The fate of Investor State Dispute Settlement Mechanism within the context of the new African

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THE FATE OF INVESTOR STATE DISPUTE SETTLEMENT MECHANISM WITHIN THE CONTEXT OF THE NEW AFRICAN CONTINENTAL FREE TRADE AGREEMENT'S (AFCFTA) LEGAL FRAMEWORK

Abstract

This paper is a commentary of the formation of the African Continental Free Trade Area Agreement with special focus on the protocol on the settlement of disputes that has been established under the agreement. The essay begins by describing how the covenant was conceived and the impact it will have for the continent particularly where disputes settlement is concerned. With this in consideration, the paper seeks to interrogate the Investor State Dispute mechanism and its agreeableness with the AfCFTA Agreement in order to assess whether foreign investors should expect an ISDS mechanism within the context of the Agreement.

Introduction

29th April 2019 monumentalized a significant stride in the spirit of Pan Africanism. It was on this day that both Sierra Leone and the Saharawi Republic deposited their instruments of ratification with the depositary of the African Union Commission (AUC), paving way for the agreement establishing the African Continental Free Trade Area's ("AfCFTA Agreement") entry into force. This, is according to Article 23 (1) of the Agreement, which stipulates that entry into force occurs 30 days after the 22nd instrument of ratification is deposited with the Chairperson of the AUC.

The AfCFTA Agreement is a mega-regional trade agreement that creates a Pan-African trade bloc which has the potential to unite 1.2 billion people and create a $2.5 trillion economic area[1] across all 55 member States of the African Union (AU). In terms of numbers of participating countries, AfCFTA will be the world's largest free trade area since the formation of the World Trade Organization (WTO). This is an outstanding achievement – one which rendered the International Monetary Fund (IMF) in its report: Sub-Saharan Africa Regional Economic Outlook: Recovery Amid Elevated Uncertainty[2] to describe the agreement as *an economic game changer*[3] for the continent.

As of July 2019, 54 states had signed the AfCFTA Agreement and 27 states had both signed and ratified the AfCFTA Agreement. This left Eritrea as the only nation not to be part of the Agreement. Eritrea's involvement was obstructed due to an

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[1] African Union, African Continental Free Trade Area Questions & Answers Pg. 1 See: https://au.int/sites/default/files/documents/36085-doc-qa_cfta_en_rev15march.pdf <accessed 28 November 2019>

[2]Sub-Saharan Africa Regional Economic Outlook: Recovery Amid Elevated Uncertainty see: https://www.imf.org/en/Publications/REO/SSA/Issues/2019/04/01/sreo0419 <28 November 2019>

[3] 'Economic 'game changer'? African leaders launch free-trade zone' See: https://www.reuters.com/article/us-africa-trade/economic-game-changer-african-leaders-launch-free-trade-zone-idUSKCN1U20BX <accessed 28 November 2019>

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ongoing state of war, but the 2018 peace agreement between Ethiopia and Eritrea ended the conflict and concluded the barrier to Eritrean participation in the free trade agreement[4].

AfCFTA provides immense opportunity for domestic and foreign investors. With its potential to overcome the historic fragmentation of African economies and open up huge investment and trading opportunities, investors stand to reap rich dividends while contributing to sustainable development.

AfCFTA Historical Background

The AfCFTA is the next step in the process set in motion in 1994 when the Treaty establishing the African Economic Community (Abuja Treaty) entered into force. The Abuja treaty put in place the framework for the establishment of an African Economic Community (AEC) and provided that the AEC was to be established gradually in 6 stages of variable duration.

This plan included the establishment of an African Continental Free Trade Area by 2018. A Common Customs Union by 2019, an African Common Market by 2023 and the African Economic Community by 2028. AfCFTA is a flagship project behind *Agenda 2063.*

Agenda 2063 is a shared framework for inclusive growth and sustainable development for Africa to be realized in the next fifty years[5]. It is a continuation of the Pan-African drive over centuries, for unity, self-determination, freedom, progress and collective prosperity pursued under Pan-Africanism and African Renaissance. It builds on, and seeks to accelerate the implementation of past and existing continental initiatives for growth and sustainable development.

Agenda 2063 seeks to:

- Galvanize and unite in action all African and the Diaspora around the common vision of a peaceful, integrated and prosperous Africa.
- Harness the continental endowments embodied in its people, history, cultures and natural resources, geo-political position to effect equitable and people-centered growth and development.
- Build on and accelerate implementation of continental frameworks, and other similar initiatives.
- Provide internal coherence and coordination to continental, regional and national frameworks and plans adopted by the AU, REC and Members states plans and strategies.
- Offer policy space for individual, sectoral and collective actions to realize the continental vision.

