkus3lurbh3lbztg254fzode-wpengine.netdna-ssl.com/wp-content/uploads/investor-state-chart-aug-2018.pdf (hereinafter NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS).

[9] *See, e.g.*, PUB. CITIZEN, NAFTA CHAPTER 11 INVESTOR-TO-STATE CASES: BANKRUPTING DEMOCRACY iv–v (2001), https://www.citizen.org/wp-content/uploads/acf186.pdf.

[10] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 54 n.3.

[11] *See More Information on Investor-State Dispute Settlement*, PUB. CITIZEN, https://www.citizen.org/article/more-information-on-investor-state-dispute-settlement/ (last visited Apr. 16, 2022).

[12] *See id.*

directly challenge domestic laws the way that ISDS enables foreign investors to challenge domestic laws via arbitration.[13] Instead, domestic companies must comply with their state's laws, regardless of the compliance cost or the extent to which the laws change the "expected investment environment."[14] Although "[e]xpectations stand just short of rights in the legal order[,]"[15] it seems foreign investors have inadvertently been given a windfall in the form of ISDS provisions to challenge host governments on legislation that has the potential to negatively impact their foreign investment.

Many prominent public figures, government officials, and international organizations have spoken out against the inclusion of ISDS clauses in United States ("U.S.") agreements.[16] Former U.S. Trade Representative Robert E. Lighthizer testified at a House Ways and Means Committee Hearing regarding U.S. Trade Policy Agenda on ISDS, stating:

> [ISDS] clearly is a balance. There is a legitimate interest in people who go overseas and invest, and the United States has an obligation to do what it can to make sure those people are treated fairly. On the other hand . . . I am troubled by the sovereignty issue. I am troubled by the fact that anyone, anyone can overrule the United States Congress and the President of the United States

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[13] *See* NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 4.

[14] Lise Johnson, *A Fundamental Shift in Power: Permitting International Investors to Convert their Economic Expectations Into Rights*, UCLA L. REV. DISCOURSE (Feb. 2018), https://www.uclalawreview.org/fundamental-shift-in-power/.

[15] *Id.*

[16] *See* PUB. CITIZEN, SELECTED STATEMENTS AND ACTIONS AGAINST INVESTOR-STATE DISPUTE SETTLEMENT (ISDS) (2018), https://www.citizen.org/wp-content/uploads/isds-quote-sheet.pdf. For example, U.S. Supreme Court Chief Justice John Roberts dissented in *BG Grp. PLC v. Republic of Argentina*, 572 U.S. 25, 49 (2014), stating:

> Indeed, "granting a private party the right to bring an action against a sovereign state in an international tribunal regarding an investment dispute is a revolutionary innovation" whose "uniqueness and power should not be overlooked." That is so because of both the procedure and substance of investor-state arbitration. . . . Substantively, by acquiescing to arbitration, a state permits private adjudicators to review its public policies and effectively annul the authoritative acts of its legislature, executive, and judiciary.

Id. at 56–59 (citations omitted).

when it has passed a law.[17]

While there has been no ISDS challenge to the U.S. that has resulted in Lighthizer's concerns,[18] Australia unfortunately provides a prime illustration. The ISDS provision in the Australian-Hong Kong free trade agreement led to Australia's battle with Philip Morris International ("Philip Morris") over plain packaging laws.[19] This dispute received international attention and cost the Australian government—and, thus, Australian taxpayers—millions of dollars only because plain packaging laws would have hurt Philip Morris's revenues in the country.[20] Australia's case is discussed in further detail in Part II.[21]

This Comment explains how ISDS morphed from an international investment protection mechanism into an intrusive tool used by corporations to challenge states' sovereignty in order to maximize profits. To conduct this explanation, Part II first examines the genesis and original purpose of ISDS clauses in international investment agreements. Next, it surveys modern ISDS issues and discusses two cases as examples. These cases illustrate how ISDS has given foreign investors the chance to circumvent host governments' legislation and regulations. Finally, this Comment argues for reform to the ISDS system by proposing to eliminate ISDS provisions in their entirety. However, recognizing the practicable unlikeliness of that solution, this Comment also proposes revisions to ISDS clauses that attempt to solve modern issues created by ISDS provisions. Ideally, these revisions would aim to serve the original purposes of investment protections without allowing foreign companies a parallel set of privileged legal rights compared to domestic companies.[22]

II. BACKGROUND

To understand the transformation of the ISDS system, it is important to clarify the investment types for which ISDS clauses are applicable

[17] *Hearing on U.S. Trade Policy Agenda Before the Comm. on Ways & Means*, 115th Cong. 28 (2017) (statement of Robert E. Lighthizer, U.S. Trade Rep.).

[18] *Investment Dispute Settlement Navigator (Advanced Search)*, UNCTAD INVEST. POL'Y. HUB, https://investmentpolicy.unctad.org/investment-dispute-settlement/advanced-search (last visited Apr. 18, 2022).

[19] Patricia Ranald, *When Even Winning is Losing. The Surprising Cost of Defeating Philip Morris Over Plain Packaging*, CONVERSATION (Mar. 26, 2019, 1:57 PM), https://theconversation.com/when-even-winning-is-losing-the-surprising-cost-of-defeating-philip-morris-over-plain-packaging-114279.

[20] *Id.*

[21] *See infra* pp. 17–20.

[22] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 1.

and to review the history of international investment protection, as ISDS was not always a tool used by corporations to challenge government actions. This Part will provide context on types of foreign investment and a history of international trade agreements before detailing two ISDS cases as examples.

A. Foreign Direct Investment and Developing States

ISDS clauses and provisions concern a certain category of capital investment in countries, not just any foreign stocks or securities. Specifically, ISDS is meant as a trade protection mechanism for foreign direct investment ("FDI"), which describes situations when investors, including companies, export domestic capital to foreign states to build enterprises over which they have control.[23] This is not the same as foreign portfolio investment ("FPI"), which concerns investor-purchased securities that are easily bought and sold on a market.[24] The main difference between FDI and FPI is the degree of liquidity.[25] FPI may be sold and bought on open markets or stock exchanges.[26] On the other hand, FDI is an investor or company owning real property, such as a warehouse or manufacturing plant, for business operations in another state.[27] ISDS provisions are primarily based on FDI.[28]

While FDI's efficacy and benefits have been debated, FDI is generally seen as an integral part of developing states' ascension up the economic development ladder.[29] Jeffrey Sachs, an American economist and Director of the Center for Sustainable Development at Columbia University, is an expert on sustainable development, economic

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[23] *What is 'Foreign Direct Investment'?*, OUR ECON., https://www.ecnmy.org/learn/your-world/globalization/foreign-direct-investment/ (last visited Mar. 2, 2022).

[24] *What Are the Pros and Cons of Foreign Direct Investment and Foreign Portfolio Investment?*, MOTLEY FOOL (Mar. 22, 2016, 8:42 PM), https://www.fool.com/knowledge-center/foreign-direct-investment-vs-portfolio-investment.aspx. An example of FPI is investing "money into another country's stock market," just as investors buy and sell stocks on the New York Stock Exchange. *Id.*

[25] *Id.*

[26] George Mathew, *FPIs Adopt Contrarian Game Plan: Invest in IPOs, Sell in Stock Market*, INDIAN EXPRESS, https://indianexpress.com/article/business/market/fpis-adopt-contrarian-game-plan-invest-in-ipos-sell-in-stock-market-7634582/ (last updated Nov. 22, 2021).

[27] *What is 'Foreign Direct Investment'?*, *supra* note 23.

[28] Lindsay Oldenski, *What Do the Data Say About the Relationship Between Investor-State Dispute Settlement Provisions and FDI?*, PETERSON INST. FOR INT'L ECON. (Mar. 11, 2015, 1:00 PM), https://www.piie.com/blogs/trade-investment-policy-watch/what-do-data-say-about-relationship-between-investor-state.

