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UNICTRAL WORKING GROUP III

Second Session on the Investor-State Dispute Settlement System Continues Discussion of Concerns with the System

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Executive Summary

Working Group III has the mandate to consider possible reforms to the Investor-State Dispute Settlement system. The Working Group continued its deliberations in New York City in late April 2018 – its second session on this topic. The Working Group's discussions again focused on identifying areas of concern regarding the present system. The perceived lack of consistency in decisions in Investor-State Disputes was debated as well as the apparent inability of the present system to guard against unjustifiable inconsistencies. The Working Group also considered issues regarding the appointment of arbitrators and decision makers and ethical issues relating to those individuals. Finally, the Working Group discussed the varying perceptions of the system by States, investors, and the general public. At its next session in Vienna later in 2018, the Working Group likely will begin consideration of the desirability of any reforms to address the concerns previously discussed.

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I. Introduction

Working Group III (WG III) of the United Nations Commission on International Trade Law (UNCITRAL) held it thirty-fifth session in New York City from 23-27 April 2018. UNCITRAL's "broad mandate" to WG III is "to work on possible reform of investor-State dispute settlement."[1] WG III began its deliberations on this important topic at its thirty-fourth session held in Vienna from 27 November 27 through 1 December 2017. At that session, WG III began the process of identifying concerns regarding the present treaty-based Investor-State Dispute Settlement (ISDS) system. More specifically, at its previous session in Vienna, WG III considered possible issues relating to:

- duration of the ISDS resolution process and resulting costs;
- transparency; and
- coherence and consistency.[2]

Perhaps reflecting the importance of the topic, as well as global interest, the thirty-fifty session of WG III was attended by many more States, international organizations, and non-governmental organizations (NGOs) than the previous session. The session in New York featured five additional observer States and almost twenty additional NGOs.[3] The new NGOs in attendance included organizations supporting the positions of trade unions and employees, proponents of sustainable development, and environmental groups.[4]

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[1] A/72/17, "Report of the United Nations Commission on International Trade Law, Fiftieth Session", Supplement No. 17 (3-21 July 2017), ¶ 264.

[2] See A/CN.9/930/Rev.1, "Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November-1 December 2017)," Part I (19 Dec. 2017); A/CN.9/930/Add. 1/Rev.1, "Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November-1 December 2017)," Part II (26 Feb. 2018).

For a discussion of the deliberations at the thirty-fourth session of WG III, see A.M. Anderson, "UNCITRAL Working Group III: First Deliberations on Reforms of the Investor-State Dispute Settlement System," available at https://fica-disputeresolution.com/news/2018/1/3/fica-participates-in-the-34th-session-of-uncitral-working-group-iii.

[3] Compare A/CN.9/930/Rev. 1, ¶s 7-10 with A/CN.9/935, "Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session (New York, 23-27 April 2018)," (14 May 2018), ¶s 4-7.

The European Union and the Swiss Agency for Development and Cooperation provided contributions to the UNCITRAL Trust Fund to allow developing States to attend sessions of the Working Group. A/CN.9/935, ¶ 16.

[4] See ibid., ¶ 7(c).

At this session, WG III continued consideration of the issue of coherence and consistency in the ISDS system. WG III also explored issues relating to arbitrators, including questions of impartiality and independence, how arbitrators are appointed, the lack of diversity amongst arbitrators, and concerns about arbitrators also acting as counsel in ISDS disputes. The final topic discussed was the views of States, investor, and the public toward the ISDS system and the general negative perceptions of the system that exist due to its appearance of inconsistency in outcomes.[5] WG III will continue its deliberations on the question of reform of the ISDS system at its next session later this year in Vienna.

II. Pre-Session Submissions

Prior to the commencement of the session in New York City, the Working Group received submissions from two international organizations (the International Centre for Settlement of Investment Disputes (ICSID) and the Permanent Court of Arbitration (PCA))[6], the European Union (EU),[7] and the Government of Thailand.[8] These submissions, particularly the EU's, provided insights into the current ISDS system and some of the concerns regarding it.

Thailand's submission was intended to identify "procedural concerns regarding ISDS from the perspective of a developing country, both as a recipient of foreign direct investment and as a capital exporter."[9] Thailand expressed concerns on the time and cost required in ISDS arbitral proceedings. It also focused on the biases and repeated appointment of arbitrators and "double-hatting" – arbitrators who act as counsel and as arbitrators in similar disputes. Thailand asserted, "Inconsistent and incoherent views of arbitrators produce inconsistent and incoherent arbitrations awards." It recommended that the Working Group should consider not only a code of conduct for ISDS arbitrators, but also the "idea of adding a new layer to the current ISDS system,

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[5] See generally ibid., ¶s 12-100.

