UNCTAD's Roadmap for IIA Reform of Investment Dispute Settlement

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International investment law is undergoing a time of reflection, review and revision. Increasing dissatisfaction with the functioning of the current system that governs the protection of international investment and the wish to ensure that investment is channelled towards sustainable development goals have led to an understanding that there is an urgent need for reform. As the United Nations focal point for investment and sustainable development, the United Nations Conference on Trade and Development (UNCTAD) has supported the development of a new generation of investment policies. The need for improved investment dispute settlement is at the heart of the new generation of international investment agreements (IIAs). UNCTAD's Roadmap for IIA Reform identifies two broad alternatives: the first one is to live with investor-State dispute settlement (ISDS) by reforming it, and the second one is to abandon and/or replace it with other dispute resolution mechanisms. This article focusses on these options, considering their respective advantages and disadvantages.

1 INTRODUCTION

International investment law is undergoing a time of reflection, review and revision. Increasing dissatisfaction with the functioning of the current system that governs the protection of international investment, and the wish to ensure that investment is channelled towards sustainable development goals, have led to an understanding that there is an urgent need for reform of international investment agreements (IIAs). The issue is "not about *whether* to reform or not, but about the *what, how* and *extent* of such reform".[1]

The advocacy of the United Nations Conference on Trade and Development (UNCTAD) for a systemic and sustainable development-oriented approach to reforming the international investment regime started in 2010. As the United Nations focal point for investment and sustainable development, UNCTAD has supported the development of a new generation of investment policies, that is, IIAs that have inclusive growth and sustainable development as their core values. This role has also been acknowledged in the

1 This article is based on UNCTAD's *World Investment Report 2015: Reforming International Investment Governance* (United Nations, New York and Geneva, 2015). (The quotation appears at 140 of the 2015 Report.)

Addis Ababa Action Agenda, the outcome document of the Third International Conference on Financing for Development,[2] which mandates UNCTAD to "continue its existing programme of meetings and consultations with Member States on investment agreements".[3]

The need for improved investment dispute settlement is at the heart of this new generation of IIAs. Reforming investment dispute settlement to address the legitimacy crisis of the current system of investor-State dispute settlement (ISDS) is one of the five reform objectives set out in UNCTAD's Roadmap for IIA Reform, published in the *World Investment Report 2015: Reforming International Investment Governance*, one of the organisation's flagship reports.

Improving investment dispute settlement is also at the core of UNCTAD's *Investment Policy Framework for Sustainable Development* (IPFSD),[4] launched in 2012, and updated in 2015 with the feedback, comments and experiences generated through two years of field-testing.

Finally, investment dispute settlement is also at the core of several of UNCTAD's products, such as its comprehensive, and publicly accessible database — the "ISDS Navigator",[5] its annual update note on ISDS,[6] and its Pink Series ("Sequels").[7]

This article focusses on the policy options for improved investment dispute settlement presented in UNCTAD's Roadmap for IIA Reform. The Roadmap identifies two broad alternatives: the first one is to live with ISDS by reforming it, and the second one is to abandon and/or replace it with other dispute resolution mechanisms. This article will consider both these options including their pros and cons.

2 IMPROVING THE EXISTING ISDS MECHANISM WHILE MAINTAINING ITS TRADITIONAL STRUCTURE

This reform path can be achieved through fixing the existing mechanism or through adding new elements.

2.1 Fixing the Existing ISDS Mechanism while Maintaining its Traditional Structure

The first set of reform options consists in improving the existing mechanism of investor-State dispute resolution while maintaining its key feature, whereby an aggrieved investor can initiate arbitration proceedings against the State that hosts its investment. The reform elements identified in UNCTAD's Roadmap for IIA Reform target the arbitral process per se and investors' access to it. Concretely, these reform elements aim to improve the arbitral process, refine investors' access to investment arbitration, establish filters whereby sensitive cases are channelled to State-State procedures and introduce local litigation requirements. These

2 *Addis Ababa Action Agenda of the Third International Conference on Financing for Development (Addis Ababa Action Agenda)* (United Nations, New York, 2015) <www.un.org>.

3 At [88] and [91].

4 See UNCTAD 2015 Investment Policy Framework for Sustainable Development (UNCTAD, Geneva, 2015) <http://investmentpolicyhub.unctad.org>.

5 See <http://investmentpolicyhub.unctad.org>.

6 See <http://investmentpolicyhub.unctad.org>.

7 See <http://unctad.org>.

reform options can be implemented by States in IIAs in a relatively "independent" manner, without the need for coordinated action or the participation of a significant number of countries.