[29] *What is 'Foreign Direct Investment'?*, *supra* note 23.

development, and poverty.[30] In his book, *The End of Poverty*, Sachs constructed the idea of the economic development ladder:

> If economic development is a ladder with higher rungs representing steps up the path to economic well-being, there are roughly one billion people around the world, one sixth of humanity, who live as . . . the "poorest of the poor," or the "extreme poor" of the planet. They all live in developing countries[.][31]

As such, Sachs's call-to-action is:

> [T]o help the poorest of the poor to escape the misery of extreme poverty so that they may begin their own ascent up the ladder of economic development. The end of poverty, in this sense, is not only the end of extreme suffering but also the beginning of economic progress and of the hope and security that accompany economic development.[32]

On the other hand, developed states typically have relatively high levels of economic growth and security.[33] The line between developing and developed states is typically drawn by benchmark measures such as income per capita, per capita gross domestic product, industrialization levels, the standard of living, and the degree of technological infrastructure.[34]

Originally, FDI was thought of as flowing primarily from developed

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[30] *University Professor Jeffrey D. Sachs*, COLUM. CLIMATE SCH., https://people.climate.columbia.edu/users/profile/jeffrey-d-sachs (last visited Apr. 16, 2022).

[31] JEFFREY D. SACHS, THE END OF POVERTY 18 (2d ed. 2015).

[32] *Id.* at 24.

[33] Christina Majaski, *Developed Economy*, INVESTOPEDIA, https://www.investopedia.com/terms/d/developed-economy.asp (last updated Mar. 14, 2022).

[34] *Id.* The United Nations Department of Economic and Social Affairs keeps a list of the Least Developed Countries, which the United Nations describes as "low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets." Currently, there are forty-six countries on this list, and the list is reviewed every three years by the department's Committee for Development. *Least Developed Countries (LDCs)*, UNITED NATIONS, https://www.un.org/development/desa/dpad/least-developed-country-category.html (last visited Apr. 12, 2022).

to developing states, but that assumption has grown less reliable.[35] Today, FDI flows in a multitude of directions, which is partly why ISDS became problematic for both developed and developing states.[36] Developed states have companies that possess knowledge, skills, and technology that developing nations do not have.[37] FDI allows not only for the flowing of capital but also for critical aspects of development.[38] Developing states benefit from foreign companies training their workforces, which can have spillover effects into domestic companies as those trained workers change jobs and bring their new expertise with them.[39] The International Monetary Fund generally supports FDI, stating that its benefits generally outweigh its potential downsides.[40] "Capital inflows from foreign direct investors help finance a country's spending—on investment, for example—and increase tax revenue, create jobs, and produce other positive spillovers for the host economy."[41]

Because FDI is an important component of developing states making their way up the development ladder, ISDS as an investment protection mechanism that safeguards FDI was seen as a necessary measure. However, today ISDS is no longer seen as a necessary measure for protecting FDI. In fact, ISDS may be hurting states that acquiesced to ISDS provisions—with hopes of attracting FDI—instead of protecting them.

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[35] Tadeusz Galeza & James Chan, *What is Direct Investment?*, INT'L MONETARY FUND, https://www.imf.org/external/pubs/ft/fandd/basics/20_direct-invest.htm (last visited Mar. 2, 2022).

[36] *See generally* Raphael Lencucha, *Is It Time to Say Farewell to the ISDS System?*, 6 INT'L. J. HEALTH POL'Y. & MGMT. 289 (2017), https://www.ncbi.nlm.nih.gov/pmc/articles/PMC5417151/pdf/ijhpm-6-289.pdf. A brief example of how ISDS is problematic for developing states is how Togo, a small West African country with annual GDP of $5.3 billion, was threatened with an ISDS proceeding by Philip Morris International, a tobacco corporation with $100 billion in annual revenues, to abandon cigarette plain packaging laws. GLOB. JUST. NOW, ISDS FILES: PHILIP MORRIS V. AUSTRALIA 2 (2019) https://www.globaljustice.org.uk/sites/default/files/files/resources/isds_files_philip_morris_web.pdf.

[37] *What is 'Foreign Direct Investment'?*, *supra* note 23.

[38] *Id.*

[39] *Id.*

[40] Galeza & Chan, *supra* note 35.

[41] *Id.*

B. History of Real Property Investment Protection in Treaties

1. The Eighteenth Century through Post-World War I Era

Provisions in international agreements relating to property protection date back to the late 1700s.[42] These international agreements were called treaties of Friendship, Commerce, and Navigation ("FCN") and had an overarching emphasis on establishing general commercial relations between states.[43] FCNs covered a significant amount of topics including human rights, taxation, and investment protection.[44] A typical FCN guaranteed that the treaty states would enjoy certain legal and economic rights across the spectrum of covered topics[45] and generally included provisions protecting investors' property located in another state's territory.[46] Property protection required compensation for expropriation or nationalization of a foreign national's property.[47] While these property protections were generally present in FCNs, they were "clearly secondary in importance to the creation of commercial relations."[48] Additionally, these treaties focused on the protection of individuals' real property, such as an individual owning a home for personal use in a foreign state, as opposed to protection of FDI, which is commercial and business-oriented in nature.[49] The U.S. concluded its first FCN with France in 1778 and later entered into FCNs with the Netherlands, Sweden, Prussia, and Great Britain, which were all vital "to the success of the United States as an independent nation" and were "used primarily to obtain economic and political support from more powerful states."[50]

Accordingly, before the first World War, international investment protection was scarce due to the focus on individual property protection, and not commercial property protection.[51] FCNs did not include investment protection and, similarly, customary international law provided inadequate investment protection.[52] Customary international

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[42] Kenneth J. Vandevelde, *A Brief History of International Investment Agreements*, 12 U.C. DAVIS J. INT'L L. & POL'Y. 157, 158 (2005).

[43] *Id.* at 158, 161.

[44] John F. Coyle, *The Treaty of Friendship, Commerce, and Navigation in the Modern Era*, 51 COLUM. J. TRANSNAT'L. L. 302, 306–07 (2013).

[45] *Id.* at 311.

[46] Vandevelde, *supra* note 42, at 158–59.

[47] *Id.* at 159.

[48] *Id.* at 161.

[49] *Id.* at 158–59.

[50] Coyle, *supra* note 44, at 307.

[51] *See* Vandevelde, *supra* note 42, at 159. "The focus was on protecting property, as opposed to investment." *Id.*

[52] *Id.*

law imposed an international minimum standard treatment to investment, but some states disputed whether the international minimum standard applied to the treatment of foreign investment at all.[53]

Simultaneously, Latin American countries infamously adhered to the Calvo doctrine.[54] In regard to foreign investment, the Calvo doctrine provided that foreign investors "were only entitled to the treatment that the host country afforded to its own investors," which could be much less than the international minimum standard.[55] Thus, even when states managed to agree upon an international minimum standard, "the content of the standard was vague and arguably not particularly demanding."[56] The only formal protection mechanism customary law norms offered was espousal, which was not effective for several reasons and also involved politics between states, which resulted in the absence of a neutral avenue for investors to pursue claims.[57] Without consensus on an international standard, foreign investment protections practically did not exist in this era.[58]

In the years following World War I, the focus of FCNs shifted slightly because "[a]s the volume and scope of U.S. investments abroad expanded, the [U.S.] sought to include in its FCN treaties more detailed

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[53] *Id.* at 159–60. The international minimum standard is:

> [A] norm of customary international law which governs the treatment of aliens, by providing for a minimum set of principles which States, regardless of their domestic legislation and practices, must respect when dealing with foreign nationals and their property. While the principle of national treatment foresees that aliens can only expect equality of treatment with nationals, the international minimum standard sets a number of basic rights established by international law that States must grant to aliens, independent of the treatment accorded to their own citizens. Violation of this norm engenders the international responsibility of the host State and may open the way for international action on behalf of the injured alien provided that the alien has exhausted local remedies.