[6] A/CN.9/WG.III/WP.146, "Possible reform of Investor-State dispute settlement (ISDS): Submissions from International Intergovernmental Organizations and additional information: appointment of arbitrators," (19 Feb. 2018).

[7] A/CN.9/WG.III/WP.145, "Possible reform of Investor-State dispute settlement (ISDS): Submission from the European Union," (12 Dec. 2017).

[8] A/CN.9/WG.III/WP.147, "Possible reform of Investor-State dispute settlement (ISDS): Comments by the Government of Thailand," (11 Apr. 2018).

[9] Ibid., ¶ 1.

be it an internationally composed entity or an appellate review mechanism of awards, and avoiding unnecessary new ISDS institutions."[10]

Thailand also pointed out that many developing countries do not have experience with ISDS cases. As a result of such lack of experience, developing countries often are unprepared when an investor-State dispute arises. International law firms specializing in ISDS disputes often are preoccupied with other cases and so devote limited resources to a particular case. Further, many law firms specializing in ISDS do not understand the concerns particular to developing countries, particularly costs and the arbitration procedures themselves. These law firms sometimes exhibit a "lack of flexibility in certain circumstances."[11]

Thailand stated that there is no international organization that specializes in providing low-cost, independent legal assistance for ISDS disputes, such as the Advisory Centre on WTO Law for World Trade Organization disputes. Creation of a similar entity for ISDS would ensure that developing countries could more readily afford defending a claim from an investor. Thailand also urged UNCITRAL to coordinate its discussions on ISDS with other organizations, such as UNCTAD, ICSID, and OECD, and should provide training to developing countries on how to avoid investor-State disputes.[12]

The submissions from ICSID and PCA described their respective methodologies for appointing arbitrators in ISDS cases they each might administer. ICSID described its process in some detail, under various scenarios that might arise. The points identified included the fact that as of February 2018, 84% of the arbitrators on ICSID tribunals were appointed by the parties or, in the case of the chair, by the party-appointed arbitrators. In addition, ICSID requires that an arbitrator cannot have the same nationality of either of the parties, unless both parties agree to such an appointment.[13]

The PCA also described its appointment process for ISDS registry cases, which usually is pursuant to the UNCITRAL Model Arbitration Rules. If the parties' party-

[10] Ibid., ¶s 6-14.

[11] Ibid., ¶s 15-18.

[12] Ibid., ¶s 19-25.

[13] A/CN.9/WG.III/WP.146, ¶s 9-40.

appointed arbitrators cannot agree on a presiding arbitrator, a list-procedure is used. It also provided statistical information regarding arbitral appointments and the number of instances where some assistance from the PCA was requested. Between 2001 and January 2018, the PCA received one or more arbitrator challenges in 33 cases it administered, meaning that over 80% of the PCA's ISDS cases did not involve a challenge to an arbitrator. Of the 43 instances where a challenge was decided by the PCA or another appointing authority, 13 challenges were upheld.[14]

The EU's submission covered twelve pages and sought to identify and consider concerns with the current ISDS system. The EU first identified six characteristics of the present ISDS system, which it asserts are framed by "two key features, i.e., the public international law basis of the [ISDS] treaties and the public law nature of the relationship" between investors and States. Those six characteristics, according to the EU, are:

> (1) a constitutional/administrative law component, with the investment treaties intended to protect investors from certain limited actions by States;
> (2) a unidirectional system, with the investor alone commencing a case against a State;
> (3) a vertical relationship, with disputes typically being brought by an investor against a State that arise primarily from the vertical regulatory relationship between foreign investors and the host State created when the foreign investor enters into the host State's economic and legal systems;
> (4) a repeat function, with investment treaties often resulting in a number of disputes over time;
> (5) a determinacy component, with general, high-level standards imposed that apply in different fact situations involving different parties; and
> (6) a predictability/consistency function, with precedents being reviewed to understand how obligations in treaties are or should be interpreted.[15]

[14] Ibid., ¶s 41-68.

[15] A/CN.9/WG.III/WP.145, ¶s 3-6.

