Strand Advocates
Law, & more...!

THE LATIN AMERICAN EXPERIENCE WITH TREATY-BASED INVESTMENT ARBITRATION:

LESSONS FOR SUB-SAHARAN AFRICA

By:
Julius Galisonga

INTRODUCTION:

Treaty-based arbitration plays a major role in dispute settlement between host states and investors. In so doing, it has the added advantage of promoting flow of Foreign Direct Investment (FDI), as investors feel that arbitration before a neutral dispute settlement fora potentially provides a fair hearing.

In Africa, as countries push for improved infrastructure and communication, fight hunger through increased agricultural output, boost tourism, as well as development of crucial sectors such as the health sector, etc. many investment opportunities will be available, consequent to which FDI inflow to Africa is expected to increase.

The World Investment Report of June 2024, (UNCTAD/WIR/2024), in support of this trend, notes that against a decline in the previous year, a growing interest in the global greenfield mega projects is causing a boom in FDI flows to Africa, while McKinsey & Co. forecasts that by 2025, investment in infrastructural projects (in Africa) to be completed will stand at approximately US$ 2.5tn.

With increased FDI inflows to Africa, the potential for disputes arising between host states and investors can be expected to increase, which necessitates devising mechanisms for avoiding them or when they arise, mechanisms for ameliorating their effects on the parties.

This Article discusses Investor-State Dispute Settlement (ISDS) mechanisms in Africa, and draws on the Latin American states' experiences on how ISDS awards can have adverse effects on states. The Article proposes precautions which African countries can take to guard against exposure to the adverse effects of ISDS when disputes end up before investment tribunals. Focus will be on claims filed before the International Center for Settlement of Investment Disputes (ICSID).

Basis of consent to establish International Tribunal Jurisdiction

One of the main issues a party must prove, when it files a claim before a tribunal, is the question of whether such tribunal is clothed with jurisdiction to hear and determine the issues raised in the claim. In international investment, it must be proved that the state party consented to subject such dispute to the arbitration of a given tribunal. Understanding the basis of consent, helps parties, especially state parties, to appreciate the consequences of the undertakings they enter into and how such consequences may affect dispute resolution when disputes arise.

Relevant to Africa, the basis for consent listed by the ICSID caseload-statistics issue 2024-1 are; Bilateral Investment Treaties, (BITs), Investment Contracts, Energy Charter Treaty, Investment Laws, and other treaties. Indeed, as of December 31st, 2023, except for Libya and South Africa, which are neither contracting nor signatory states, the rest of the African States are Contracting States of the ICSID Convention, save for Ethiopia and Namibia, which are just signatories to ICSID Convention,

To promote FDI, African countries have signed Bilateral/Multilateral Investment Treaties, and entered other undertakings, and organizations such as World Trade Organization, (WTO), Trade Related Investment Measures Agreement,(TRIMS), Organization for Economic Cooperation and Development, (OECD) Multilateral Investment Guarantee Agency, (MIGA), United Nation's Commission on International Trade Laws, (UNCITRAL), etc.

The 2014 UNCTAD Data base of BITs, reported that as of June 2013, a total of 854 BITS had signed by African Countries, that is between African and African Country, and African and non African country. This number has certainly since increased. While the purview of these legal instruments and organizations varies, the binding factor of them all, is that they seek to protect and promote investments.

All the aforementioned legal instruments and undertakings create rights and obligations for the signatory states and foreign investors, including consent to subject Investor-State disputes to the jurisdiction of international investment tribunals. As such, almost all of the African States are potential parties to Disputes before ICSID tribunals.

The need for precaution

ISDS damages are usually substantial, covering amounts for principle investments, pre-award and post-award interest, direct loses, and loss of expected future profits. The reported trend in the award of damages and compensation in treaty-based Investor–State dispute settlement proceedings (ISDS) is that the amounts awarded in damages and compensation by investment tribunals have been increasing.

The UNCTAD IIA Issues Note on International Investment Agreements of September 2024, reports that the average award in the decade between 1994 and 2003 stood at US dollars 25 million but increased tenfold to USD dollars 256 in the decade between 2014 and 2023. Tribunals have awarded sums exceeding US dollars 100 million in more than a quarter of all ISDS cases won by investors.

The UNCTAD Issues Note further reports that besides inflation and increased sizes of investment projects, the surging amounts of damages can be attributed inter alia to increasing reliance by tribunals on Discounted Cash Flow (DCF) valuations (Marzal, 2021), a valuation method that considers estimated future income which has been applied in claims for projects that never became operational in the host State, for example, in **Tethyan Copper v. Pakistan**, where the investor's mine remained in the planning stage, with key aspects as to the fiscal framework governing the project yet to be negotiated. While in **Rockhopper v. Italy case**, the investor won almost USD 200 million in damages for a project that never received the necessary operating permits. Both tribunals relied on valuation methods based on estimated future income.

Secondly, higher awards are driven by the increasingly large amounts claimed. In the decade between 2014 and 2023, the average investor claim in ISDS proceedings stood at USD 1.1 billion, up from approximately USD 400 million in the period between 1996 and 2005 (ISDS Navigator).

Because of precedent, it is arguable that damages will continue increasing. The rationale for the argument being that while under the ICJ statute, precedent is a subsidiary source of Law and binding on only parties, in practice, tribunals are heavily relying on precedent to justify their decisions.