Catherine Yannaca-Small, *Fair and Equitable Treatment Standard in International Investment Law*, 8 n.32 (Org. for Econ. Coop. & Dev., Working Paper No. 2004/3, 2004).

[54] Vandevelde, *supra* note 42, at 159–60.

[55] *Id.* at 159.

[56] *Id.*

[57] *Id.* at 160. "Espousal is a mechanism whereby an injured national's state assumes the national's claim as its own and presents the claim against the state that has injured the national." *Id.* Reasons that espousal was ineffective include that the national's state did not have to espouse a claim, the claim may only be espoused after exhaustion of local remedies of the host state, and if a claim is espoused the injured national lost control over the claim to their own government. *Id.*

[58] *Id.* at 159–60.

provisions relating to property protection."[59] But no significant changes occurred in international investment protections until after the Second World War.[60]

2. *The Post-World War II Era*

Following World War II ("WWII"), the protection of property and U.S. foreign investments became the focus of increased global attention.[61] This was because the "promotion of American shipping was a major consideration" and "[a]fter the Second World War, the interests of investors tended to become predominant."[62] These post-war years saw a major increase in the amount of FCNs, as the U.S. negotiated more than twenty between 1946 and 1968.[63] Post-WWII FCNs still included property protection clauses that were present in pre-WWII FCNs, but they included two new aspects as well.[64] First, treaty provisions were expanded to cover corporate entities, whereas earlier protections in FCNs only provided protections to individuals.[65] Second, post-WWII FCNs included a dispute resolution provision where parties consented to the jurisdiction of the International Court of Justice over disputes involving the interpretation or application of the agreement.[66] ISDS provisions did not yet exist, but this dispute resolution provision was a precursor to ISDS and also furthered the ability of foreign investors to obtain a neutral avenue for claims arising from the agreement.[67] As Kenneth Vandevelde, an international economic law expert, pointed out:

> The inclusion of a dispute resolution provision solved the problem that a host state could not be subject to the jurisdiction of an international tribunal without its consent, though it did not relieve investors of the need to exhaust local remedies and to persuade their home state

[59] Coyle, *supra* note 44, at 308.
[60] *Id.*
[61] *Id.*
[62] *Id.* at 308 n.20.
[63] *Id.* at 308.
[64] Vandevelde, *supra* note 42, at 164–65.
[65] *Id.* at 164. "[P]ostwar FCN treaties differ from their predecessors in that they place greater emphasis on the right of establishment and the promotion of private foreign investment than on trade and shipping." Coyle, *supra* note 44, at 308 n.23.
[66] Vandevelde, *supra* note 42, at 165.
[67] *Id.* The main difference between this dispute resolution provision and ISDS is that ISDS dispute resolutions are administered by a small panel of arbitrators selected by the parties, whereas here the parties are consenting to the jurisdiction of the International Court of Justice. Coyle, *supra* note 44, at 315.

> to espouse their claim before pursuing a remedy under international law.[68]

Although the primary justification for these new FCNs and their new provisions "was to protect the property of U.S. investors abroad, they continued to address the broad range of issues that had historically been included in the FCN treaty."[69] Thus, foreign investment had gained some protections but was still not the primary focus of the agreements.[70]

In the meantime, the conclusion of the General Agreement on Tariffs and Trade ("GATT") marked an important turning point for the use of FCNs in post-WWII years.[71] The GATT "shifted the primary legal framework for international trade relations from bilateral to multilateral agreements[.]"[72] This shift made the GATT the main vehicle for international trade relations, thus diminishing FCNs' importance as bilateral trade relation agreements.[73] Amongst these new multilateral trade agreements, FCNs were increasingly "seen as less than ideal vehicles because they were primarily trade agreements and trade relations now were being negotiated principally through the GATT."[74]

Further, the Cold War also put a damper on the FCN program in the U.S.[75] Amidst the political tensions of the Cold War, states did not want to be seen as entering into "friendship" treaties with the U.S. during that time.[76] The last U.S. FCN treaty was between the U.S. and Thailand; it was ratified by the U.S. in 1967 and entered into force in 1968.[77] Between the Cold War, the GATT, and the shifting focus of the FCN's purpose, FCNs slowly became obsolete for establishing bilateral general commercial relations between states.[78]

Then, from the late 1960s to the early 1970s, an upsurge in foreign

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[68] *Id.* Vandevelde represented the U.S. before the International Court of Justice in The Hague and served as a treaty negotiator while working for the State Department Legal Adviser's Office, served as Dean of the Thomas Jefferson School of Law, and worked in the Obama White House as a policy analyst. *Kenneth J. Vandevelde*, THOMAS JEFFERSON SCHOOL OF LAW, https://www.tjsl.edu/directory/kenneth-j-vandevelde (last visited Apr. 16, 2022).

[69] Coyle, *supra* note 44, at 308.

[70] *See id.*

[71] *Id.*

[72] Vandevelde, *supra* note 42, at 162.

[73] *Id.*

[74] *Id.* at 166.

[75] Coyle, *supra* note 44, at 309.

[76] *Id.*

[77] *Id.* at 309, 359. "Although the United States negotiated no new FCN treaties after 1968, more than forty of these agreements remain in force today." *Id.* at 310.

[78] *Id.* at 309, 359; Vandevelde, *supra* note 42, at 162.

nationalizations took place, which directly led to the creation of the highly specialized bilateral investment treaty ("BIT").[79] The decolonialization process that started after WWII created many newly independent but economically undeveloped states.[80] These states were "fiercely protective of their independence and came to regard foreign investment as a form of neocolonialism because it involved foreign control over the means of production."[81] Particularly, FDI caused these states great concern "because it involve[d] a foreign presence in the territory of the developing country[.] "[82] Developing states feared that trade between developing states and developed states "would result in the exploitation of the [developing states]" to the advantage of the developed states.[83] This resulted in the closure of many newly independent and developing states' economies to foreign investment and the expropriation of existing foreign investment.[84] The expropriation of existing foreign investment was the direct impetus for the creation of the BIT and ISDS provisions.[85]

3. *Creation of the Bilateral Investment Treaty and ISDS*

Developed states created the BIT in response to these threatened and actual uncompensated expropriations.[86] BITs, still utilized today, are international agreements that establish "terms and conditions for private investment by nationals and companies of one state in another state."[87] The creation of the BIT and its ISDS provisions was simultaneously the death of the FCN treaty. BITs deal exclusively with investment protections and are considered the modern version of FCNs.[88] In developing a model BIT, the U.S. borrowed heavily from FCN investment provisions and then strengthened them even further or added more specificity.[89] BITs provided for, among other things, "the right to prompt, adequate and effective compensation in the event that one state nationalized" or expropriated property that nationals of the other state

[79] *Id.* at 309.
[80] Vandevelde, *supra* note 42, at 166.
[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] *Id.*
[85] Vandevelde, *supra* note 42, at 165–68.
[86] *Id.* at 168.
[87] *Bilateral Investment Treaty*, CORNELL LEGAL INFO. INST., https://www.law.cornell.edu/wex/bilateral_investment_treaty (last visited Apr. 16, 2022).
[88] *See* Coyle, *supra* note 44, at 327–29.
[89] *Id.* at 327.

owned.[90]

From the 1950s and into the 1980s, many states concluded their initial BITs with other states.[91] During this time period, BITs were primarily executed between developing and developed states.[92] The overarching point of the BIT was to protect developed states' investments in undeveloped states from expropriation, or to adequately compensate if expropriation occurred.[93] On the other hand, developing states participated in BITs to attract foreign investment by offering legal protections that would induce investment.[94]