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[4] *Nigeria signs African free trade area agreement* See: https://www.bbc.com/news/world-africa-48899701 <accessed 5 December 2019>

[5] Background Note, 'Agenda 2063: The Africa we want' See: https://au.int/sites/default/files/documents/33126-doc-01_background_note.pdf <accessed 5 December 2019>

Negotiations for the AfCFTA Agreement were launched by the African Union Heads of State and Government in June 2015. By late 2017, the intensity of negotiations had escalated, culminating in the drafting of the agreement itself. By early March 2018, the negotiating forum met for the tenth time to finalize outstanding matters and conclude legal scrubbing in preparation for the signature of the agreement on 21 March 2018.

The African Union formally kicked off the operational phase of the Agreement during a high-level summit in Niger in early July 2019. Here, deliberations concerning Phase I of the Negotiations were concluded which produced four legal instruments: The AfCFTA agreement, Protocol on Trade in Goods, Protocol on Trade in Services and the Protocol on Rules and Procedures on the Settlement of Disputes (Protocol on the Settlement of Disputes).

More negotiations are expected to expedite a further deepening of trade in Africa with "Phase II" of the negotiations that commenced in February 2019. Phase II will focus on provisions for investment, competition and intellectual property rights. A facilitative environment for e-commerce is also being mooted as a possible additional phase-two topic. The talks are expected to continue throughout 2020.

AfCFTA & Dispute Settlement

African governments do not litigate against each other. At least, this has been the narrative within the international trade and dispute settlement community. In fact, the contrary stands to be true as it is western investors who are most notorious for initiating arbitral cases. This sentiment is a reflection of the ICSID case load statistics 2019[6]. The annual report revealed that Sub-Saharan Africa represented 15% of the cases initiated against; placing Africa third only after Eastern Europe and South America which represented a combined total of 49% of cases.

Moreover, according to *ISID in Numbers* Report, European and US investors combined accounted for more than 80% of the total Investor-State Dispute Settlement (ISDS) cases against African countries in the year 2019[7].This is not to say however that African Countries abstain from litigating against each other, the occurrences are just simply "few in number"[8] and this point can be exemplified by the fact that South Africa is the leading Country with just 3 claims against other African States.

Formal dispute settlement therefore, has not been a feature of Intra-African trade. This, may be due to the belief that an openly declared dispute signifies disrespect or a lack of solidarity. Whichever the case, African Governments are not active

[6] ICSID, Caseload Statistics Issue 2019, Pg.11 See: https://icsid.worldbank.org/en/Documents/resources/ICSID%20Web%20Stats%202019-1(English).pdf <accessed 5 December 2019>

[7] ISID in Numbers: Impacts of Investment Arbitration Against African States, Pg. 7 see: https://www.tni.org/files/publication-downloads/isds_africa_web.pdf <accessed 6 December 2019>

[8] *Ibid*

multilateral litigators either and as a consequence, African trade practice has not developed a jurisprudence for guiding trade policy choices.

Nevertheless, the promulgation of the AfCFTA agreement represents a new dawn for Africa. For the first time ever, the Agreement creates a continental dispute settlement body under Part VI of the Agreement which establishes the Protocol on Rules and Procedures on the Settlement of Disputes.

The first reference to a dispute settlement mechanism is mentioned in Article 4(f) of the AfCFTA agreement - which provides for specific objectives. It reads:

> *"For purposes of fulfilling and realizing the objectives set out in Article 3, State Parties shall: … establish a mechanism for the settlement of disputes concerning their rights and obligations."*

Part VI of the Agreement under Article 20 specifically address this declaration as it stipulates:

> *"(1) A Dispute Settlement Mechanism is hereby established and shall apply to the settlement of disputes arising between State Parties.*
>
> *(2) The Dispute Settlement Mechanism shall be administered in accordance with the Protocol on Rules and Procedures on the Settlement of Disputes.*
>
> *(3) The Protocol on Rules and Procedures on the Settlement of Disputes shall establish, inter alia, a Dispute Settlement Body."*

The settlement of disputes under the AfCFTA will be administered in terms of the Protocol on the Settlement of Disputes. It is, to a considerable extent based on the dispute settlement understanding of the World Trade Organization.

The dispute settlement body is empowered to interpret and apply all AfCFTA legal instruments (Protocols, Annexes and Appendices) and determine state parties' rights and obligations under those legal instruments.

