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# Reforming The Investor-State Dispute Settlement System: Increasing Transparency and Efficiency



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## Introduction

The Investor-State Dispute Settlement (ISDS) system allows a foreign national, either an individual or an entity, with an investment in a State, to assert a claim directly against a sovereign State. ISDS represented a major change to the international judicial system which generally foreclosed such direct actions and, instead, relied on diplomacy to resolve investment-related disputes.

International investment treaties were conceived to encourage foreign investment in States which were parties to the treaties and, often, were under-developed nations desiring foreign direct investment. Such agreements seek to provide foreign investors with a degree of confidence in the stability and safety of their investments, including substantive guarantees that

impose enforceable obligations on States. These include undertakings by States to provide fair and equitable treatment for the foreign national and, also, to protect against expropriation and discriminatory treatment.

## ISDS Reform

Today, more than sixty years after adoption of the first bilateral investment treaty (BIT), over 2,500 BITs have been executed world-wide. Additionally, more than 3,250 international investment agreements (IIAs) exist.<sup>1</sup> These agreements have spawned more than 1,000 treaty-based ISDS cases. Fifty-five publicly-known cases were filed in 2019 alone, with seventy-one decisions issued that year by arbitral tribunals. Damages awarded against States ranged from a few million dollars to USD 8 billion.<sup>2</sup>

The increased number of ISDS cases and the frequently substantial awards against States, however, led to increased criticism of the entire ISDS system. Many commentators contended that the ISDS system was unfair, lacked transparency, and resulted in inconsistent or incorrect decisions.<sup>3</sup>

As a result, in 2015 the United Nations Commission on International Trade Law (UNCITRAL) considered whether to begin discussion of potential reforms of the ISDS system. In 2017, UNCITRAL assigned its Working Group III (WG III) with a broad mandate to work on possible reform of ISDS. WG III was instructed to '(i) first, identify and consider concerns regarding ISDS; (ii) second, consider

1 See Rudolf Dolzer & Christoph Schreuer, *Principles of International Investment Law* (Oxford, 2008), 2; United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development* (United Nations, 2006), 26; UNCTAD, *World Investment Report 2020: International Production Beyond the Pandemic: Key Messages and Overview* (United Nations, 2020), xii.

2 UNCTAD, *World Investment Report 2020*, *supra* n.1, at xii.

3 See, e.g., Michael Nolan, 'Challenges to the Credibility of the Investor-State Arbitration System', 5 *Am. U. Bus. L. Rev.* (2015), 429-445; Raphael Lencucha, 'Is It Time to Say Farewell to the ISDS System?', 6 *Int'l J. Health Policy Manag.* (2016), 289-291. See generally Michael Waibel, Asha Kaushal, Kyo-Hwa Chung & Clair Balchin, *The Backlash Against Investment Arbitration: Perceptions and Reality* (Kluwer Law International, 2010).

whether reform was desirable in light of any identified concerns; and (iii) third, if the Working Group were to conclude that reform was desirable, develop any relevant solutions to be recommended to the Commission.<sup>4</sup>

WG III began its work in Vienna in November 2017. It soon became apparent that the discussions would be intense, often controversial, and not easy. The number of State and non-State participants in the sessions has increased significantly since WG III began its work.<sup>5</sup> At its continued 40<sup>th</sup> Session on 4-5 May 2021, WG III debated a plan of action that would require increasing the number of annual sessions (presently, two) and adding multiple informal intersessional meetings over the next few years with the aim of concluding ISDS reform by 2026. This increased work tempo will require more than USD 4 million to be added to WG III's budget.<sup>6</sup>

WG III has identified many topics for discussion. They include: the duration and cost of ISDS; lack of transparency in ISDS proceedings; lack of an early dismissal mechanism to eliminate meritless claims; the lack of a mechanism to address counterclaims by respondent States; the apparent lack of consistency and coherence in ISDS decisions, including review mechanisms; and issues regarding arbitrators, including their appointment and ethical requirements.<sup>7</sup> It has raised possible reforms of the ISDS system, some of them far-reaching. These include: the creation of a multi-national investment court or ISDS court of appeal; creation of an advisory centre similar to the World Trade

Organisation's Advisory Centre; development of a code of conduct for ISDS arbitrators; improving security for costs; and addressing claims by shareholders for reflective loss.<sup>8</sup>

Consideration of all the reforms and issues now being debated – and others likely to arise over the next several years – will require a lengthy discussion.<sup>9</sup> The focus of this article is on proposals to increase transparency, particularly the issue of 'double-hatting' in ISDS cases; the thorny questions surrounding third-party funding; and some of the proposals being considered to increase efficiency and reduce costs. Clear disclosure obligations regarding 'double-hatting' will almost certainly be imposed. The latter two issues are still in the early stages of discussion, but more concrete proposals to address them are certain to result from WG III over the next several years.