Importantly, the dispute resolution mechanism in BITs was the birth of ISDS, which is significantly different from the mechanisms set out in the last FCNs.[95] While the last FCNs provided for disputes arising under them to be resolved by the International Court of Justice or some other jurisdiction that both parties agreed to, BITs include ISDS provisions that allow for foreign investors to initiate international arbitral proceedings directly against the state alleged to have violated the treaty provisions.[96]

An initial benefit of ISDS was the depoliticization of investor enforcement claims against states, which was an issue with espousal when trying to enforce international minimum standards for foreign investment.[97] The establishment of the International Centre for Settlement of Investment Disputes ("ICSID") in 1965 was intended to provide an available venue for administering arbitrations prompted by ISDS provisions.[98]

By the late 1980s, the number of BITs with these ISDS clauses dramatically increased for two reasons.[99] First, several Asian economies with high rates of private investment and exports had significant economic success that demonstrated the benefits of foreign investment to other developing economies—unlike developing states that had closed off their economies after WWII.[100] Second, the 1980s debt crises caused a lack of alternatives to foreign investment as a

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[90] *Id.* at 327–28.

[91] *See* Vandevelde, *supra* note 42, at 169–70. Germany was actually the first to conclude a BIT in 1959, signing two separate BITs: one with Pakistan and one with the Dominican Republic. France, Switzerland, the Netherlands, Italy, Sweden, Denmark, and Norway all followed suit, concluding BITs throughout the 1960s. *Id.*

[92] *Id.* at 170.

[93] *Id.*

[94] *Id.* at 170–71.

[95] Coyle, *supra* note 44, at 328.

[96] *Id.*

[97] Vandevelde, *supra* note 42, at 175.

[98] *Id.*

[99] *Id.* at 177.

[100] *Id.*

source of capital, which forced states to turn to foreign investment since they were unable to utilize other avenues for gaining capital.[101] Consequently, "[w]hile fewer than 400 BITs had been concluded in the thirty years from 1959 to 1989, during the next fifteen years some 2,000 BITs would be concluded."[102]

Ensuing this exponential increase in BITs, NAFTA came into effect in 1994.[103] NAFTA was a multilateral trade agreement that "gradually eliminated most tariffs and other trade barriers on products and services passing between the [U.S.], Canada, and Mexico," and created a free trade bloc among the three countries.[104] NAFTA also contained investment chapters, the first of its kind since the now-extinct FCNs that addressed both trade and investment topics.[105] Chapter 11 of NAFTA contained an ISDS clause, and agreements that contained trade *and* investment provisions became more frequent after NAFTA.[106]

Notably, Canada has completely withdrawn from the ISDS mechanism in the USMCA, an update to NAFTA that took effect in 2020.[107] This is despite the fact that NAFTA's investment chapter was updated and revised for the USMCA to reflect changes that try to address the issues that accompany ISDS.[108] Regarding future ISDS claims against Canada, its government must allow "legacy investment claims" under the USMCA for three years following the expiration of NAFTA, at which point Canada will no longer be subject to an ISDS

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[101] *Id.* at 177–78.

[102] Vandevelde, *supra* note 42, at 179. As of April 2022, a total of 2,794 BITs have been concluded with 2,227 currently in force and a total of 424 treaties with investment provisions have been concluded with 331 currently in force. *International Investment Agreements Navigator,* UNCTAD INVEST. POL'Y HUB, https://investmentpolicy.unctad.org/international-investment-agreements (last visited Apr. 17, 2022).

[103] North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 289 [hereinafter NAFTA].

[104] Peter Bondarenko, *North American Free Trade Agreement*, ENCYC. BRITANNICA, https://www.britannica.com/event/North-American-Free-Trade-Agreement (last updated Mar. 13, 2022).

[105] Vandevelde, *supra* note 42, at 179–80.

[106] *Id.* at 181–82.

[107] Agreement between the United States, the United Mexican States, and Canada, Nov. 30, 2018, available at https://ustr.gov/trade-agreements/free-trade-agreements/united-states-mexico-canada-agreement/agreement-between [hereinafter USMCA].

[108] *See* Martin J. Valasek et al., *Major Changes for Investor-state Dispute Settlement in New United States-Mexico-Canada Agreement*, NORTON ROSE FULBRIGHT (Oct. 2018), https://www.nortonrosefulbright.com/en/knowledge/publications/91d41adf/major-changes-for-investor-state-dispute-settlement-in-new-united-states-mexico-canada-agreement.

mechanism under NAFTA or the USMCA.[109]

Despite Canada's later withdrawal from the USMCA ISDS provisions, the dramatic increase in the amount of agreements with ISDS provisions led to a significant amount of international investor-state arbitrations.[110] The United Nations Conference on Trade and Development created an Investment Dispute Settlement Navigator (the "Navigator") which actively tracks ISDS cases that arise from treaties between states.[111] As of April 2022, the Navigator has tracked 1,104 total publicly-known treaty-based ISDS cases since 1987.[112] However, it does not contain an exhaustive list of all ISDS arbitrations because not all are publicly available.[113] Of the 655 cases that the ICSID has administered, 533 have arisen from a BIT, with the rest arising from treaties with investment provisions.[114] In the first thirty years of the ISDS system, less than fifty total cases were filed; but over a six year period from 2012 to 2018, corporations filed fifty cases each year.[115]

Overall, the history of international investment protections shows that states after WWII—especially developing states—held more bargaining power when agreeing to ISDS clauses due to the general trend of closing off economies from foreign investors.[116] This bargaining power favoring developing states gave them a significant advantage over foreign investors, and as a result, there were no issues with ISDS then—unlike today.[117] Now, however, foreign investors tend to have an advantage over states due to the omnipresence of ISDS

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[109] PUB. CITIZEN, NAFTA 2.0 AND INVESTOR-STATE DISPUTE SETTLEMENT (ISDS): U.S.-CANADA ISDS IS TERMINATED, EXPANSIVE INVESTOR RIGHTS ELIMINATED AND NEW REVIEW PROCEDURES MOSTLY REPLACE ISDS BETWEEN U.S. AND MEXICO 1, https://mkus3lurbh3lbztg254fzode-wpengine.netdna-ssl.com/wp-content/uploads/nafta-2.0-and-isds-analysis_2.pdf (last visited Mar. 3, 2022).

[110] Coyle, *supra* note 44, at 328.

[111] *ISDS Navigator: About and Methodology*, UNCTAD INVEST. POL'Y HUB, https://investmentpolicy.unctad.org/pages/1057/isds-navigator-about-and-methodology (last visited Apr. 19, 2022).

[112] *Investment Dispute Settlement Navigator*, UNCTAD INVEST. POL'Y HUB, https://investmentpolicy.unctad.org/investment-dispute-settlement?status=1000 (last updated Dec. 31, 2020).

[113] *ISDS Navigator: About and Methodology*, *supra* note 111.

[114] *Investment Dispute Settlement Navigator (Advanced Search)*, *supra* note 18 (select "BITs" under "Applicable IIA"; then select "ICSID" under "Administering institution" under "Arbitral rules and administering institution"; then select "Search" at the bottom for these results).

[115] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 1.

[116] *See* JOSEPH M. GRIECO, THE INTERNATIONAL POLITICAL ECONOMY SINCE WORLD WAR II 5–7 (2000), https://www.files.ethz.ch/isn/6843/doc_6845_290_en.pdf.

