



# IIA ISSUES NOTE

## INTERNATIONAL INVESTMENT AGREEMENTS



## IMPROVING INVESTMENT DISPUTE SETTLEMENT: UNCTAD POLICY TOOLS

### H I G H L I G H T S

- Investor-State dispute settlement (ISDS) has been the subject of an increasingly intense debate in the investment and development community and the general public at large. The mounting number of ISDS cases and systemic challenges arising from them have pushed ISDS to the forefront of the broader agenda for sustainable development-oriented reform of the international investment agreements (IIA) regime.
- Over the past five years, UNCTAD has intensified its work on IIA and investment dispute settlement reform to respond to these developments. Guided by the overall imperative to align international investment policy with today's sustainable development paradigm, the organization supports policymaking in accordance with all three of its pillars of activities: providing data and analysis, developing policy options and policy tools, and offering a platform for intergovernmental consensus-building.
- Through its IIA and ISDS Navigators, databases that are accessible through its Investment Policy Hub, UNCTAD provides a "one-stop shop" for investment policy makers and other investment and development stakeholders for comprehensive information on the latest trends in this rapidly evolving area of policymaking.
- UNCTAD's 2012 *Investment Policy Framework for Sustainable Development* (updated in 2015) presented the organization's vision on designing both national and international investment policies for sustainable development. In doing so, it set out a number of policy options to shield countries from unjustified liabilities and procedural costs arising out of ISDS.
- UNCTAD's *World Investment Report 2013* summarized the main concerns regarding the functioning of the investment dispute settlement system and sketched out five reform paths: (i) promoting alternative dispute resolution, (ii) tailoring the existing system through individual IIAs, (iii) limiting investors' access to ISDS, (iv) introducing an appeals facility, and (v) creating a standing international investment court.
- UNCTAD's *World Investment Report 2015* looked at ISDS as part of the broader *Road Map for IIA Reform*, alongside the need to: safeguard the right to regulate, while also providing protection; promote and facilitate investment; ensure responsible investment; and enhance systemic consistency. The *Road Map* categorized policy options for improving investment dispute settlement along two prongs of actions: reforming the existing ISDS system or replacing it.

- In 2016 and 2017, UNCTAD's *World Investment Reports* recorded steps taken by States and other stakeholders to improve the IIA/investment dispute settlement regime at various levels of policymaking – national, bilateral, regional, and multilateral. Among others, countries adopted new model treaties and concluded IIAs with modern, sustainable-development friendly provisions (so-called “phase 1 reform actions”).
- UNCTAD's *World Investment Report 2017* then focused on phase 2 of IIA reform, i.e. modernizing the existing stock of “old-generation” investment treaties. Among the ten policy options identified in that respect, “multilateral engagement” stands out as a particularly promising option for improving investment dispute settlement.
- The multilateral initiative on transparency in treaty-based investor-State arbitration, led by UNCITRAL and culminating with the 2014 “Mauritius Convention on Transparency”, presents a practical example of a phase 2 IIA reform action. The approach followed by UNCITRAL may offer a unique opportunity for more in-depth reform of the investment dispute settlement system, including by institutionalizing the regime through a permanent adjudicatory body.
- Reform of investment dispute settlement cannot be viewed in isolation; it needs to be synchronized with reform of the substantive investment protection rules embodied in IIAs. Without a comprehensive package that addresses both the substantive content of IIAs and ISDS, any reform attempt risks achieving only piecemeal change and potentially creating new forms of fragmentation and uncertainty.
- As the United Nations' focal point for international investment and development, UNCTAD is committed to providing a backstop to the IIA reform processes and to ensuring that the IIA regime – including the way in which investment disputes are settled – works for sustainable development.
- The 2018 World Investment Forum (WIF), scheduled for 22-26 October 2018, will provide another unique occasion for high-level, inclusive and multi-stakeholder-oriented consensus-building on IIA reform, in support of international investment for sustainable development.