Pursuant to article 20 of the AfCFTA Agreement and Article 3(1) of the Protocol on the Settlement of Disputes, the protocol will only: *apply to disputes arising between State Parties concerning their rights and obligations under the provisions of the Agreement*[9]*.*

It is apparent from this Provision that the classical approach to international dispute settlement is adhered to under the Protocol. This is whereby only state parties to an agreement have access to dispute settlement mechanisms established under international agreements.

This is certainly a logical approach but it is not the '*only'* approach to dispute settlement. This kind of methodology made sense when the sovereign equality of states dominated inter-governmental exchanges. "The approach however is

[9] Article 3 (1) AfCFTA

unsuitable for addressing the contemporary needs and realities of globalization"[10]. In here lies one of the controversies behind the ISDS mechanism which shall be discussed later on.

The Agreement is however cognizant of the integral role the Private sector plays in development. Development "must be wielded by private enterprise"[11] active private industry involvement has therefore not been understated as "businesses can benefit from the great opportunities that the continent has to offer, and contribute to its sustainable growth and development"[12]

Considering the stature of the private industries therefore, its irrational that their say in the participation of dispute settlement is only pronounced if their states of nationality act on their behalf when trade agreements are violated. This is merely one observation what is to be expected from adherence to the classical approach.

What is 'ISDS' and what are the challenges it presents?

ISDS stands for Investor – State Dispute Settlement, under which a foreign investor can bring a case to an international arbitration tribunal in accordance with an investment treaty, a domestic legislation or an investment contract between the two parties. ISDS mechanism is based on investment arbitration.

In her proposal, Professor Shan Wenhua was quick to point out that ISDS has become a "buzzword"[13] to the extent the EU Trade Commissioner Cecilia Malmstrõm, described the mechanism as" the most toxic acronym in Europe"[14]. "ISDS has been blamed for triggering the 'legitimacy crisis' of the entire international investment treaty system!"[15]

A brief history behind how ISDS was conceived and designed might shed some insight into why Academics like Professor Wenhua believe the mechanism continues to presents challenges to the international investment community.

From a historical perspective, it is interesting to notice that when the ICSID Convention was drafted between 1961 and 1965, the model of commercial-style arbitration was transplanted to the system for the settlement of Investor-State disputes, without differentiating between contract-based and treaty-based disputes. With hindsight, this was to present the first obstacle behind the mechanism. To their defense however, the drafters of the convention had estimated around 90% of the cases to be under investment contracts and

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[10] This assessment was made by Gerhard Erasmus' in *Dispute Settlement under the AfCFTA. he* comments on the appropriateness of ISDS mechanism for AfCFTA *See: https://www.tralac.org/publications/article/13136-dispute-settlement-under-the-afcfta.html <accessed on 02/12/2019>*
[11] See note 1
[12] *ibid*
[13] Professor Shan's proposal during the ISDS Reform Conference 2019. This was an Oxford-style debate with the motion being: The Permanent Investment Court system is the solution to the concerns over ISDS.
[14] Global Policy Forum, 'The Zombie of ISDS', See: https://www.globalpolicy.org/component/content/article/270-general/52843--the-zombie-isds.html <accessed 13 December 2019>
[15]Professor Shan's remarks

concessions. As it turned out, over 70% of ISDS cases are based on investment treaties and only less than 20% of the cases are based on investment contracts[16].

As previously mentioned, much of the criticism that surrounds ISDS comes from the concern that "it is a system which impacts and limits genuine regulatory activities".[17]

The essence of international law is about the reciprocal protection of foreign interest ergo imposing and accepting certain limits on a reciprocal basis so that actions of sovereign states do not have negative effects on foreign interest.

Despite the Abuja Treaty's vision for an African Economic Community by 2028, presently, so much of our economic growth as a continent is contingent on our ability to export extractive commodities and Invest in 3rd country markets. The share of Africa's exports to other African State account for less than 20% (See Table 1 Below).

Importing from foreign states and dealing with multinational companies currently dictates the African economic framework. This structure provides some insight into our current reliance on ISDS mechanism. Unfortunately, the mechanism has continuously been panned for allowing investors such as multinationals to take governments to International arbitration tribunals - which critics argue interferes with a country's right to regulate. As a result, this usually has the effect of lowering standards.