2.1.1 Improving the arbitral process

There are several ways to improve the arbitral process, streamlining it to make its functioning smoother and more efficient, and more broadly enhance the legitimacy of the ISDS system. UNCTAD's Roadmap for IIA Reform proposes a number of reform options. A first option targets increasing transparency of the arbitral process, through public access to documents, open hearings and amicus curiae participation. The need for transparency has lately been recognised in many quarters, including in United Nations Commission on International Trade Law (UNCITRAL) negotiations on the Transparency Rules and more recently the Transparency Convention.[8] Similarly, provisions on transparency are being taken up in a number of new treaties, such as in the EU-Canada Comprehensive Economic and Trade Agreement (CETA), for which negotiations were concluded in August 2014.[9] A second option focuses on the need to ensure that adjudicators have the necessary qualifications and that ethical requirements are in place. The latter include independence and impartiality requirements, absence of conflicts of interest and affordability of the process for the disputing parties. A third option consists in detaching adjudicators from the disputing parties, by establishing a roster of arbitrators, randomly selected, by lot, for each individual case they are called to hear. Such provisions, although in the context of a court rather than an arbitral tribunal, have been included in the European Union's proposal to the United States for the negotiations on the Transatlantic Trade and Investment Partnership (TTIP) tabled for discussion and made public on 12 November 2015 (hereinafter EU TTIP proposal).[10]

A fourth option consists in reserving a role for the contracting parties in the interpretation of their investment treaties, such as providing for joint party interpretations binding on tribunals. Provisions on joint interpretations by the parties are common in new generation investment treaties, for example in North American treaties (such as, the Uruguay-United States bilateral investment treaty (BIT) of 2005).[11] UNCTAD's Roadmap for IIA Reform highlights the need to avoid spending resources on lengthy proceedings where the investor engages in frivolous or manifestly unfounded claims, for instance through the early dismissal of such claims. A further reform option consists in establishing a more equitable distribution of legal costs, for example by adopting the "loser pays" principle. Finally, barring investors from pursuing multiple remedies for the same dispute, for example through the inclusion of a waiver clause, is another element to be considered. These options have, for example, been adopted in the EU TTIP proposal.

2.1.2 Refining investors' access to investment arbitration

A second approach identified in UNCTAD's Roadmap for IIA Reform is to circumscribe investors' access to ISDS, in order to reduce States' exposure to the legal and financial risks involved in ISDS. Options suggested are the following: States can exclude from the scope of investment dispute settlement

8 UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration (entered into force 1 April 2014); United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (Mauritius Convention on Transparency) GA Res 69/116 (adopted 10 December 2014).

9 See <http://trade.ec.europa.eu>.

10 The proposal is available at <http://trade.ec.europa.eu>.

11 Treaty between the United States of American and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (signed 4 November 2005, entered into force 1 November 2006).

claims that relate to sensitive sectors (for example, finance), the specific treaty provisions (for example, pre-establishment aspects of investment protection), or to sensitive policy areas (for example, those that involve national security). A second option is to limit arbitrable claims only to those that are born out of alleged treaty breaches, excluding for instance claims arising from contractual obligations. A third option is to require the lapse of a limitation period before making recourse to ISDS possible; in this case, it may be useful to clarify whether the limitation period includes the time that the investor has been pursuing its claims in domestic courts. A fourth option is to declare inadmissible claims by investors that engage in "treaty shopping" or "nationality planning" through mailbox companies, in order to limit the potential for treaty abuse. A fifth option is to consent to investment arbitration on a case-by-case basis. With the exception of this last option, UNCTAD's Roadmap for IIA Reform is reflected in choices made in recent IIAs, including in the CETA and in the EU TTIP proposal.

2.1.3 Establishing filters for channelling sensitive issues to State-State dispute settlement

A further option is put forward in UNCTAD's Roadmap for IIA Reform concerning disputes over sensitive issues. Where a joint committee by the parties fails to resolve the question, at "first instance", UNCTAD suggests a renvoi to State-State dispute settlement. An example could be the determination of whether a given measure is adopted for prudential reasons to safeguard the integrity and stability of the host economy's financial system; or whether a taxation measure constitutes an expropriation. This so-called "filter" was adopted in the Canada-China BIT of 2012.[12] The Roadmap's assumption here is that State-State dispute settlement may be better suited to sensitive issues of systemic significance, such as the integrity and stability of financial systems.