## 1. Introduction

This Note responds to a request from the Secretariat of the United Nations Commission on International Trade Law (UNCITRAL) to provide an overview of UNCTAD's work on reforming the system of investment dispute settlement under international investment agreements (IIAs).

For over ten years, investment dispute settlement-related issues have been debated with increasing intensity by the international investment and development community, and in recent years discussions have reached the highest levels of government. The mounting number of investor-State dispute settlement (ISDS) cases, as well as the systemic challenges arising from them, have pushed ISDS to the forefront of the broader agenda for the sustainable development-oriented reform of the IIA regime.

Debates about reform have been on-going in the academic literature, intergovernmental and parliamentary meetings, academic and practitioner conferences and through the advocacy work of civil society organizations. ISDS-related debates have also found reflection in the mainstream media and have raised interest among the public at large.

In the UNCTAD context, these discussions have been carried forward at UNCTAD's Annual IIA Conferences and sessions at UNCTAD's multi-stakeholder World Investment Forum (WIF), its Investment Commission and its Expert Meetings. Other relevant forums have included, for example, the OECD's Freedom of Investment Roundtables<sup>1</sup> and the IISD/South Centre's Annual Forums for Developing Country Investment Negotiators.<sup>2</sup>

Already at UNCTAD's 2012 IIA Conference, "[ISDS] was considered one of the most topical and most sensitive issues and participants agreed on the need to address challenges emerging from it".<sup>3</sup> Two years later, at a similar event, "[i]t was broadly agreed that the IIA regime and ISDS system need to be reformed in a comprehensive and gradual way, taking into account the interests of a wide range of stakeholders".<sup>4</sup>

Also in 2015 and 2016, governments and other stakeholders shared their experiences on ISDS, identified best practices and considered options for the reform of the ISDS system at several UNCTAD meetings.<sup>5</sup> Deliberations showed that governments worldwide were taking a variety of actions and approaches with a view toward addressing concerns about substantive treaty standards and ISDS procedures. Among other actions, governments have developed new model treaties and negotiated more modern IIAs (so-called "phase 1 reform actions"). At the High-level IIA Conference 2016, participants also requested that UNCTAD further explore options to reform investor-State arbitration.<sup>6</sup>

<sup>1</sup> See <http://www.oecd.org/investment/investment-policy/oecdroundtablesonfreedomofinvestment.htm>.

<sup>2</sup> See <http://www.iisd.org/project/annual-forum-developing-country-investment-negotiators>.

<sup>3</sup> UNCTAD, World Investment Forum, 22 April 2012, summary available at [http://unctad.org/meetings/en/SessionalDocuments/td472\\_en.pdf](http://unctad.org/meetings/en/SessionalDocuments/td472_en.pdf).

<sup>4</sup> These include UNCTAD, IIA Conference, 16 October 2014, summary available at <http://unctad-worldinvestmentforum.org/programme2014/sessions/reforming-the-international-investment-agreements-regime/>.

<sup>5</sup> UNCTAD, Report of the Expert Meeting on the Transformation of the International Investment Agreement Regime: The Path Ahead, 25 to 27 February 2015, available at [http://unctad.org/meetings/en/SessionalDocuments/ciim4d3\\_en.pdf](http://unctad.org/meetings/en/SessionalDocuments/ciim4d3_en.pdf); UNCTAD, Report of the Multi-year Expert Meeting on Investment, Innovation and Entrepreneurship for Productive Capacity-building and Sustainable Development on its fourth session, 16 to 17 March 2016, available at [http://unctad.org/meetings/en/SessionalDocuments/ciimem4d12\\_en.pdf](http://unctad.org/meetings/en/SessionalDocuments/ciimem4d12_en.pdf).

<sup>6</sup> James Zhan and Diana Rosert, "UNCTAD's International Investment Agreements Conference 2016: Taking IIA Reform to the Next Level", *Investment Treaty News*, 12 December 2016, available at <https://www.iisd.org/itn/2016/12/12/unctads-international-investment-agreements-conference-2016-taking-ii-a-reform-to-the-next-level-james-zhan-diana-rosert/>.