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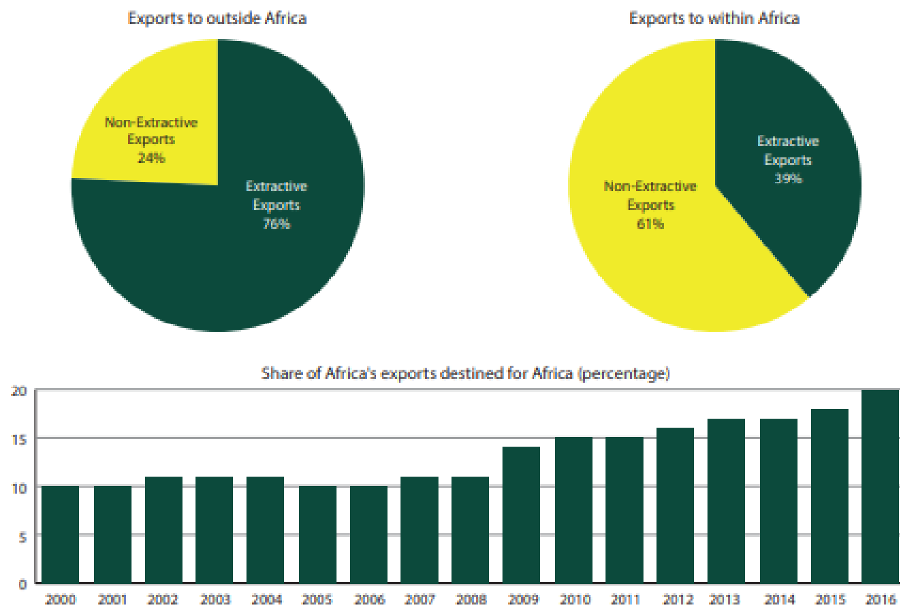
[16] See Note 14

[17] C. Brown's remarks at the 3rd Vienna Investment Arbitration Debate, The European Union's approach to investment dispute settlement (22 June 2018), See: https://trade.ec.europa.eu/doclib/docs/2018/july/tradoc_157112.pdf <accessed 12 December 2019>

Table 1

African Continental Free Trade Area - Questions and answers



Source: Figures I and II: Extractive exports: CEPII-BACI trade dataset, three-year averaged exports (2012-2014), extractive exports include petroleum oils, gas, non-ferrous metals, metalliferous ores and metal scrap, crude fertilizers and minerals, coal, coke and briquettes, and the remaining precious metals in HS 71, uranium, and the basic iron products of HS7201–HS7206. Figure III: Intra-African trade: IMF Direction of Trade Statistics.

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Source: [1] African Union, African Continental Free Trade Area Questions & Answers Pg. 1 See: https://au.int/sites/default/files/documents/36085-doc-qa_cfta_en_rev15march.pdf

ISDS in the AfCFTA Legal Framework

The future of ISDS in the architecture of the AfCFTA is presently unclear. There are a number of factors working together to muddy the landscape. To begin with, AfCFTA's legal framework appears to be unfavorable due to the fact that some African states have abandoned the ISDS mechanism through cancellation of existing Bilateral Investment Treaties (BITs). Moreover, the retreat from ISDS by some regional economic communities in Africa, coupled with the ghost of the disbanded South African Development Community Tribunal (SADC Tribunal) that continues to hover, complicates optimal use of the mechanism.

Conversely, there are a few compelling reasons why ISDS remains a viable option for investors. For instance the fact that there is currently in existence at least 30[19] in-force intra-African BITs utilizing ISDS - may prove difficult to discontinue use of the mechanism. Likewise, an additional 120 intra-African BITs have been signed

[19]Maximizing investment protection in Africa: the role of investment treaties and investment arbitration, China Law insight blog, (July 2 2015) See: https://www.lexology.com/library/detail.aspx?g=1e540917-3888-460f-9b0c-298c52ad864e <accessed on 09/12/2019>

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but not ratified not mention the existence of numerous 'in force' BITs between African States and third states that also provide for ISDS. Finally, it must be noted that states may be less committed to investor-state arbitration, but are likely to continue to embrace it in at least some of their treaty practice given their position as rule-takers rather than rule-makers.[20]

These are just a few observations. A close inspection of ISDS might reveal whether it is indeed the appropriate mechanism to employ within the context of AfCFTA's Legal Framework.

Why should ISDS mechanism be expected?

To begin with, Africa already embraces an Investor-State Arbitration framework. This is illustrated by the fact that Africa represents a third of the 153 countries that have ratified the ICSID Convention.