Through, precedent, tribunals are giving expanded interpretation to terms of treaties and investment agreements, resulting in unanticipated meanings to terms of treaties as well as investment contracts, as seen in the awards in **Quiborax v Bolivia, 2002** (where rights to provisional measures were created), **Santa Elena v Costa Rica, 1996** (introduction of compound interest instead of simple interest), etc. As such, potentially, tribunals while relying on precedent, will find justification for awarding exorbitant damages.

> **Given that the majority of African Countries are classified among the Least Developed Countries, these exorbitant figures, if awarded against any African state, will have an overwhelming effect on the economy, with social-political implications.**

The Latin American experience and possible actions by African States

Latin American states have a long history with claims before ICSID arbitral tribunals with several impactful awards going against them. On the impact of the decisions and their effects, Nicolas Boeglin noted that "The increasing importance of Latin American states before ICSID proceedings in recent years, and the unfavorable decisions obtained, probably explain the recent regional discussions as they try to find an alternative regional framework to deal with state-foreign investors disputes...the idea is to find a mechanism to resolve foreign investor-state disputes outside ICSID framework... While discussions on a new mechanism will continue in Latin America regional organizations, some states of the region have also decided that the withdrawal of ICSID Convention is a striking mechanism to reduce ICSID´s power..."

Indeed, so aggrieved have the Latin American States been with the ICSID framework that some including, Honduras, Bolivia, Ecuador, and Venezuela have chosen to withdraw from the Convention,

Therefore, as African states enter into new BITs as well as making new legal investment undertakings, and as investors flock to Africa, especially from countries that have signed BITs with African countries, African countries must pay particular attention to dispute resolution mechanisms adopted in the BITs and investment agreements executed with investors, the investment laws enacted as well as the concessions and undertakings they make to the investors, in investment agreements.

African states must also critically consider the identified criticisms against ICSID operations, including; "...pressure on developing countries to hire legal services of extremely expensive foreign law firms, lack of transparency by arbitration panels; a shadow of arbitrator bias in favor of the investor, with different ad hoc tribunals analyzing similar cases reaching different results; the absence of an appeals process, but only a limited annulment procedure; failure to take into account situations of massive economic downturns; cracks in its system of voluntary enforcement and compliance with the award,..." etc (Boeglin Nicolas, 2013).

Proposed Key actions:

It is thus proposed that to guard against the identified risks above, African states ought to take actions to limit exposure to as well as mitigate adverse effects arising from unfavorable awards. African states should consider;

1. Undertaking a deliberate effort to develop citizen expertise in matters of international investment law and in ISDS, to create a pool of experts from which arbitrators as well as legal representatives can be appointed. This way, African states will address the standing criticisms of pressure to hire legal services of extremely expensive foreign law firms, lack of transparency by arbitration panels; a shadow of arbitrator bias in favor of the investor, with different ad hoc tribunals analyzing similar cases reaching different results, etc. as then, experts with an understanding of African perspectives will be involved in ISDS.

2 1Where possible, consideration should be given to renegotiation and or amendment of BITs and MITs, Investment agreements, as well as investment laws, to clarify the wording of treaties to better define obligations and rights, such as international minimum standard of treatment, expropriation, clarification that investment protection should not be pursued at the expense of other public policy objectives and to achieve greater transparency between the contracting parties and in the process of domestic rule-making.

For example the South African Development Community (SADC) crafted a model BIT for its members, calculated to better protect legal interests of stakeholders. In that same vein, SADC member states in 2016 adopted an amendment to the Protocol on Finance and Investment removing provisions on ISDS.

Notably however, while ISDS schemes might have their negatives, opting out is rather extreme, given that to promote FDI while protecting Foreign investor without undermining interests of host states there is need for a balance, especially with respect to dispute settlement.

This can be achieved through pushing for reforms of the ISDS schemes to achieve a balance of the interests of all stakeholders.

3 Explore innovations in ISDS procedures, to not only provide guidance generally to tribunals but also provide greater control of the contracting parties over arbitration procedures, reduce costs and possibly damages awarded in dispute resolution.

4 Additionally, when entering into investment agreement, states ought agree on bespoke compensation clauses.

Through these clauses, the state can define the parameters for determination of compensation, the kinds of damages or compensation and manner of calculation thereof, a state would be liable for in the even of a dispute arising.

Conclusion

When states enter into treaties with other states and make undertakings to investors, obligations arise, a breach of which entitles an aggrieved investor to seek redress from an agreed ISDS scheme. Potentially, as the experience of Latin American States demonstrates, dispute resolution schemes can become very costly for the states and risk undermining the benefits that accrue from FDI inflows. However, through certain precautionary actions, African states can protect themselves from the risks while continuing to attract FDI as well as protecting foreign investors.

Julius Galisonga

About the Author

- Julius is an Advocate of the High Court and all courts of Judicature in Uganda, a Partner at Strand Advocates, Uganda.
- He holds a Master Degree in Business Administration (MBA) and a Master of Science, Construction Law and Dispute Resolution (MSc. CLDR)

+256 752 060099

juliusgalisonga@gmail.com

Disclaimer:

This article is intended to provide general legal information and is not a substitute for professional legal advice. The content is accurate to the best of our knowledge at the time of writing, but laws and regulations may change. Reading this article does not create an lawyer-client relationship. Strand Advocates is not responsible for any reliance on the information contained herein.

Strand Advocates

Law, & more...!