As part of these developments over the past five years, UNCTAD has intensified its policy research on investment dispute settlement reform. In addition to collecting and making available comprehensive data on ISDS<sup>7</sup> and reviewing treaty practice,<sup>8</sup> several of the organization's publications have analysed ISDS-related concerns, provided policy options and detailed the respective pros and cons of each. In doing so, UNCTAD has been guided by an overarching imperative to align international investment policies with today's sustainable development paradigm.

## 2. Optimising Treaty Design Investment Policy Framework for Sustainable Development (WIR12)

The 2012 version of the *Investment Policy Framework for Sustainable Development* (launched as part of the World Investment Report 2012) presented UNCTAD's vision on designing both national and international investment policies. With respect to ISDS, it noted, in particular:

*"As the number of ISDS cases increases, questions have arisen with regard to the effectiveness and the sustainable development implications of ISDS. Many ISDS procedures are very expensive and often take several years to resolve. ISDS cases increasingly challenge domestic regulatory measures implemented for public policy objectives. Almost all ISDS cases lead to the breakdown of the relationship between the investor and the host State. Due to the lack of a single, unified mechanism, different tribunals have issued divergent interpretations of similarly worded treaty provisions, resulting in contradictory outcomes of cases involving identical/similar facts and/or treaty language. Many ISDS proceedings are conducted confidentially, which has raised concerns when tribunals address matters of public policy."*

The *Investment Policy Framework* suggests options to address these issues in treaty design. The second edition of the *Investment Policy Framework* (UNCTAD, 2015) updated the available policy options for various treaty elements in light of the most recent treaty practices.

## 3. Sketching Out Five Paths Toward Reform of Investment Dispute Settlement (WIR13)

The *World Investment Report 2013* (WIR13) summarized main concerns about the investment dispute settlement system and proposed five reform paths: (i) promoting alternative dispute resolution, (ii) modifying the existing ISDS system through individual IIAs, (iii) limiting investors' access to ISDS, (iv) introducing an appeals facility, and (v) creating a standing international investment court.

### a. The pros and cons of the ISDS mechanism

At the outset, the WIR13 recalled the rationale for allowing investors to pursue relief directly through investor-State arbitration:

*"The ISDS mechanism was designed to depoliticize investment disputes and create a forum that would offer investors a fair hearing before an independent, neutral and qualified tribunal. It was seen as a mechanism for rendering final and enforceable decisions through a swift, cheap and flexible process, over which disputing parties would have considerable control. Given that investor complaints relate to the conduct of sovereign States, taking these disputes out of the domestic sphere of the State concerned provides aggrieved investors with an important guarantee that their claims will be adjudicated in an independent and impartial manner."*

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<sup>7</sup> See <http://investmentpolicyhub.unctad.org/ISDS>.

<sup>8</sup> UNCTAD, *Investor-State Dispute Settlement: A Sequel* (New York and Geneva, 2014).

It then summarized the concerns about the actual functioning of ISDS under investment treaties that by then were already well-documented in academic and policy literature. The broad challenges addressed are as follows:

### **Legitimacy**

It is questionable whether an *ad hoc* international tribunal is the most appropriate mechanism to assess the validity of States' acts, particularly when they involve public policy issues. The pressure on public finances and potential disincentives for public-interest regulation may pose obstacles to countries' sustainable development paths.

### **Transparency**

Although the transparency of the ISDS system has improved since the early 2000s, proceedings can still be kept fully confidential – if both disputing parties so wish – even in cases where the dispute involves matters of public interest.

### **Nationality planning**

Investors may gain access to ISDS procedures using corporate structuring, i.e. by channelling an investment through a company established in an intermediary country with the sole purpose of benefitting from an IIA concluded by that country with the host State.