[117] *Id.*

clauses and the way that foreign investors utilize ISDS provisions.[118]

4. ISDS Modern Issues and Exemplative Cases

Since the rapid increase of ISDS clauses in BITs and other international agreements around the world, serious issues with ISDS provisions have emerged. These issues include: lack of legitimacy of the ad hoc tribunals; transparency issues; nationality planning; consistency of arbitral decisions; erroneous decisions; arbitrators' independence and impartiality; and the high financial costs of the system.[119] Additionally, ISDS decisions can blatantly reduce a state's sovereignty when it comes to passing laws or regulations because companies can circumvent the laws at issue in ISDS tribunals.[120] Also, companies threatening ISDS litigation can also pre-emptively kill laws.[121] This is known as "regulatory chill," and ISDS is a mechanism that companies use to pressure states not to enact laws or promulgate regulations that may be in the public's best interest but that are not good for profits.[122] An example of both nationality planning and regulatory chilling is seen in the 2011 *Philip Morris Asia Limited v. Australia* ISDS case.[123]

i. *Philip Morris Asia Limited v. Australia*

Philip Morris is an international tobacco company that sells in more than 180 markets and owns six of the world's top fifteen international cigarette brands, including Marlboro.[124] The cigarette industry's lobbying efforts and power are well known, and Philip Morris is a primary player in the tobacco space.[125] In a bid to protect the cigarette industry and its sales, Philip Morris initiated a claim against Australia

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[118] *Primer on International Investment Treaties and Investor-State Dispute Settlement*, COLUMBIA CTR. ON SUSTAINABLE INV., https://ccsi.columbia.edu/content/primer-international-investment-treaties-and-investor-state-dispute-settlement (last updated Jan. 2022).

[119] UNCTAD, IMPROVING INVESTMENT DISPUTE SETTLEMENT: UNCTAD POLICY TOOLS 5–6 (2017), https://unctad.org/system/files/official-document/diaepcb2017d8 en.pdf.

[120] Patel, *supra* note 6, at 279–80.

[121] *Id.*

[122] GLOB. JUST. NOW, *supra* note 36.

[123] *Id.*; *see also* Ranald, *supra* note 19.

[124] *Discover Who We Are*, PHILIP MORRIS INT'L., https://www.pmi.com/who-we-are/overview (last visited Mar. 2, 2022).

[125] *See generally* Aditya Kalra et al., *Inside Philip Morris' Campaign to Subvert the Global Anti-smoking Treaty*, REUTERS (July 13, 2017, 11:15 AM), https://www.reuters.com/investigates/special-report/pmi-who-fctc/.

in June 2011 in response to Australia's Tobacco Plain Packaging Act (the "Act").[126] This Act included "a comprehensive range of tobacco control measures to reduce the rate of smoking in Australia" because smoking is one of the state's leading causes of preventable death and disease.[127] Essentially, the legislation banned logos and put dire health warnings and "graphic images of sick or dying smokers on [cigarette] packs[.]"[128] The law, which is currently in effect, was a legitimate public health measure based on studies and reports, and leading public health experts supported it.[129]

If Philip Morris had been an Australian company, it could not have invoked any rights to try and circumvent the Act and thus would have been subject to the legislation—just like all other Australian companies.[130] However, as a foreign company in Australia, Philip Morris remained out-of-reach to any ISDS provisions to challenge the Act. That is, as an American company, Philip Morris was unable to invoke ISDS arbitration against Australia pursuant to the U.S.-Australia agreement because it did not contain an ISDS clause.[131] Consequently, Philip Morris shuffled through its catalog of international locations to pinpoint states that Philip Morris had operations in that also had an agreement containing an ISDS clause with Australia.[132] Philip Morris identified a Hong Kong-Australia investment agreement that did contain an ISDS provision, and then shifted company assets to Hong Kong to claim status as a Hong Kong company.[133] The tobacco company then utilized the Hong-Kong ISDS provision to sue Australia, demanding "billions" in compensation for passing the Act.[134] This is

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[126] *See* Philip Morris Asia Ltd. v. Australia, PCA Case Repository No. 2012-12, Notice of Claim (June 27, 2011), https://www.ag.gov.au/sites/default/files/2020-03/Philip-Morris-Asia-Limited-Notice-of-Claim-27-June-2011.pdf.

[127] *Tobacco Plain Packaging – Investor-state Arbitration*, AUSTL. GOV'T. ATT'Y-GEN'S. DEP'T., https://www.ag.gov.au/international-relations/international-law/tobacco-plain-packaging-investor-state-arbitration (last visited Mar. 2, 2022).

[128] Michelle Innis, *Australia's Graphic Cigarette Pack Warnings Appear to Work*, N.Y. TIMES (June 11, 2014), https://www.nytimes.com/2014/06/12/business/international/australias-graphic-cigarette-pack-warnings-appear-to-work.html.

[129] *Id.*

[130] Ranald, *supra* note 19.

[131] William S. Dodge, *Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement*, 39 VAND. J. TRANSNAT'L L. 1, 3 (2006) ("[T]he only way of enforcing the agreement's investment provisions is through Chapter 21's state-to-state dispute settlement provisions . . . .").

[132] Adam Gartrell, *Philip Morris Ordered to Pay Australia Millions in Costs for Plain Packaging Case*, SYDNEY MORNING HERALD (July 9, 2017, 2:18 PM), https://www.smh.com.au/politics/federal/philip-morris-ordered-to-pay-australia-millions-in-costs-for-plain-packaging-case-20170709-gx7mv5.html.

[133] *See id.*

[134] Philip Morris Asia Ltd. v. Australia, *supra* note 126, at ¶¶ 11, 48.

an example of nationality planning—Philip Morris used corporate structuring with an intermediary state for the sole purpose of benefitting from the investment agreement.[135]

In the notice of claim, Philip Morris stated: "Plain packaging legislation will result in the expropriation of [Philip Morris] Asia's investments due to the substantial deprivation of the intellectual property and goodwill, the consequent undermining of the economic rationale of its investments and substantial destruction of the value of [Philip Morris] Australia and [Philip Morris Limited]."[136] The "expropriation" of investments via newly-implemented legislation that costs companies money is the new expropriation of real property that FCNs and the early model BITs were designed to solve.[137] The way in which Philip Morris utilized this ISDS provision is like the "failings of a system that was designed to protect . . . enterprises doing business in developing nations but . . . suddenly turned against the designers."[138]

Fortunately, Philip Morris was not successful in its bid to void a legitimate public health measure that would eliminate preventable deaths.[139] In December 2015, the appointed tribunal decided that Philip Morris had moved ownership of its Australian operations to Hong Kong solely to take advantage of the ISDS provision.[140] This was viewed as a significant win for Australia but it had downsides, including the cost of the whole ordeal and regulatory chill in other nations.[141] Australia's costs were about $18 million, and even though the case was thrown out, Philip Morris only has to pay half of Australia's costs.[142] The nine million dollars left is a significant and unjustifiable loss to Australian taxpayers solely because Philip Morris wanted to avoid decreased sales and profits resulting from legislation aimed at saving lives.[143]

Regulatory chill followed Philip Morris' challenge to the Australian law.[144] New Zealand considered plain packaging laws at the same time as Australia, but as soon as the legal challenges to Australia were underway, New Zealand dropped the idea.[145] Only after Australia won against Philip Morris in 2015 did New Zealand introduce plain

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[135] UNCTAD, *supra* note 119, at 6.

[136] Philip Morris Asia Ltd. v. Australia, *supra* note 126, at ¶ 10(a).

[137] *See* Krzysztof J. Pelc, *What Explains the Low Success Rate of Investor-State Disputes?*, 71 INT'L ORG. 559, 559 (2017).

[138] George Kahale III., *Rethinking ISDS*, 44 BROOK. J. INT'L L. 11, 14 (2018).

[139] Ranald, *supra* note 19.

