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SYMPOSIUM ON INSTITUTIONALIZING INVESTMENT DISPUTE PREVENTION

INSTITUTIONALIZING INVESTMENT DISPUTE PREVENTION: THE U.S. EXPERIENCE

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Introduction

The steady rise of international investment arbitration in recent years suggests that many states still struggle to prevent investor grievances from becoming international investment disputes and ultimately arbitration claims. The United States is not exempt from such difficulties, but it has some institutional advantages contributing to its successful approach to mitigating and managing international investment disputes. Key advantages include its practice of: (1) "internationalizing" domestic law in U.S. international investment agreements (IIAs); (2) encouraging foreign investors to pursue domestic remedies in U.S. courts; and (3) domesticating the international investment regime within the U.S. government. The U.S. experience offers some valuable lessons for the ongoing reform of the international investment regime.

"Internationalizing" Domestic Law

The U.S. government's practice of aligning its international investment obligations with its domestic law obligations is an important means of preventing disputes and reducing exposure to international investment arbitration. International investment agreements typically afford foreign investors legal protections beyond those available in domestic law.[1] This creates several challenges. When host state officials adopt investment-related measures, they may not know that foreign investors may claim international law protections, or that a particular investor may qualify as a foreign investor for such purposes.[2] Further, key investment protections, such as fair and equitable treatment, often have no clear analog in domestic law. Host state officials thus may adopt a measure deemed consistent with the state's domestic law obligations and still put the state in breach of its international law obligations. For many states, this disconnect between domestic and international obligations is a central challenge of the international investment regime.

The issue of "special rights" for foreign investors attracted significant controversy in the United States from the late 1990s, after foreign investors began suing the United States under the investment chapter of the North American Free Trade Agreement (NAFTA). Critics complained that such agreements offered foreign investors

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[1] States may afford similar substantive and procedural protections through international investment contracts and foreign investment laws.

[2] *See* Barton Legum, *Defining Investment and Investor: Who Is Entitled to Claim?*, 22 ARB. INT'L 521, 525 (2006).

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an "end run around the Constitution."[3] In 2002, the U.S. Congress instructed U.S. negotiators to conclude free trade agreements that accord no greater substantive rights to foreign investors than are accorded to U.S. investors under U.S. law.[4] To that end, U.S. negotiators were instructed to introduce "guidelines" into U.S. IIAs for use by arbitral tribunals. Such guidelines were to be "consistent with United States legal principles and practice"[5] and draw on "U.S. case law interpreting the relevant legal principles."[6]

The United States has developed guidelines, for example, for determining whether there has been an "indirect expropriation."[7] U.S. IIAs, as is common, generally require contracting states to pay compensation when expropriating covered investments, including when done indirectly through measures equivalent to a direct expropriation. In practice, it often can be difficult to distinguish an indirect expropriation from a non-compensable regulatory measure. To help arbitrators draw that line, U.S. negotiators have borrowed from the U.S. Supreme Court's test in *Penn Central v. New York City* for determining a "regulatory taking" (effectively an indirect expropriation) under the U.S. Constitution.[8] Tracking the test, U.S. IIAs identify three factors for determining whether government measures constitute an indirect expropriation: (1) the economic impact of the regulation on the claimant; (2) the extent of interference with the claimant's reasonable investment-backed expectations; and (3) the character of the government action.[9] Following such guidance, arbitral tribunals may evaluate the United States' expropriation obligations in U.S. IIAs in a manner similar to how U.S. officials assess such obligations when adopting regulatory measures. Such guidelines thus help U.S. government officials comply with the United States' international investment obligations simply by complying with domestic U.S. law obligations. This practice likely helps the United States avoid some international investment disputes and defend against such disputes when brought to arbitration.

Encouraging Domestic Litigation

The United States' second institutional advantage is its practice of encouraging investors to pursue domestic judicial remedies rather than immediately resorting to international arbitration. Most IIAs, including U.S. agreements, generally permit investors to commence international arbitration without first pursuing domestic judicial remedies.[10] Many such agreements, however, give investors a one-time choice to pursue either international arbitration or domestic litigation. Under such "fork-in-the-road" provisions, an investor that makes a claim before a domestic court generally forfeits its right to submit that claim to investment treaty arbitration.[11] Given a choice,

[3] *See* Gary H. Sampliner, *Arbitration of Expropriation Cases Under U.S. Investment Treaties: A Threat to Democracy or the Dog That Didn't Bark?*, 18 ICSID Rev.—For. Inv. L.J. 1, 2 (2003) (quoting critics).