### **Consistency of arbitral decisions**

Recurring experiences of inconsistent findings by arbitral tribunals have resulted in divergent legal interpretations of identical or similar treaty provisions as well as differences in the assessment of the merits of cases involving the same facts. Inconsistent interpretations have led to uncertainty about the meaning of key treaty obligations and lack of predictability as to how they would be read in future cases.

### **Erroneous decisions**

Substantive mistakes of arbitral tribunals, if they arise, cannot be corrected effectively through existing review mechanisms. In particular, ICSID annulment committees have very limited review powers. Furthermore, a committee that is individually created for a specific dispute may also disagree with committee(s) examining similar issues in other cases.

### **Arbitrators' independence and impartiality**

The increasing number of challenges to arbitrators suggests that disputing parties perceive them as biased or predisposed. Particular concerns have arisen from a perceived tendency of disputing parties to appoint individuals sympathetic to their case. Arbitrators' interest in being re-appointed in future cases and their frequent "changing of hats" (serving as arbitrators in some cases and counsel in others) have amplified these concerns.

### **Financial stakes**

The high cost of arbitrations is a concern for both investors (especially small and medium-size enterprises, or SMEs) and States. From a State's perspective, even if it wins the case, the tribunal may refrain from ordering claimants to pay the government's costs, rendering the average of \$8 million spent on lawyers and arbitrators a significant burden on public finances and preventing the use of those funds for other goals.

The challenges identified in the *World Investment Report 2013* largely persist today, even though improvements have been achieved in some areas, notably with regard to the transparency of ISDS proceedings.

## **b. Five paths for ISDS reform**

In response to these challenges, UNCTAD identified in *WIR13* five broad paths for investment dispute settlement reform. They were developed further and presented, in a modified fashion, in the *World Investment Report 2015* (*WIR15*), discussed below.

### Promoting alternative dispute resolution methods

This approach calls for increasing resort to so-called alternative methods of dispute resolution (ADR) and dispute prevention policies (DPPs), both of which have formed part of UNCTAD's technical assistance and advisory services on IIAs. This reform path is considered a complementary rather than stand-alone avenue for investment dispute settlement reform. ADR may be either enshrined in IIAs or implemented at the domestic level, without specific references in the IIA. In terms of implementation, the approach is relatively straightforward, and some countries have already implemented it. ADR and DPPs cannot solve key ISDS-related challenges, but they can help in reducing the number of full-fledged legal disputes.

### Tailoring the existing system through individual IIAs

This option preserves the main features of the existing system and recommends that individual countries apply “tailored modifications” of selected aspects of the ISDS system in their new IIAs. A number of countries have already embarked on this course of action. Procedural innovations, many of which also appeared in UNCTAD's *Investment Policy Framework 2012*, include: setting time limits for bringing claims, increasing the contracting parties' role in interpreting the treaty, establishing a mechanism for consolidation of related claims, providing for more transparency in ISDS, and including a mechanism for an early discharge of frivolous claims. In addition, clarifying the scope and content of substantive IIA provisions is an important means to enhance the certainty of the legal norms and reducing the margin of discretion of arbitrators. The “tailored modifications” option has its advantages and limitations; in part because of its treaty-by-treaty approach, it is considered to stop short of offering a comprehensive, integrated way forward.

### Limiting investors' access to ISDS

This option narrows the range of situations in which investors can resort to ISDS, by (i) reducing the subject-matter scope for ISDS claims, (ii) restricting the range of investors who qualify to benefit from the treaty, and (iii) introducing the requirement to exhaust local remedies before resorting to international arbitration. Some countries have adopted policies of this kind. A far-reaching version of this approach would be to abandon ISDS as a means of dispute resolution altogether and return to State–State arbitration proceedings, as some treaties have done. Limiting investor access to ISDS can help to slow down the proliferation of ISDS proceedings, reduce States' financial liabilities arising from ISDS awards and save resources. To some extent, however, this approach would be a return to the earlier, pre-ISDS system. Furthermore, similarly to the “tailored modification” option, it would result in a piecemeal approach towards reform.