[140] *Id.*

[141] *Id.*

[142] *Id.*

[143] *Id.*

[144] GLOB. JUST. NOW, *supra* note 36, at 2.

[145] *Id.*

packaging laws.[146] The small African country of Togo also began considering the inclusion of images with health warnings on cigarette packages in 2013—until Philip Morris wrote to them threatening to initiate an ISDS case.[147] For context, Togo's annual GDP was $4.3 billion in 2013; Philip Morris' annual revenue was $80 billion.[148]

The Philip Morris case against Australia highlights three ways ISDS is misused by companies: nationality planning, attempting to subvert state sovereignty by avoiding legislation, and imposing immensely high costs on host governments (and thus taxpayers). This case illustrates how companies attempt to gain windfall payouts from governments for passing routine legislation rather than making legitimate claims for expropriation of corporate FDI.

ii. *Exxon Mobil and Murphy Oil v. Canada*

Many ISDS cases exemplative of other modern ISDS issues come from NAFTA's Chapter 11. The high number of claims under NAFTA's ISDS provision has received international attention, especially those against Canada.[149] Canada was not only sued the most under NAFTA Chapter 11, but also lost more cases to foreign investors than either the U.S. or Mexico.[150] It is not clear why Canada is sued the most between the three countries, but nearly all claims were brought by U.S. investors.[151] According to the Navigator, under NAFTA's ISDS provision, Canada has been sued thirty times, Mexico twenty-four times, and the U.S. eighteen times.[152] Canada has lost to or settled with investors ten times; Mexico has lost to or settled with investors five times; but the U.S. has never had an arbitral decide against them and has only settled with investors four times.[153] This may be an

[146] *Id.*

[147] *Id.*; *see also Last Week Tonight with John Oliver: Tobacco* (HBO television broadcast Feb. 15, 2015).

[148] GLOB. JUST. NOW, *supra* note 36, at 2; *Last Week Tonight with John Oliver*, *supra* note 147.

[149] Sonja Pavic & Riyaz Dattu, *Canada Seeks to Reform NAFTA's Investor-state Dispute Settlement Chapter*, OSLER (Aug. 23, 2017), https://www.osler.com/en/resources/cross-border/2017/canada-seeks-to-reform-nafta-s-investor-state-disp.

[150] SCOTT SINCLAIR, CANADA'S TRACK RECORD UNDER NAFTA CHAPTER 11, at 3 (2018), https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2018/01/NAFTA%20Dispute%20Table%20Report%202018.pdf.

[151] *See id.* at 15–30.

[152] The number of lawsuits for each country represents the current total at the time this article was written in April 2022. *Investment Dispute Settlement Navigator (Advanced Search)*, *supra* note 18 (under "Applicable IIA" select "NAFTA" from the individual IIAs selector; then select "Search" at the bottom for these results) (the Navigator tracks 72 total ISDS cases under NAFTA Chapter 11).

[153] *Id.*

underestimate as sources on the number of suits filed and the total number of ISDS disputes vary, probably due to the fact that many ISDS proceedings are not publicly available.[154] Until 2018, Canada's federal government spent more than $95 million in legal costs defending itself in addition to the $219 million paid out in damages and settlements.[155]

In 2007, Exxon Mobil and Murphy Oil jointly filed an ISDS claim against Canada under NAFTA's Chapter 11.[156] Both companies were incorporated in the U.S. and held subsidiaries in Canada.[157] When NAFTA was negotiated, Canada took a reservation for the imposition of performance requirements on investors in its oil sector.[158] Performance requirements have no universally agreed-upon definition, but they essentially involve host states imposing regulatory conditions "requiring investors to achieve certain economic and social goals in relation to the establishment or operation of their investments."[159]

In other words, under NAFTA, Canada specifically reserved the right to impose new rules and regulations as it relates to the oil sector and companies in the oil sector, whether foreign or domestic, without triggering a valid ISDS claim.[160] The reservation listed specific provincial-federal boards and the laws that the boards establish that contain conditions for investment in the oil sector.[161] These conditions required firms involved in offshore oil fields to submit benefit plans that show compliance with the obligation that firms invest in research and

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[154] *Compare id.* (stating that Canada has been the respondent in 31 treaty-based ISDS cases) *with* SINCLAIR, *supra* note 150, at 3 (stating there are 85 known ISDS cases against Canada under NAFTA's Chapter 11).

[155] SINCLAIR, *supra* note 150, at 1.

[156] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 17–18.

[157] *Cases Filed Against the Government of Canada: Mobil Investments Inc. and Murphy Oil Corporation v. Government of Canada*, GOV'T. CAN., https://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/mobil.aspx?lang=eng (last updated Dec. 19, 2017).

[158] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 17–18. Taking a reservation is reserving a right, as opposed to instead giving up that right. In this instance, Canada retained the right to impose requirements on oil companies. This was most likely done because without a reservation of rights, imposing new requirements on oil companies would be the new kind of expropriation that companies have begun to use ISDS clauses for—similar to the Philip Morris and Australia case. *See id.*; *Reservation of Rights Definition*, LAW INSIDER, https://www.lawinsider.com/dictionary/reservation-of-rights (last visited Apr. 19, 2022).

[159] Catherine Edoardova Costaggiu, *Performance Requirements*, JUS MUNDI, https://jusmundi.com/en/document/wiki/en-performance-requirements (last updated Dec. 23, 2021).

[160] *Id.*; NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 18.

[161] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 18.

development as well as worker training.[162] Guidelines on the amount and types of research and development activities that oil companies were required to perform had been regularly issued by these boards since the late 1980s.[163]

Exxon Mobil and Murphy Oil took issue with the 2004 guidelines in their claim against Canada.[164] They argued that the guidelines imposed impermissible performance requirements since the guidelines compelled a certain amount of expenditures by the oil companies in research and development.[165] Performance requirements of investors are not allowed under Chapter 11 Article 1106.[166] However, Canada specifically negotiated for, and got an exception to, the performance requirements section as it applied to both the board that promulgated the 2004 guidelines and the oil sector.[167] Canada countered Exxon Mobil and Murphy Oil's claims with these points, but two of the three-person arbitral panel rejected Canada's arguments and ruled in favor of Exxon Mobil and Murphy Oil in 2012.[168] One arbitrator dissented, noting that Canada had taken a reservation that specifically allowed the policies being challenged by the oil companies.[169] Because there is no appeal mechanism in ISDS systems, Canada was stuck with the arbitral decision, which ordered Canada to pay $13.9 million plus interest to the oil companies.[170] This decision by the panel of arbitrators was wrong and not persuasive—the decision contradicted the exact items that Canada had negotiated exceptions for in NAFTA.

This case illustrates several thorny points on ISDS issues. First, even when the plain text of the agreement speaks directly to the issue, the ISDS arbitral panel is able to decide against the plain text of the agreement.[171] Since there is no appeal mechanism in ISDS systems,

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[162] *Id.*

[163] *Id.*

[164] *Id.*

[165] Mobil Invs. Canada Inc. v. Canada, ICSID Case No. ARB(AF)/07/4, Notice of Intent to Submit a Claim to Arbitration under NAFTA Chapter Eleven, ¶¶ 31, 33 (Aug. 2, 2007), https://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/mobil-01.pdf; Murphy Oil Corp. v. Canada, ICSID Case No. ARB(AF)/07/4, Notice of Intent to Submit a Claim to Arbitration under NAFTA Chapter Eleven, ¶¶ 31, 33 (Aug. 2, 2007), https://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/mobil-02.pdf.

[166] NAFTA, art. 1106.