### Increasing Transparency – The Issue of 'Double-Hatting'

At its first meeting in late 2017, WG III recognised that 'enhancing public understanding of ISDS was key in addressing the perceived lack of legitimacy of the system.'<sup>10</sup> Both prior to and during the following session, some States focused on the biases and repeated appointment of arbitrators and 'double-hatting' – arbitrators who act as counsel and arbitrators in similar disputes.<sup>11</sup> Empirical evidence showed that 'double-hatting' was endemic in ISDS, and that it created a number of issues, including actual and potential conflict

4 UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS): Note by the Secretariat', A/CN.9/WG.III/WP.142 (18 Sept. 2017), s 2-3.

5 Alan M. Anderson & Ben Beaumont, 'Introduction', in *The Investor-State Dispute Settlement System: Reform, Replace or Status Quo?*, Alan M. Anderson & Ben Beaumont, eds. (Kluwer Law International, 2020), 3.

6 UNCITRAL, 'Workplan to implement investor-State dispute settlement (ISDS) reform and resource requirements: Note by the Secretariat', A/CN.9/WG.III/WP.206 (17 Mar. 2021), s 5-33.

7 UNCITRAL, A/CN.9/WG.III/WP.142, *supra* n 4, s 20-44.

8 See, generally, UNCITRAL, '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', A/CN.9/930/Rev. 1 (19 Dec. 2017), s 11-16; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session (New York, 23-27 April 2018)', A/CN.9.935 (14 May 2018), s 12-97; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-sixth session (Vienna, 29 October-2 November 2018)', A/CN.9/964 (6 November 2018), s 14-134; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1-5 April 2019)', A/CN.9.970 (9 April 2019), s 14-40; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-eighth session (Vienna, 14-18 October 2019)', A/CN.9/1004 (23 October 2019), s 28-104; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its resumed thirty-eighth session', A/CN.9/1004/Add. 1 (28 January 2020), s 6-9.

9 For consideration of many of the reform issues under discussion at WG III, see generally Anderson & Beaumont, eds., *Investor-State Dispute Settlement System*, *supra* n 5.

10 UNCITRAL, A/CN.9/930/Add. 1/Rev.1, *supra* n 8, s 1-7.

11 See, for example, UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS): Comments by the Government of Thailand', A/CN.9/WG.III/WP.147 (11 April 2018), s 6-14.

situations. There was a consensus ISDS reform should address the concerns surrounding 'double-hatting'.<sup>12</sup> WG III also discussed whether there were sufficient guarantees of an arbitrator's independence and impartiality. Further, 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. There were preliminary discussions of possible solutions which led to broad agreement on the need for a mandatory ethical code for arbitrators. Other approaches raised included: the creation of a system whereby arbitrators are appointed by an independent body, not the parties; the creation of a body with permanent judges; and greater transparency regarding the appointment process by administering arbitral institutions.<sup>13</sup> At the WG III sessions in October 2019, January 2020, and online February 2021 session, further discussions regarding the selection and appointment process for ISDS tribunal members were held. The focus of these deliberations was revisions to the arbitrator appointment process; in part, to ameliorate 'double-hatting' by individuals.<sup>14</sup> WG III reached a consensus that a mandatory code of conduct should be drafted applicable to arbitrators in ISDS cases and that such a code should address the issue of 'double-hatting'.<sup>15</sup>

The result is a draft code of conduct, prepared in conjunction with the International Centre for Settlement of Investment Disputes (ICSID). This code, now in its second iteration, explicitly addresses 'double-hatting' and allows such conduct only 'with [the] informed consent of the disputing parties.' Draft Article 4 of the code provides, 'Unless the parties agree otherwise, an [arbitrator] in an

[ISDS] proceeding shall not act concurrently as counsel or expert witness in another [ISDS] case. ... It remains unresolved whether this prohibition will be limited to another case 'involving the same factual background and at least one of the same parties or their subsidiary, affiliate or parent entity' or be more generally applicable.<sup>16</sup>

Discussion of other means to increase transparency in ISDS will continue, and further changes relating to the appointment of arbitrators are likely. There is little doubt that a mandatory code of conduct for ISDS tribunal members will be adopted and that such a code will preclude 'double-hatting' except with full disclosure and agreement by all parties to the dispute.