### Introducing an appeals facility

This option implies a standing body with a competence to undertake a substantive review of awards rendered by arbitral tribunals. It is viewed as a means to improve the consistency of case law, correct erroneous decisions of first-level tribunals and enhance the predictability of the law. If the facility were constituted of permanent members appointed by States from a pool of the most reputable jurists, it would have the potential to become an authoritative body capable of delivering consistent – and balanced – opinions, which could rectify some of the legitimacy concerns about the current ISDS regime. At the same time, absolute consistency and certainty would not be achievable in a legal system that consists of about 3,000 legal texts. Added to this are the significant, although not insurmountable, practical challenges of time and cost of appellate proceedings, the likelihood of support by a significant number of countries, scope of review, constitution and budget.

### Creating a standing international investment court

This option implies the replacement of the current system of *ad hoc* arbitration tribunals with a standing international investment court, which could also have an appeals chamber. The court would consist of judges appointed or elected by States on a permanent basis, e.g. for a fixed term. The court would address most of the problems outlined above: it would go a long way toward ensuring the legitimacy and transparency of the

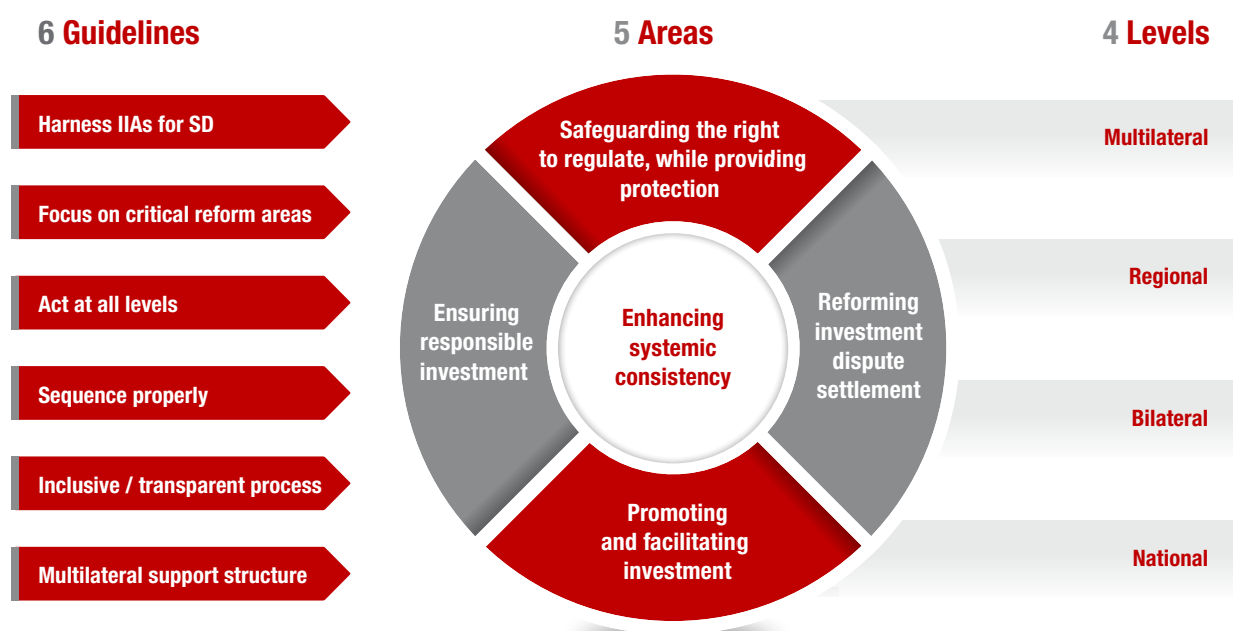
system, facilitating the consistency and accuracy of decisions and promoting the independence and impartiality of adjudicators. Yet, this option is also the most difficult one to implement as it requires a complete overhaul of the current regime through the coordinated action of a large number of States. Questions have been raised as to whether a new court would be fit for a fragmented regime that consists of a huge number of mostly bilateral IIAs.