[167] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 18. This is the reservation of rights mentioned above that Canada specifically carved out in NAFTA. *Id.*

[168] *Id.*

[169] *Id.*

[170] *Id.*

[171] *See Primer on International Investment Treaties and Investor-State Dispute Settlement*, *supra* note 118.

neither countries nor foreign investors are able to appeal these types of decisions.[172] Second, since these are not published cases heard by courts but instead by arbitral tribunals, there is no binding case law.[173] Third, the three-person arbitral panels that deliver these ISDS decisions are flawed. The arbitrators are not subject to selection requirements or any meaningful guarantees of independence.[174] Many arbitrators also "double hat," meaning they represent "claimants in ISDS disputes while also sitting as arbitrators in other cases."[175] Lastly, this case shows that companies can use ISDS to circumvent oil regulations just as Philip Morris attempted to sidestep compliance with plain packaging laws as well.

Exxon Mobil and Murphy Oil's dispute with Canada and Philip Morris' dispute with Australia illustrate how expensive the ISDS system is to governments, no matter if the state wins or loses against the investor's claim.[176] It is also important to note that if both companies were domestic companies, there would have been no route available like ISDS to challenge the legislation or regulations—other than the usual domestic routes through domestic courts.[177] Foreign companies are only afforded that opportunity by ISDS provisions in international agreements.[178] Put simply, "ISDS creates a parallel and privileged set of legal rights for multinational corporations to . . . operate . . . under privileged terms relative to domestic enterprises."[179]

Canada's withdrawal from the ISDS system in the USMCA allows the state to accomplish a greater degree of success in environmental, health, and safety regulatory regimes that mostly U.S. companies have been challenging for years. Additionally, empirical research shows that ISDS generally plays a minor, if not absent, role in FDI.[180] Thus,

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[172] *Id.*

[173] *Id.*

[174] *See id.*

[175] *Id.* "This can and has led to scenarios in which attorneys have used awards they have issued as arbitrators to support their legal positions when arguing as counsel."

[176] GLOB. JUST. NOW, *supra* note 36, at 2; Mobil Invs. Canada Inc. v. Canada, ICSID Case No. ARB(AF)/07/4, Award, ¶ 178 (Feb. 20, 2015).

[177] *ISDS: Important Questions and Answers*, OFF. U.S. TRADE REPRESENTATIVE, https://ustr.gov/ABOUT-US/POLICY-OFFICES/PRESS-OFFICE/BLOG/2015/MARCH/ISDS-IMPORTANT-QUESTIONS-AND-ANSWERS-0 (last visited Mar. 3, 2022).

[178] *Id.*

[179] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 18.

[180] JOHANNES SCHWARZER, INVESTOR-STATE DISPUTE SETTLEMENT: AN ANACHRONISM WHOSE TIME HAS GONE 3 (2018), https://www.cepweb.org/wp-content/uploads/2018/09/CEP-Policy-Brief-ISDS-1.pdf. The basic premise linking ISDS "with increased FDI flows is not supported by either empirical facts or qualitative evidence."

Canada is not likely to experience any decline in FDI from its neighbors due to its withholding from the ISDS mechanism in the USMCA.

Overall, the power dynamic that has accompanied investment protection has shifted multiple times in response to the context in which the world finds itself. It has ranged from FCN foreign investment protections aimed at protecting foreign investment from host governments, to using ISDS to pressure host governments into bowing to powerful companies' demands, to states now opting out of ISDS clauses.[181] Today, the potential for manipulation makes it clear that ISDS is either in need of reform with an eye towards its original purpose, or ISDS is not needed at all.

III. PROCESS OF IMPROVEMENT: ELIMINATION OR REFORM

A. ISDS Elimination

The global economy has evolved enough to eliminate ISDS. The decolonization period after WWII that caused destabilization for foreign investment is over, and those developing states are well underway on their climb up the development ladder.[182] Along the same lines, hostility toward FDI in the decolonization period ended in the 1980s,[183] which begs the question: how should the ISDS paradigm shift since decolonization and destabilization are the main reasons as to why it was developed? Today, even if FDI were to be expropriated, other provisions of trade and investment agreements besides ISDS provide foreign investors with options for compensation.[184] Thus, developing nations no longer need to provide investment protections along the lines of the current ISDS regime. Some developing states' economies and available business opportunities are robust enough to attract foreign investment without ISDS investment protection. It may not be the case for every developing state in the world, but sophisticated investors sending FDI to foreign states in pursuit of an illiquid long-term investment will know the risks of the political climate where they send their capital.

On the other hand, critics argue that FDI protection in the form of BITs and ISDS clauses are vital to investors' decisions to send FDI abroad, and that proposals to eliminate ISDS would thus be a step backward from protecting the positive effects that FDI provides to

[181] *Id.* at 1–2.
[182] *Id.* at 2–3.
[183] *Id.*
[184] *See, e.g.*, Coyle, *supra* note 44, at 327–28.

developing nations.[185] While it is true that eliminating ISDS would eliminate protections for FDI, those protections are no longer needed. This is more apparent now because they have evolved to be less like protections and more like a "parallel and privileged set of legal rights"[186] that afford foreign investment too much power over host governments. Philip Morris' threat to initiate ISDS proceedings against Togo is a prime example of a developing state at the mercy of a powerful company threatening to use an ISDS clause.[187] Additionally, as mentioned above, there remain other options for investors who may have their real property, as opposed to potential profits, expropriated via other provisions of trade and investment agreements. Lastly, if empirical research shows that ISDS generally plays a minor, if not absent, role in FDI, then the critics' arguments are moot.

Similar to developing states, the downsides for developed states that agree to ISDS seem to outweigh the upsides as well. Like Canada, many developed states may not want to provide investment protection because ISDS gives investors a powerful route to constantly challenge public policy on environmental, health, and safety measures.[188] Whether the investor wins or loses, defending against the claim in the first place still causes significant fiscal loss to the host state.

ISDS issues are now mutual issues for states, which is peculiar given that foreign companies are the entities that take advantage of ISDS.[189] If states no longer see any benefit from participating in an ISDS regime, states can opt out of ISDS, taking that benefit away from foreign companies without companies having any say in the matter; the treaties that provide ISDS protections are agreements between two or more states, not states and companies.[190] With the original motivation behind ISDS clauses being to attract foreign investment, and the fact that ISDS has a minimal, if any, effect on FDI now,[191] there is little reason for states to include ISDS clauses in investment or trade agreements,

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[185] Charles N. Brower & Sadie Blanchard, *What's in a Meme? The Truth About Investor-State Arbitration: Why It Need Not, and Must Not, Be Repossessed by States*, 52 COLUM. J. TRANSNAT'L. L. 689, 700–01 (2014).

[186] NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 1.

[187] GLOB. JUST. NOW, *supra* note 36, at 2.

[188] *See generally* NAFTA FOREIGN INVESTOR-STATE CASES AND CLAIMS, *supra* note 8, at 1.

[189] *See* James Roberts et al. *Investor-State Dispute Settlement (ISDS) Mechanisms: An Important Feature of High-Quality Trade Agreements,* HERITAGE FOUND. (Feb. 20, 2015), https://www.heritage.org/trade/report/investor-state-dispute-settlement-isds-mechanisms-important-feature-high-quality-trade.

[190] *See id.*

[191] *See* Gary Clyde Hufbauer, *ISDS Controversy,* PETERSON INST. INT'L. ECON. (May 13, 2015, 10:00 AM), https://www.piie.com/blogs/trade-investment-policy-watch/isds-controversy.

especially developed states. The downsides outweigh the upsides for the state and its taxpayers.

But is that true? Will foreign companies be upset about the loss of their investment "protections" and threaten to withdraw the FDI that greatly benefits the host state? From a business perspective, this will likely not be the case. Foreign companies will likely not expend resources to remove FDI from a state that decides to opt out of ISDS simply because the company may not have the option to unilaterally invoke arbitration with the host government to circumvent laws or regulations. Because FDI is an illiquid investment form, it would entail a significant amount of capital, operation changes, and time for a company to fully extract itself from established FDI in a state.[192] Hence, it is unlikely that foreign companies will decide to fully remove business operations from states that opt out of ISDS.