[4] The U.S. government applies these same directives when negotiating bilateral investment treaties (BITs), thus "ensuring greater consistency with US [free trade agreements] and broad congressional support for the US BIT programme." Lee M. Caplan & Jeremy K. Sharpe, *United States*, *in* Commentaries on Selected Model Investment Treaties 755, 756 (Chester Brown ed., 2013).

[5] Trade Act of 2002, Pub. L. 107-210, § 2102(b)(3), 116 Stat. 933, 995 (2002).

[6] S. Rep. 107-139, at 15 (2002).

[7] *See, e.g.*, U.S. Dep't of State & U.S. Trade Representative, 2012 U.S. Model BIT, Annex B, para. 4 (2012) [hereinafter 2012 U.S. Model BIT].

[8] Penn Central Transportation Co. v. New York City, 438 U.S. 104, 124 (1978).

[9] *See, e.g.*, 2012 U.S. Model BIT, *supra* note 7, Annex B, para. 4(a).

[10] Joachim Pohl et al., *Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey* 13–14 (OECD Working Papers on International Investment, 2012/02).

[11] *See, e.g.*, MCI Power Group, L.C. et al. v. Rep. Ecu., ICSID Case No. ARB/03/6, Award, para. 181 (July 31, 2007) ("[T]he 'fork-in-the-road' rule is … a right to choose irrevocably between different jurisdictional systems. Once the choice has been made there is no possibility of resorting to any other option.").

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many investors forgo domestic litigation altogether, perhaps assuming that investment arbitration offers better protections and a fairer forum.

More recent U.S. IIAs, by contrast, generally permit investors to challenge government measures in domestic courts before electing to pursue investment arbitration exclusively.[12] These agreements aim to encourage investors to seek redress in domestic courts, on grounds that U.S. law "on the whole provides a high level of protection for investment, consistent with or greater than the level required by international law."[13] Consistent with this aim, the practical effect of such "no U-turn" provisions "is to provide investors with a strong incentive to exhaust their remedies in the courts of the host country, especially in host countries like the United States where the courts are thought to provide plaintiffs with a fair hearing and a broad panoply of remedies."[14] The availability and efficacy of domestic legal protections in the United States likely has helped steer some investment disputes to U.S. courts rather than to investment treaty arbitration.

Domesticating the International Investment Regime

The United States' third advantage is the institutionalization of investment protection within its bureaucracy, which helps the government prevent disputes and reduces exposure to international investment arbitrations. An acute downside of the international investment regime is its decentralization and lack of institutionalization. The regime is *ad hoc* and largely bilateral, with no comprehensive treaty governing international investment protection. The regime also lacks an intergovernmental organization mandated and adequately funded to provide the institutional support, training, and capacity building that many states require to engage effectively in avoiding, mitigating, and managing international investment disputes.[15] Contrast this, for example, with the World Trade Organization, which provides a legal and institutional framework for states to engage with the international trade regime, including within state bureaucracies.

The U.S. government has developed sound institutional arrangements for investment protection and dispute settlement within its bureaucracy, consistent with the federal government's shared authority with U.S. states under the U.S. Constitution. Key arrangements in the federal government include the designation of a lead state agency and the use of in-house government counsel possessing the necessary experience, support, funding, permanence, and perspective to effectively assess, mitigate, and manage international investment disputes.

Lead state agency. Governments are advised to designate a lead state agency for international investment disputes.[16] Government officials need to know where to turn for specialized legal advice when problems arise with foreign investors, and investors need to know where to turn to resolve disputes that cannot be resolved with the government entity whose measures are impugned. Aggrieved investors with nowhere to turn for negotiations are more likely to proceed directly to investment arbitration where available, potentially fracturing party relationships and entrenching adversarial positions. Many states, however, initially failed to designate a responsible

[12] *See, e.g.*, 2012 U.S. Model BIT, *supra* note 7, Art. 26(2); *see also* United States-Mexico-Canada Agreement, Art. 14.D.5(b) (2020).

[13] Trade Act of 2002, *supra* note 5, § 2 102(b)(3).

[14] Sampliner, *supra* note 3, at 34.