In sum, *WIR13* made a case for ISDS reform, encouraging States to re-assess the current system, weigh options for reform and decide upon the most appropriate route.

## 4. Road Map for IIA Reform: Improving Investment Dispute Settlement (*WIR15*)

UNCTAD's *World Investment Report 2015* (*WIR15*) took stock of sixty years of IIA rule-making and drew lessons on how IIAs worked in practice and what could be learned for future IIA rule-making. On this basis, the *WIR15* presented a comprehensive *Road Map for IIA Reform*, where investment dispute settlement featured as one of the reform areas, alongside the need to safeguard countries' right to regulate, while providing protection to investors; promote and facilitate investment; ensure responsible investment; and enhance systemic consistency of the global IIA regime (figure 1).

**Figure 1. UNCTAD's Road Map for IIA Reform (2015)**



Source: ©UNCTAD, *WIR15*.

### a. The need to address investment dispute settlement-related concerns

The *WIR15* acknowledged once again that IIAs “bite and may have unforeseen risks”:

*“IIAs are legally binding instruments and not ‘harmless’ political declarations. As shown by the surge in ISDS cases during the last 15 years, they ‘bite’. Broad and vague formulation of IIA provisions has allowed investors to challenge core domestic policy decisions, for instance in the area of environmental, energy and health policies. Whereas in the past, it was mostly developing countries that were exposed to investor claims, there are nowadays also more and more developed countries as defendants.”*



The increase in the number of ISDS cases over the years, together with sometimes expansive, unexpected and inconsistent interpretations of IIA provisions by arbitral tribunals, had triggered a worldwide debate on the pros and cons of ISDS. Responding to these developments, a number of countries had reassessed their positions on ISDS and some had adopted certain reform measures.

The *WIR15* observed the emerging shared view on the need to reform the IIA regime, moving away from the question of *whether* to reform or not, to the “*what, how and extent*” of such reform. Reforming investment dispute settlement had become a core aspect of the broader IIA reform.

The *WIR15* continued exploring avenues for reform to address investment dispute settlement-related concerns. By setting out the arguments made in favour and against the current ISDS system, *WIR15* assists policy makers making strategic choices on whether to keep and reform ISDS or to abandon and/or replace it (table 1).

**Table 1. Summary of arguments put forward in favour and against ISDS**

Main arguments made in favour of ISDS	Main arguments made against ISDS
<ul style="list-style-type: none"> <li>Provides an additional avenue of legal redress to covered foreign investors and enforces the substantive treaty obligations.</li> <li>Allows foreign investors to avoid national courts of the host State if they have little trust in their independence, efficiency, or competence.</li> <li>Avoids recourse to diplomatic protection (investors do not need to convince their home State to bring claims or exercise diplomatic protection).</li> <li>Ensures adjudication of claims by a qualified and neutral tribunal.</li> <li>Removes any State immunity obstacles that may complicate domestic legal claims in some States.</li> <li>May be faster than domestic court procedures in some countries.</li> <li>Allows recognition and enforcement of arbitral awards in many jurisdictions (under the ICSID Convention or the New York Convention).</li> </ul>	<ul style="list-style-type: none"> <li>Grants foreign investors greater rights than those of domestic investors, creating unequal competitive conditions.</li> <li>Exposes host States to legal and financial risks, without bringing any additional benefits, and can lead to “regulatory chill”.</li> <li>Lacks sufficient legitimacy (is modelled on private commercial arbitration, lacks transparency, and raises concerns about arbitrators’ independence and impartiality).</li> <li>Fails to ensure consistency between decisions adopted by different tribunals on identical or similar issues.</li> <li>Does not allow for correcting erroneous decisions.</li> <li>Creates incentives for “nationality planning” by investors from third countries (or from the host State itself) in order to gain access to ISDS.</li> <li>Is very expensive for users.</li> <li>Holds little additional value in the presence of well-established and well-functioning domestic legal systems.</li> </ul>

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