Moreover, if a majority of states begin to eliminate ISDS provisions from their trade and investment agreements, it becomes especially impractical for companies to pull FDI from multiple states in retaliation. It would hurt companies' bottom-lines, and assuming profits drive businesses, they are unlikely to do so.

Further, if states withdraw from ISDS provisions in agreements, companies do not have options to stop that withdrawal. For now, the benefits of ISDS to states are marginal compared to the potential costs that businesses impose on states through the ISDS system.[193] National sovereignty must be protected, otherwise companies will continue to take advantage of ISDS. When companies can obtain windfall payouts, circumvent government legislation, and potentially prevent forward-looking legislation in pursuit of profits, they will continue to do so. When the costs of taking those actions is less than the gain the company obtains from successfully challenging host governments, most companies will choose to challenge host governments. However, governments must be able to enact legislation and regulations in the public interest regarding the environment, health, and safety, and the existence of ISDS in its current form is a direct impetus to those goals.

Originally meant to provide protection for companies, ISDS has instead evolved into a mechanism for companies to obtain windfalls in the form of significant damages awards from governments for routine lawmaking.[194] In light of this evolution, the mechanism is no longer serving its original purpose—and thus, is no longer needed.

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[192] *What is 'Foreign Direct Investment'?*, *supra* note 23.

[193] *See Primer on International Investment Treaties and Investor-State Dispute Settlement*, *supra* note 118.

[194] Roberts, *supra* note 189.

B. ISDS Reform

Short of states not being party to ISDS provisions at all, changes to the current ISDS regime must be implemented to allow governments to pass routine legislation and regulations without viable challenges from foreign companies. Many improvements on Chapter 11 were implemented in the USMCA's investment chapter, Chapter 14,[195] although it is too early to tell if the attempted modifications actually resulted with improvements to the ISDS mechanism. These changes include elimination of the ISDS mechanism between the U.S. and Canada, limiting ISDS claims between the U.S. and Mexico to certain claims and industries, tightening procedural requirements, and requiring all arbitrators to comply with the International Bar Association's Guidelines on Conflict of Interest in International Arbitration.[196]

ISDS provisions should be more specific about the type of claims that states are willing to arbitrate. Most importantly, states should carve out an exception to ISDS claims that allows host states to routinely legislate without ISDS claim interference. For example, ISDS clauses could provide that all reasonable inferences are to be construed *against* the investor and in favor of the state—although, even with that added provision, tribunals may still decide to disregard it, as the tribunal in Exxon Mobil and Murphy Oil's suit against Canada explicitly disregarded Canada's negotiated exceptions.[197]

Another option to consider is, instead of a reservation or exception for certain ISDS claims, states could narrow the scope of claims to only legislation that may disproportionately discriminate against a single company.[198] This option would ideally protect the government from irregular ISDS outcomes in most instances, given that legislation and regulations generally apply to multiple companies in certain industries, or companies across industries.[199] A narrowed scope of claims would also solve the problem of foreign investment challenging domestic laws with mechanisms that are not available to domestic investment. Theoretically, limiting the scope of claims would put domestic and foreign companies on a level playing field without giving foreign

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[195] *See* USMCA, *supra* note 107, at Annex 14-C.

[196] *See* Jerry L. Lai, *A Tale of Two Treaties: A Study of NAFTA and the USMCA's Investor-State Dispute Settlement Mechanisms*, 35 EMORY INT'L L. REV. 259, 281–83 (2021).

[197] *See Cases Filed Against the Government of Canada: Mobil Investments Inc. and Murphy Oil Corporation v. Government of Canada*, *supra* note 157.

[198] This could also be a potential test for determining if legislation is "routine" or not for the proposal in the previous paragraph.

[199] *See* Meredith Wood, *11 Important Government Regulations on Business You Must Know*, FUNDERA, https://www.fundera.com/blog/government-regulations-on-business (last updated Oct. 15, 2020).

investment more "protection" than domestic investment. A potential downside to this option involves a situation where a host state decides to pass legislation or regulations for a given industry dominated by a monopoly—a single company that operates dominantly in a given industry—and which largely affects the singular company. This may be the case in smaller states.

Even then, states could stipulate that foreign companies cannot challenge legislation and regulations concerning public health, environmental issues, and public safety. Factors for determining if the challenged legislation is a valid public policy initiative rather than a discriminatory act towards a single company could include: (1) a determination of whether or not the law purports to solve a significant public policy issue in the state; (2) the legislative history of the law; (3) the degree of burden that compliance with the law will impose on a company compared with domestic companies' compliance burdens; (4) whether it is outright discriminatory against a single company; and (5) whether there are any other viable ways for the legislature to achieve the public policy objective. States including any of the above suggestions, or all, in treaties would be significantly protecting themselves from foreign companies taking advantage of ISDS clauses.

Finally, for these provisions in investment or trade agreements to be interpreted fairly and also be subject to precedent and an appellate mechanism, arbitral tribunals do not need to decide investors' claims. Instead, a sitting court with judges should evaluate and rule on claims. Or at least, rules should be implemented that better require neutral parties be chosen as arbitrators. ISDS arbitral tribunals may be interpreting investment agreements differently than courts would because tribunals are insulated from public policy and governmental sovereignty implications that courts must account for,[200] which is why courts should make ISDS decisions. Having a court decide investor claims would also solve the issue of transparency with the proceedings as well, since it would all be publicly available information.

Parties to the agreement should negotiate and agree on a court to decide any investment disputes. It could be courts of the host state or courts of the domestic state of the foreign investment. States could also, as many already do today, agree to jurisdiction of the ICSID which would at least give more predictability, structure, and transparency to arbitrations as compared to the current system of private arbitral tribunals. Requiring that courts hear ISDS claims would provide a neutral location, sitting judges, and public records for determination of investment dispute outcomes—an ideal situation.

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[200] *Political Questions, Public Rights, and Sovereign Immunity*, 130 HARV. L. REV. 723, 725 (2016).

In sum, states that are unable to eliminate ISDS entirely should attempt to implement these changes to their ISDS regimes to better protect themselves from foreign companies misusing ISDS provisions.

IV. CONCLUSION

The power struggle between foreign investment and host states explains the current ISDS regime and is a result of the type of investment and trade environment in which the world finds itself.[201] Today, ISDS provisions are still in place that were originally drafted with the intention of protecting foreign investment from host state expropriation as a result of hostility towards FDI after WWII.[202] But these "protections" are no longer needed since the result is foreign companies wielding too much power over host states. States should eliminate ISDS by opting out of ISDS provisions, or if not, they at least should heavily revise ISDS mechanisms to which they are currently subject. These potential revisions include: effectively limiting foreign investors from challenging any routine host state legislation or regulations; allowing foreign investors to sue only if they can show the host state has singled out a certain company for discrimination; and requiring investors to agree to jurisdiction of a court beforehand that would rule on any disputes arising out of the investment agreement instead of using ad hoc tribunals of private lawyers to determine disputes. These changes would transform the ISDS mechanism for the better to allow host states to legislate without fear of retaliation from powerful companies that are dissatisfied with public policy laws.

[201] Patel, *supra* note 6, 280–82.

[202] PIETER JAN KUIJPER ET AL., INVESTOR-STATE DISPUTE SETTLEMENT (ISDS) PROVISIONS IN THE EU'S INTERNATIONAL INVESTMENT AGREEMENTS 6 (2014), https://www.europarl.europa.eu/RegData/etudes/STUD/2014/534979/EXPO_STU(2014)534979(ANN01)_EN.pdf.