[15] *See* Jeremy K. Sharpe, *Control, Capacity and Legitimacy in Investment Treaty Arbitration*, 112 AJIL Unbound 261 (2018).

[16] *See* David A. Pawlak & José Antonio Rivas, *Managing Investment-Treaty Obligations and Investor-State Disputes: A Guide for Government Officials*, *in* Latin American Investment Treaty Arbitration: The Controversies and Conflicts 163, 177–78 (Mary H. Mourra ed., 2008). Some lead state agencies primarily manage international investment disputes, but such entities can and should be empowered to help prevent such disputes, including through negotiations with foreign investors and pre- and post-dispute advice to government agencies. *See, e.g.,* Jeremy K. Sharpe, *The Agent's Indispensable Role in International Investment Arbitration*, 33 ICSID Rev.—For. Inv. L.J. 675, 687–88 (2018).

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office, or even a responsible ministry, for addressing international investment disputes, creating difficulties for government officials and foreign investors alike. Without a lead state agency in place to receive arbitration notices, unwitting government officials may ignore or misunderstand them, squandering the "cooling off" period for negotiations typically imposed on foreign investors before they can commence arbitration.[17]

Although the United States similarly failed to designate a lead state agency when it concluded its initial IIAs, the Office of International Claims and Investment Disputes (L/CID) in the U.S. State Department's Office of the Legal Adviser took the lead when the United States began facing investment claims.[18] L/CID's mandate, however, is far broader than just defending the United States in international investment disputes. As reported on the State Department website, L/CID "represents the United States and coordinates activities within and outside the Department with respect to all aspects of international claims and investment disputes."[19] Creating an office specifically tasked with such oversight and coordination has clarified for investors and government officials alike where to turn for all matters relating to international claims and investment disputes, including before a dispute has crystallized or has been formally notified.[20] Newer U.S. IIAs also instruct investors to submit notices of disputes and other arbitration-related documents to a specific office within the State Department's Office of the Legal Adviser.[21] This practice helps ensure that L/CID promptly learns of international investment disputes, giving it time to investigate, negotiate with foreign investors, and prepare for any settlement discussions or arbitration proceedings.

Experienced in-house counsel. Few states engage in sufficient international litigation to justify a heavy investment in establishing, training, and sustaining a dedicated office to represent the state in international investment disputes. Most states thus outsource their defense in investment disputes to external counsel.[22] There are obvious advantages to states' reliance on experienced external counsel, particularly for important, complex, and high-value cases. States that exclusively rely on external counsel, however, lose practical experience that can help them mitigate and manage international investment disputes. All states thus require some government lawyers with sufficient expertise to educate and advise government officials on international investment obligations, facilitate amicable dispute resolution, and promote litigation positions consistent with the state's legal and policy interests.[23] For the United States, L/CID serves those functions. The office has extensive experience with international dispute resolution, including experience from investment arbitrations involving the United States or U.S. investors, international claims commissions, diplomatic protection, and other interstate litigation and arbitration.

Permanence. Many government offices face routine changes in personnel, causing a loss of experience, expertise, and institutional memory. Such transitions are particularly challenging for international investment-related matters, where the applicable law is often complex, fast-changing, and unfamiliar. The United States has fostered institutional capacity by maintaining a permanent staff of highly competent career international lawyers and other

[17] One survey found that almost 90% of treaties with investor-state dispute settlement provisions require the investor to respect a cooling-off period before bringing a claim. Pohl et al., *supra* note 10, at 17.

[18] The U.S. Justice Department initially represented the United States in the NAFTA case The Loewen Group et al. v. United States, ICSID Case No. ARB(AF)/98/3, Award (June 26, 2003). The U.S. State Department later joined as co-counsel and has represented the United States in subsequent disputes brought under U.S. IIAs.

[19] U.S. Dep't of State, International Claims and Investment Disputes (last accessed June 28, 2024).

[20] These could include U.S. and foreign investors as well as government officials at the national, state, and local levels in the United States and officials in the home state of the investor.

[21] *See, e.g.*, 2012 U.S. Model BIT, *supra* note 7, Annex C (Service of Documents on a Party).

[22] *See* United Nations Commission on International Trade Law (UNCITRAL), Note by the Secretariat: Possible Reform of Investor-State Dispute Settlement (ISDS), Advisory Centre, para. 8, UN Doc. A/CN.9/WG.III/WP.168 (July 25, 2019).