Collectively, African countries have signed hundreds of BITs that provide for ISDS specifically; more than 960 BITs involve an African state, with Egypt, Morocco and Tunisia taking the lead[21]. Furthermore, more than half the Continent have also ratified the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the 'New York Convention'.

Both these Conventions are key indicators of a strong legal framework for cross-border dispute settlement, as they are frequently used as reference when evaluating trade and investment attractiveness and contribute significantly to the investor-friendly environment. With these kind of guaranties in place, it's not difficult to see why Africa may continue to embrace the ISDS mechanism.

The weak legal and regulatory frameworks existing in many member states is another compelling reason that may lead to the integration of the ISDS mechanism within the context of AfCFTA Agreement.

According to the World Justice Project (WJP) Rule of law Index 2019, where good governance, transparent, effective and accountable institutions were concerned, African Nations ranked last.[22] This could translate into a lack of investor confidence generally as member states need to be assured of a robust legal structure to facilitate the process of trading across borders otherwise, they may not be eager to engage in business with member states who have weak legal frameworks.

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[20] 'UNCITRAL and ISDS Reform: Pluralism and Plurilateral investment', See: **ejiltalk.org**/uncitral-and-isds-reform-pluralism-and-the-plurilateral-investment-court/ <10 December 2019>

[21] E Lindsey and L D Burnett, 'International Investment in Africa: Year in Review 2016', Bryan Cave LLP, (2016), p. 6

[22] World Justice Project, 'Rule of Law Index' (2019) Pg. 19. The WJP Rule of Law Index measures countries' rule of law performance across eight factors:

- ✓ Constraints on Government Powers,
- ✓ Absence of Corruption,
- ✓ Open Government,
- ✓ Fundamental Rights,
- ✓ Order and Security,
- ✓ Regulatory Enforcement,
- ✓ Civil Justice and Criminal Justice.

In fact, it was reported that more than half of the countries in Africa are found in the bottom quartile of the World Bank Group's Doing Business 2019 rankings[23]. Given the weak regulatory environment, countries may see a need to use ISDS as it's a mechanism praised for its - predictability. A crucial element, that has been pronounced as one of the bedrock principles found in the preamble of the AfCFTA Agreement.

Member States affirm:

> *"the need to establish clear, transparent, predictable and mutually-advantageous rules" to govern trade in goods and services and investment among State Parties".*[24]

Why should ISDS mechanisms be rejected?

Deep skepticism about the ISDS mechanism is being felt globally and in the context of Africa, skepticism has matured into an overhaul of the mechanism in countries like South Africa which foreclosed future participation in international investment arbitration except in very limited circumstances. Tanzania followed suit in August 2018 when it tendered notice of its intention to terminate the Tanzania-Netherlands BIT.

The growing concerns over the ISDS mechanism is both systemic and fundamental in nature. After extensive discussions and consultations with member states and other stakeholders, the Working Group III of UNCITRAL identified three main concerns attributable to the systemic nature of ISDS. These concerns range from, the decision making process, arbitrators, to outcomes in addition to the costs and cost allocation.

First, the concerns relating to the lack of consistency of arbitral decisions by ISDS tribunal are chief amongst the growing concerns[25]. Issues relating to coherence and correctness of arbitral decisions made by ISDS tribunals have left many nations to question the soundness of the mechanism.

ISDS has proved highly controversial in a number of states, resulting in strong pushback. Countries like Nigeria[26] and Egypt[27] have both suffered numerous inconsistent awards and these concerns are related to unjustifiably inconsistent interpretations of investment treaty provisions especially where it provides for principles afforded to foreign investors from the Most Favored Nation and National Treatment clause.

Furthermore, a drawback of ISDS mechanism has been observed where it relates to the limited devices available to address inconsistency and incorrectness of

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[23] World Bank Group, Doing Business 2019, See: https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf Pg. 5 <accessed 10 December 2019>

[24] Preamble of the AfCFTA Agreement

[25] See note 13

[26] Process and Industrial Developments Limited (P&ID) v. Federal Republic of Nigeria [Ad Hoc Arbitration]

[27] Unión Fenosa Gas, S.A. v. Arab Republic of Egypt, ICSID Case No. ARB/14/4

decisions. This point has been exemplified by the inadequacies of the ICSID annulment mechanism and domestic court procedures.

Secondly, ISDS has been continuously criticized for the lack of appropriate diversity amongst decision makers specifically where it pertains gender and geographical diversity.