The EU then compared similar systems, which it concluded typically result in the creation of permanent bodies with full or part-time decision-makers to decide disputes, such as the European Court of Human Rights. The EU reviewed the expanding number of ISDS disputes and concluded that there are "significant concerns with the existing ISDS system." It summarized these concerns as:

- the lack of consistency and predictability flowing from the ad-hoc nature of the system, "inasmuch as arbitrators are repeat players, or are seeking to be repeat players, in a system where the adjudicators need to be appointed afresh for each dispute";
- the adverse perceptions caused by the present system;
- limited systemic checks on correctness and consistency in the absence of an effective appeal mechanism;
- the nature of the appointment process impacting the outputs of the adjudicative process;
- significant costs; and,
- a lack of transparency.[16]

The EU concluded that these concerns are "systemic in nature" that derive "above all" from "the ad hoc nature of the tribunals and the lack of appellate review."[17]

III. The April 2018 Session of WG III

This thirty-fifth session of WG III in New York City continued to follow the outline for deliberations contained in the Note from the Secretariat circulated prior to its initial session on ISDS reform.[18] In general remarks by various delegations and the chair, WG III emphasized the importance of the Group's mandate from UNCITRAL "for developing States in light of the impact of investment and ISDS on sustainable development." Further, "the need for any ISDS reform to strike a balance between rights and obligations of States on the one hand and of the investors on the other was stressed."[19]

[16] Ibid., ¶s 7-36.

[17] Ibid., ¶ 37.

[18] See generally A/CN.9/WG.III/WP.142, "Possible reform of investor-State dispute settlement (ISDS): Note by the Secretariat," (18 Sept. 2017).

[19] A/CN.9/935, ¶s 13-14.

The importance of discussing possible reforms at the multilateral level also was emphasized. In this regard, the "UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (the "Mauritius Convention on Transparency") was referenced as an example of how States could, in fact, reach an understanding on reform of the ISDS system. While some discussion occurred on reform options, WG III agreed that discussion of any such reforms was still premature, until a full discussion of concerns with the current system had concluded.[20]

WG III then discussed three areas of concern: coherence and consistency of arbitral outcomes (continuing the discussion of this particular topic from the previous session), arbitrators/decision makers in ISDS, and the perceptions of States, investors, and the public regarding the present system.[21] The deliberations covered each of these topics in some detail.

A. Arbitral Outcomes

The Working Group returned to its discussion at its first session regarding coherence and consistency in ISDS outcomes. "Two questions had underlined consideration of that matter: one, regarding the desirable level of consistency in ISDS outcomes and, the other, the extent to which undesirable inconsistency was perceived to be a concern."[22] It was pointed out that different outcomes could be expected under different treaties, and that even cases involving the same treaty provisions might result in different outcomes in light of the specific facts of each case.[23]

Moreover, correctness in the result should not be sacrificed in the name of consistency. Rather, the focus should be on cases in which different outcomes were unjustifiable. In that regard, based on a review of published decisions, few such instances in fact occurred. Examples raised included inconsistent interpretation of most-favoured nation (MFN) clauses; differing expressions of the scope and effect of the umbrella clause; and contradictory interpretations of what was an investment and expropriation. Regardless of their number, the impact of such inconsistencies was asserted to be large, particularly on the credibility of the ISDS system, both from the

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[20] Ibid., ¶s 12-19.

[21] See generally ibid., ¶s 20-97.

[22] Ibid., ¶ 20.

[23] Ibid., ¶s 21-28.

standpoint of investors and States. There was considerable consensus that the current ISDS system did not provide adequate safeguards against unjustifiable inconsistencies.[24]

While a number of possible solutions were discussed, including States amending investment treaties to eliminate ambiguous provisions or to provide greater consistency across treaties, there was much debate on creation of an appeals process or similar mechanism to ensure greater consistency. There was emphasis that in the context of any possible reforms, efficiency, flexibility and reducing costs should guide such discussions.[25]

B. Arbitrators/Decision Makers

WG III next turned to a discussion of the appointment of arbitrators and decision makers in ISDS cases and ethical issues relating to those individuals. The Group first discussed whether there were sufficient guarantees of an arbitrator's independence and impartiality. This is a critical issue for the acceptability of the ISDS process. There was much criticism of the party-appointment process and the incentives emanating from that process. Evidence was presented of investors or States repeatedly appointing the same individuals. Preliminary discussion occurred of possible solutions to this issue, including broad agreement on the importance of ethical codes for arbitrators. Other preliminary approaches raised included creation of a system where arbitrators are appointed by an independent body, not the parties; creation of a body with permanent judges; and greater transparency regarding the appointment process by administering arbitral institutions.[26]

Discussion of the appointment process focused on the limited number of individuals who are repeatedly appointed as arbitrators in investor-State disputes. The focus was on two aspects: first, the lack of diversity in arbitrator appointments and second, the fact that some arbitrators were repeatedly appointed. There was a consensus that these issues raised concerns regarding the ISDS process.[27]

[24] Ibid., ¶s 29-38.