### Third-Party Funding

Third-party funding, and its increasing use in ISDS disputes, raises many issues.<sup>17</sup> The question of third-party funding was highlighted early in the WG III discussions, particularly the current lack of transparency and regulation. Discussions have focused on possible regulation of third-party funding in ISDS disputes; the need for a clear definition of what it is for any such regulation to be effective; the need for disclosure relating to third-party funding; and the possibility of requiring security for costs in cases where third-party funding exists. WG III has asked the UNCITRAL Secretariat to prepare draft provisions on third-party funding. The Secretariat also was asked to coordinate its work with that of ICSID and other institutions to avoid gaps or inconsistencies in any proposed third-party funding regulations.<sup>18</sup> While relatively early in the process, increased disclosure requirements, and regulation of third-party funding in ISDS disputes is likely to come from WG III.<sup>19</sup>

12 UNCITRAL, A/CN.9/935, *supra* n 8, s 78-88.

13 *Ibid.* s 45-68.

14 See UNCITRAL, A/CN.9/1004, *supra* n 8, s 51-77; UNCITRAL, A/CN.9/1004/Add. 1, *supra* n 8, s 95-133; UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its fortieth session (Vienna, 8-12 February 2021), A/CN.9/1050 (17 March 2021), s 17-56.

15 UNCITRAL, A/CN.9/1004, *supra* n 8, s 78.

16 UNCITRAL & ICSID, 'Draft Code of Conduct for Adjudicators in International Investment Disputes: Version Two', Art 4 (19 April 2021) <[https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/draft\\_code\\_of\\_conduct\\_v2.pdf](https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/draft_code_of_conduct_v2.pdf)>.

17 For analyses of third-party funding and its impact on ISDS, see generally Brooke S. Güven, Frank J. Garcia, Karl M.F. Lockhart & Michael R. Garcia, 'Regulating Third-Party Funding in Investor-State Arbitration Through Reform of ICSID and UNCITRAL Arbitration Rules: Holding Global Institutions to Their Development Mandate', in Anderson & Beaumont, eds., *Investor-State Dispute Settlement System*, *supra* n.5, 287-318; Victoria Shannon Sahani, 'Addressing Financial Access to Justice in Investment Treaty Arbitration', in Anderson & Beaumont, eds., *Investor-State Dispute Settlement System*, *supra* n 5, 271-286.

18 See UNCITRAL, A/CN.9/1004, *supra* n 8, s 79-98.

19 The draft Code of Conduct, for example, requires potential ISDS tribunal members to disclose any financial, business or personal interest with any third-party funder within the previous five years at the time of possible appointment. See UNCITRAL & ICSID, 'Draft Code of Conduct', *supra* n.16, Art. 10.

## Increasing Efficiency

Reforms to the ISDS system to increase its efficiency – both in terms of duration and expense – are a key element of the discussions in WG III. The topic spans several areas, including dispute prevention and settlement, procedural rules reforms, and the imposition of costs. States have raised the use of expedited procedures, the need for principles on the allocation of costs and security for costs, and possible streamlined procedures and approaches to manage costs for consideration. Overall, ‘the systematic nature of the concerns identified indicated a need for systemic solutions, which would bring with them the reduction of the overall costs through enhanced predictability and a greater ability to control proceedings themselves.’<sup>20</sup> Thus far, these issues, while identified, have not been subjected to detailed scrutiny or debate.<sup>21</sup> WG III has tasked the UNCITRAL Secretariat with preparing and providing further information on best practices, possible model investment treaty clauses, and to coordinate its efforts with other relevant organizations, such as ICSID as well as interested stakeholders.<sup>22</sup> Under the recently-presented revised workplan for WG III, consideration of procedural rules reforms extends into 2025. Regardless, substantive revisions to the present ISDS system to increase efficiency and reduce costs, for the benefit of all parties to a dispute regardless of their size or status, is certainly looming on the horizon.

## Conclusion

UNCITRAL’s WG III has already spent over three years and multiple formal and informal sessions tackling the question of whether and how to reform the ISDS system. Whether to reform the system has been answered with a resounding ‘yes.’ *How* to reform a system that has grown considerably over the past sixty years is the more difficult task. Increased transparency – and elimination of ‘double-hatting’ by arbitrators absent full disclosure – is a near certain outcome of the process. The use of third-party funding also will undoubtedly be subject to full disclosure requirements as well as other regulations, including possibly making third-party funders responsible for any cost awards against their client. Changes to procedural rules and methods to streamline the ISDS arbitral process, shorten its length, and thereby reduce costs, also are forthcoming. While the work of WG III is now expected to extend over the next four or five years, there is one certainty: reforms are coming that will significantly and substantively change the ISDS system, hopefully for the benefit of all stakeholders in the ISDS system.

20 UNCITRAL, A/CN.9/930/Rev. 1, *supra* n 8, s 34-78.

21 See UNCITRAL, ‘Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-ninth session (Vienna, 5-9 October 2020)’, A/CN.9/1044 (10 November 2020), s 17-89.

22 *Ibid.* s 21, 26, 32-34, 61-63, 74-77, 84-89.