

**IV Annual Forum for Developing Country Investment Negotiators**

Background Papers

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**The Stakes of States in Defending  
Investment Treaty Arbitrations:  
A Game of luck and chance?**

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## 1.0 Introduction

Investment treaty arbitration can be a high-stakes gamble for developing States. If a State loses the arbitration, public funds will be required to pay the damage awards to the investor and to cover the costs of defending the arbitration claim. For example, most recently, an investor was awarded the amount of US\$700 million, plus interest.<sup>1</sup> However, even if a State is successful in defending the arbitration claim, it may still have to bear the costs of arbitration, which can amount to several million.<sup>2</sup>

International investment treaties typically contain an offer by the host State to arbitrate disputes related to the investment with the investor from the other treaty party. The investor accepts the State's offer to arbitrate by filing its request for arbitration for alleged violations of treaty obligations by the host State. As all the obligations under the treaty are borne by the host State with investors only having rights, host States are able to defend the investor's claim, not bring a counter-claim. This is different from a commercial arbitration, which typically arises from a contract in which both investor and the State have rights and obligations, and thus a State can both initiate a claim as well as defend and counterclaim.

Thus, the odds in investment treaty arbitration are stacked in favour of the investor from the start. States can only defend claims, and "winning" the arbitration means that the investor's claim is dismissed on the merits, without the prospect of recovering damages. The best result the State can hope to achieve is recovering all of its costs of defending the arbitration, which, in fact, is rare. In order to fight the investor's claim successfully, States typically incur the "costs of defending the arbitration." The costs of defending the arbitration can include both the "costs of the arbitration proceedings" and "legal fees." Legal fees are those the disputing parties pay to their counsel. Costs of the arbitration include fees paid to the arbitration tribunal and institutional or administrative costs of conducting the arbitration. This paper discusses the stakes for States with respect to recovering the costs of defending an investment treaty arbitration claim.

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<sup>1</sup> *Chevron Corporation (USA) and Texaco Petroleum Corporation (USA) v. The Republic of Ecuador* under UNCITRAL Rules, dated March 30, 2010.

<sup>2</sup> In the 2006 case of *Thunderbird v. Mexico* (NAFTA/UNCITRAL, 2006), the tribunal's majority said that the same approach to costs should apply to international investment arbitrations as to international commercial arbitrations. The investor's claim was dismissed with prejudice, and, although the claimant was ordered to pay the claimant's legal fees in the sum of US\$6,000,000, the total arbitration fees were divided equally between the parties.

## 2.0 Can States Really Win in the Investment Treaty Arbitration Game?

Research analyzing a selection of investment treaty arbitrations indicates that States have even if not better odds in successfully defending claims. According to a recent UNCTAD study, at the end of 2009, 164 investment treaty arbitrations were concluded. Of these 164 cases, 62 cases were in favour of the State; 47 cases were in favour of the investor, and 55 cases were settled.<sup>3</sup> The study thus finds that, of the 109 cases that were not settled, States were successful in 57 per cent of the cases, with investors prevailing in 43 per cent. However, these statistics do not tell the complete story.

First, it must be remembered that the UNCTAD study analyzes a selection of the awards that were made publicly available. The figures may change if an equal or larger number of investment treaty awards that are confidential were to be introduced in the study.

Second, it is not known if the “settled” cases, which represent almost a third of the total number of cases, were settled in favour of the State or the investor. As the claim is brought by the investor, it is likely that the investor could have received some benefit in “settling” the matter.

Third, a State’s success in investment treaty arbitration means that the investor’s claim has been dismissed on the merits. This does not take account of whether the State is also successful in recovering the costs of defending the arbitration claim. The costs of defending investment treaty arbitrations are substantial, and require the use of public funds. Thus, even a State that has successfully defended the claim may still be out of pocket for a few million dollars.

Although international investment treaties are public international law instruments, the disputes under them are settled using rules and institutions designed primarily for commercial arbitration disputes. However, there appears to be a selective application of practices from both genres. In commercial arbitration, the general practice is for the costs to follow the event; that is, the losing party will pay the successful party’s costs.<sup>4</sup> Thus, in commercial arbitration, unless an arbitration agreement provides to the contrary or other factors (e.g., the conduct of the parties) merit otherwise, the arbitral tribunal has the discretion to ensure that “costs should follow the event.”<sup>5</sup> Typically, the party successful on the merits is able to look to the unsuccessful party to pay its reasonable costs of

<sup>3</sup> [http://www.unctad.org/en/docs/webdiaeia20103\\_en.pdf](http://www.unctad.org/en/docs/webdiaeia20103_en.pdf)

<sup>4</sup> This is subject to the arbitration agreement between the parties providing otherwise and other factors (e.g., procedural conduct), which may provide otherwise. See *Cost awards: Are there significant differences between commercial and investment treaty arbitration?*, presented by Dr Sebastian Seelman-Eggebert at the 15<sup>th</sup> ITF Public International Conference- Recent Developments in Investment Arbitration Procedure, London, September 2010.

<sup>5</sup> 61(2) English Arbitration Act, 1996; see also Article 44 SCC 2010.

the arbitrating the claim. In contrast, under public international law arbitrations,<sup>6</sup> the norm has been for each party to bear its own costs of participating in the arbitration.

In investment treaty arbitration, tribunals use their discretion to allocate costs between the parties. A study of 54 publicly available arbitration awards from 2007–2010<sup>7</sup> shows that tribunals adopt a hybrid approach using both the “costs follow the event” principle from commercial arbitration and the practice of each party to bear its own costs from public international law. However, it appears that tribunals are more likely to ask the State when it is the losing party to pay the costs when the investor is successful. For example, in 12 out of 20 claims decided in favour of the investor, the State was asked to pay some costs of the investor, whereas in the remaining eight cases the costs were borne equally between the parties. On the other hand, in only six out of the 20 cases in which the State was successful in defending the arbitration, the State recovered some of its costs of defending the arbitration from the investor. The parties bore the costs equally in the remaining 14 cases. This shows that, even if successful, States are likely to cover their own costs of defending the arbitration in 70 per cent of the cases, whereas successful investors have had to do this in only 40 per cent of the cases. Further, in the 14 claims declining jurisdiction, States were awarded some costs in only three cases, whereas in the remaining 11 they had to meet their own costs. Thus, in approximately 80 per cent of the cases, States have had to cover their own costs even though jurisdiction was declined.

Playing the investment treaty arbitration game is risky for both investors and States. The odds of winning the claim for either appear to be 50:50. However, if investors win, they can look forward to receiving damages and have a strong chance of recovering some of their costs back. On the other hand, if States win, there are no damages to recover, and only a slim chance of even recovering their costs of arbitration, leaving governments out of pocket for a few million dollars. Thus, the stakes are in favour of the investors. This is evident also by the fact that investors now have access to third-party financing of investment treaty claims and contingency fee agreements with law firms. Both of these entitle the funder of the legal costs of the investment treaty claim to a share in damages, thus minimizing the risk for investors in bringing claims. States do not have access to any “no win no fee” arrangements as there are no damages to claim in the investment treaty claims. States remain exposed to having to meet the costs of claims even if they are successful in defending the case.

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<sup>6</sup> For example, Article 64 ICJ Statute.

<sup>7</sup> Sebastian Seelman-Eggebert. (September 2010). *Cost awards: Are there significant differences between commercial and investment treaty arbitration?* Paper prepared for the 15<sup>th</sup> ITF Public International Conference: Recent Developments in Investment Arbitration Procedure, London.