[25] Ibid., ¶s 20-44.

[26] Ibid., ¶s 45-68.

[27] Ibid., ¶ 69.

“The lack of diversity was said to be exemplified by a concentration of arbitrators from a certain region, a limited age group, one gender and limited ethnicity.”[28] Statistical evidence was presented to show this point. There was general agreement that there should be much greater diversity – in each of the above-mentioned areas – in arbitrator appointments, and that investors, States, and arbitral institutions had roles to play in addressing this issue.[29]

Similarly, States play a role in repeat appointments of arbitrators. Concerns regarding a lack of transparency in the appointment process again were raised, as well as the need to increase such transparency. Possible preliminary solutions raised to the lack of diversity and repeat appointments included creation of a permanent pool of arbitrators and training to expand the pool of potential international arbitrators.[30]

The Working Group also addressed concerns relating to “double-hatting” – an individual acting as an arbitrator in one case while also acting as counsel in another. Empirical evidence showed this practice was endemic in ISDS, and that it created a number of issues, including actual and potential conflict situations. There was general agreement that concerns surrounding “double-hatting” needed to be addressed as part of ISDS reform. Questions also were raised whether arbitrators adequately understood the public interest concerns of States compared with judges holding public office. There was a desire expressed for empirical studies and analysis on this issue. It was generally agreed that qualifications of arbitrators were important, but that that topic did not require a particular systemic solution.[31]

Lastly, the increasing prevalence of third-party funding was discussed in the context of arbitrators and decision makers. The potential for third-party funders to have effective control over an ISDS case, regardless of its merits, was raised. While pros and cons regarding third-party funding were discussed, the general consensus was that this was a topic to be further considered in relation to the need for greater

[28] Ibid., ¶ 70.

[29] Ibid., ¶s 71-73.

[30] Ibid., ¶s 74-77.

[31] Ibid., ¶s 78-88.

transparency, disclosure, and security for costs when WG III turned to discussion of possible reforms.[32]

C. The Perceptions of States, Investors, and the Public

Finally, for this session, WG III considered how States, investors, and the public perceived ISDS, although this topic had been previously considered in connection with the discussions on other issues. Concerns were raised that "the current ISDS system was perceived to be at odds with global governance and accountability requirements." While perceptions should be considered, it was generally agreed that they should not drive the Working Group's work, but rather any reforms should be based on empirical evidence and facts.[33]

It was in connection with consideration of perceptions that the Working Group heard a number of interventions from NGOs promoting labour rights, environmental protection, democracy and the role of domestic courts, and impacts on non-investors and access to justice. These organizations emphasized the need to take a complete review of the system and that any reforms should take into account their concerns.[34]

IV. Conclusion

With the end of its thirty-fifth session, WG III now has completed consideration of sections 2 and 3 of its proposed outline for discussions.[35] It was agreed that further discussion of concerns relating to the current ISDS system was not foreclosed, and that the group would continue to work "at a measured pace." The primary topic for discussion at its next session later in 2018 in Vienna likely will be consideration of the desirability of any reforms to address the concerns heretofore raised. Suggestions were made for the UNCITRAL Secretariat to prepare a framework for future deliberations. States were also invited to submit papers prior to the next session.[36]

[32] Ibid., ¶s 89-92.

[33] Ibid., ¶s 93-96.

[34] Ibid., ¶ 97.

[35] Ibid., ¶ 98. See A/CN.9/WG.III/WP.142, ¶s 5-47.

[36] Ibid., ¶ 99-100.

The Republic of Korea proposed to host an intersessional regional meeting on ISDS reform in part to raise awareness of the issues in the Asia-Pacific region and indicated such a meeting might be held in late August or early September. Morocco also indicated it would be interested in hosting a similar event. Ibid., ¶s 101-102.

Given the extensive discussions thus far, the future work of WG III surely will continue to be interesting, informative, and important for investors, States, and other parties interested in the ISDS system and its possible reform.