[23] *See, e.g.*, Sharpe, *supra* note 16.

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professionals within L/CID. Such stability helps ensure institutional expertise and capacity over time and across administrations. L/CID lawyers are well placed to advise and educate policymakers on international investment-related issues, identify and mitigate investment disputes, and effectively represent the United States as a party or non-disputing party in investment arbitrations.

Balance. International investment disputes often raise enormous financial, political, and public-policy stakes. Governments may act opportunistically toward foreign investors or prioritize narrow litigation interests over broad, long-term legal and policy interests. The U.S. government balances investor and defensive interests at three levels. First, L/CID has multiple roles in international investment disputes: addressing U.S. investor interests (including by espousing claims of U.S. nationals, as appropriate);[24] defending the United States in international investment disputes brought by foreign investors; and "provid[ing] its views on the correct interpretation" of U.S. IIAs through non-disputing party submissions in cases not involving the United States.[25] L/CID is acutely aware that arguments made in one case may be made against the United States[26] or its investors[27] in other cases. Second, L/CID coordinates closely with other offices within the Legal Adviser's Office (including its economic and business affairs office) and more broadly within the State Department (including its investment affairs office). Third, L/CID coordinates significant investment-related issues with a number of other U.S. government agencies, including those responsible for attracting and retaining foreign investment, as well as regulatory agencies whose measures might impact investors.[28] Intragovernmental disagreements on such issues may be elevated to higher-level officials in the Department, in the interagency, or even to the White House for a final decision.[29] L/CID's multiple roles, close interagency coordination, and access to high-level government engagement promote well-considered, balanced, and consistent positions on such issues, helping mitigate and manage international investment disputes.

Conclusion

The U.S. government's approach to preventing international investment disputes has distinct advantages, as well as some limitations inherent in a federal system of government. But the U.S. approach is one among many. States cannot easily "internationalize" their domestic law to prevent international investment disputes or simply steer aggrieved foreign investors to domestic courts. Almost all states, however, now recognize the importance of institutionalizing investment protection within their government bureaucracies. States also are sharing their diverse practices in the UNCITRAL Working Group III.[30] The Working Group recently concluded a draft statute for

[24] *See, e.g.*, Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. It.), Judgment, 1989 ICJ Rep. 15 (July 20).

[25] The Carlyle Group L.P. v. Kingdom of Morocco, ICSID Case No. ARB/18/29, Oral Non-disputing Party Submission of the United States (Jan. 22, 2021).

[26] *See, e.g.*, Glamis Gold Ltd. v. United States, Claimant's Memorial, para. 530 (UNCITRAL May 5, 2006) (citing U.S. arguments made when acting as claimant in the *ELSI* case).

[27] *See, e.g.*, Memorandum from John Duncan et al. to John D. Potesta, Chief of Staff to the President, at 23 (Dec. 17, 1999) (citing State Department concerns that the Justice Department's proposed jurisdictional defense in the NAFTA case *Loewen v. United States* would undermine protections for U.S. investors, whether or not the argument prevailed, "since our pleadings will be made public and other countries will cite our arguments to the detriment of U.S. investors").

[28] When international investment disputes concern measures adopted by U.S. states, the U.S. State Department coordinates closely with relevant state authorities. *See, e.g.*, Methanex Corp. v. U.S., Award on Jurisdiction and Merits, Pt. II, Ch. A, 2–3 (UNCITRAL Aug. 3, 2005).

[29] *See, e.g.*, Memorandum from Beth Nolan, White House Counsel, et al. to John D. Potesta, Chief of Staff to the President (Feb. 10, 2000).

[30] *See* UNCITRAL, Working Group III: Compilation of Best Practices on Investment Dispute Prevention and Mitigation (Mar. 2023).

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a multilateral advisory center on international investment dispute resolution, which aims to provide states with ongoing capacity building and other institutional support.[31] In reality, Working Group III already serves as a nascent advisory center for states, upon which any future center may build and expand. The Working Group's most important, and lasting, contribution may be in helping states institutionalize the international investment regime within their bureaucracies—the indispensable condition for operating effectively within such a decentralized regime.

[31] UNCITRAL, Note by the Secretariat: Possible Reform of Investor-State Dispute Settlement (ISDS): Draft Statute of an Advisory Centre on International Investment Dispute Resolution, UN Doc. A/CN.9/WG.III/WP.238 (Feb. 7, 2024).

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