Throughout the history of investment arbitration, African arbitrators have been underrepresented even in cases involving an African state. According to the ICSID database, out of 613 cases registered under the ICSID Convention and the Additional Facility Rules as of 2017, 22 per cent involved an African state party.[28] However, African arbitrators, conciliators and ad hoc committee members represented only 4 per cent,[29] which accounted for a total of 90 individuals, compared to 979 Western Europeans and 437 North Americans including Mexicans, appointed by both ICSID and the parties.[30]

The changing political landscape of investment arbitration in Africa with the promotion of the Protocol on the Settlement of Disputes represents an opportune moment for African states to improve the training of professionals in arbitration law which will strengthen the demand for home-grown arbitrators. This opportunity could only be realized if AfCFTA member states decide to opt for an active state-state dispute settlement mechanism which embraces African arbitrators as alternative to ISDS mechanism.

Finally, concerns relating to cost and duration of ISDS cases have left many to question the jurisdiction of ISDS. The amounts at stake in investment treaty arbitration are usually astronomical. The average claim in investor–state arbitrations based on bilateral investment treaties and other international investment agreements (IIAs) is about US$492 million[31] and multibillion-dollar claims are increasingly common.

To put this in perspective, Africa alone bears 8 of the most expensive known awards or settlements according to the ISDS in Number report[32] with the most recent case targeting Nigeria in *Process and Industrial Developments Ltd. v. The Ministry of Petroleum Resources of the Federal Republic of Nigeria*[33].

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[28] ICSI Process and Industrial Developments Limited (P&ID) v. Federal Republic of Nigeria [Ad Hoc Arbitration] See:
https://www.irishtimes.com/business/energy-and-resources/nigeria-to-appeal-9-billion-award-to-irish-backed-
company-over-failed-gas-deal-1.3991155 D, Caseload Statistics on Africa, (2017), p. 7

[29] ICSID, Caseload Statistics on Africa, (2017), p. 29

[30] ICSID, Caseload Statistics on Africa, (2017), p. 28

[31] D Rosert, 'The Stakes Are High: A review of the financial costs of investment treaty arbitration' (July 2014) See: https://www.iisd.org/sites/default/files/publications/stakes-are-high-review-financial-costs-investment-treaty-arbitration.pdf <accessed 12 December 2019>

[32] See note 7 Pg. 6

[33] Process and Industrial Developments Limited (P&ID) v. Federal Republic of Nigeria [Ad Hoc Arbitration] See:
https://www.irishtimes.com/business/energy-and-resources/nigeria-to-appeal-9-billion-award-to-irish-backed-
company-over-failed-gas-deal-1.3991155 <accessed 4 October 2019>

This case witnessed the parties who had entered into a written Gas Supply and Processing Agreement ('GSPA') whereby the Nigerian Government agreed that for a term of 20 years it would make available to the Claimant Wet gas which they would in return process and return to the Government in the form of Lean Gas.

The Claimant alleged that the Government was in breach of its obligations by not providing any Wet Gas by the dates stipulated. Consequently, the Claimant repudiated the GSPA and claimed USD 6.6 billion in damages for lost profits. The tribunal ruled in favor of the Claimant with an interest of 7 per cent per annum, due to accrue on the award until the date of payment. The Claimant began recognition and enforcement proceedings in the UK with Nigeria in full resistance. However, the UK Courts upheld and converted the award into a UK judgement with the interest topping at USD 9 billion as at August 2019.

Also, the fact that ISDS mechanism burdens the loser of the party with the allocation of cost by arbitral tribunals is more compelling reason to reject the mechanism.

The concerns over the aforementioned aspects are closely intertwined. The quality of decisions depends on the quality of decision makers; and the quality of decision makers also impacts costs. The cost of arbitration, in turn, is not only closely linked to both the qualifications and appointment of the decision makers, but also relates to the consistency of the decisions since money is unlikely to be wasted on arguing for a claim upon which a consistent negative decision has been made.

The concerns voiced against the ISDS mechanisms are multifaceted and wide-ranging, but they are only manifestations of the fundamental problem of the system. Only a systemic structural change can address some of the perceived problems in the system and perhaps If these reforms are achieved to restructure the entire ISDS mechanism it may reduce the concerns however, it stands however, the dissuading factors outweigh to potential benefits from reliance of the ISDS mechanism. What is incontrovertible however is that there is need for legal remedies to accommodate and ensure efficient outcomes and optimal practices. Given the growing International pushback against the legitimacy of ISDS, it is vital that AfCFTA member states first deliberate what they stand to benefit and lose from the mechanism before committing to it

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