2.1.4 Introducing local litigation requirements

The option of introducing local litigation requirements aims to encourage investors to use domestic courts, while retaining access to ISDS as a remedy of "last resort". UNCTAD's Roadmap for IIA Reform identifies two options in this respect. The first is to require the exhaustion of local remedies before giving investors access to investment arbitration, and the second is to put in place limited local litigation requirements, for instance a requirement for the investor to pursue the dispute for 18 months before local courts. An argument that lends support to this proposal is that local litigation requirements put foreign and domestic investors on an equal footing and help create a level playing field among foreign investors (small and generally medium-sized ones being de facto excluded from investment arbitration due to the high costs involved). Domestic jurisdictions are also well-positioned to interpret and apply the domestic laws of the host State. Also, the argument that instead of focusing solely on ISDS, domestic reforms create robust and well-working legal and judicial systems, is gaining momentum. Domestic reforms are important, as they can help improve the overall investment climate.

However, host States cannot always guarantee such sound or reliable court systems, independent and free of political pressure and State control — in this respect, domestic reforms aimed at fostering robust and well-functioning judicial institutions in host States are at least as important as reform of ISDS. Such problems may be more pronounced in governance weak countries, where judicial decisions are difficult to enforce. Exhaustion of local remedies itself can be a long affair. In addition, if the investor turns to international arbitration after it has failed at the national level, with international arbitration seen as playing

12 Agreement between the Government of Canada and the Government of the People's Republic of China for the Promotion and Reciprocal Protection of Investments (signed 9 September 2012, entered into force 1 October 2014).

the role of an "appeal", this can aggravate legitimacy concerns with ISDS. Furthermore, national courts, especially in dualist systems, may not always have the legal competence to apply international law, and so they may be unable to apply and enforce investment treaty obligations.

While, maybe for these reasons, exhaustion of domestic remedies is not habitual in investment treaties, limited local litigation requirements do exist, for example in the IIAs concluded by Argentina (for example Argentina-Netherlands BIT of 1992).[13]

2.2 Improving the Existing ISDS Mechanism by Adding New Elements

The second set of reform options presented in UNCTAD's Roadmap for IIA Reform aims to improve investment dispute settlement by incorporating in it new elements. Two reform options are particularly pre-eminent in today's public debate: the creation of an appeals facility and effective alternative dispute resolution. These two options will now be considered in turn.

2.2.1 An appeals facility

An appellate mechanism may be added to the current system of ISDS, establishing a second level of substantive review of arbitral tribunals' decisions that go beyond the currently limited scope of review as part of an annulment process.[14] The latter has famously prevented annulment committees from annulling decisions despite finding "manifest errors of law".[15] The establishment of an appellate mechanism would help increase predictability of treaty interpretation and improve consistency between arbitral awards. This would enhance "political acceptability" and the legitimacy of ISDS and of international investment law in general.

The creation of an appellate mechanism would require addressing a number of issues, for instance, whether the appeals facility would be a standing body or an ad hoc mechanism. The choice between a permanent or an ad hoc nature of this mechanism has wide implications: ad hoc mechanisms are easier to establish but a standing appeals body may be more appropriate to ensure coherence in arbitral practice. In particular, an appellate mechanism with permanent adjudicators could address some of the legitimacy issues of the current system of investment dispute settlement. Other issues that would need to be determined are whether the mechanism would be bilateral, regional or multilateral; how it would be integrated into the current ISDS rules, for example the ICSID Convention or the UNCITRAL Arbitration Rules; and, what would be the organisational and institutional set-up of such a body (for example, method for selection of

13 Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Argentine Republic (signed 20 October 1992, entered into force 1 October 1994).

14 For example on the basis of art 52(1) of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (entered into force 14 October 1966) (known as the International Centre for the Settlement of Investment Disputes or ICSID Convention), which provides that an award exhaustively lists the grounds for annulment of an ICSID award (tribunal not properly constituted, manifest excess of powers, corruption, serious departure from a fundamental rule of procedure or failure to state reasons).

15 *CMS Gas Transmission Co v Argentina (Decision on Annulment)* ICSID ARB/01/8, 25 September 2007 at [158].

members). Further issues relate to the competence of such an appellate mechanism, for instance whether it would be able to review only issues of law or also issues of fact; or whether the body would be able to remand an erroneous award for reconsideration by the ("first instance") tribunal, or whether it would be able to amend the decision itself.

The potential creation of an appellate mechanism is envisaged in recent treaties concluded by the United States (for example, the United States-Korea and United States-Panama FTAs of 2007[16] and the United States Model BIT of 2012[17]), in the EU-Canada CETA (2014)[18] and the EU-Singapore FTA (2014).[19] The EU TTIP proposal goes a step further by proposing such a mechanism, although in the context of an international investment court system, rather than arbitration.

2.2.2 Building effective alternative dispute resolution

Another approach consists in promoting the use of alternative dispute resolution (ADR) mechanisms as a preliminary step before commencing investment arbitration. UNCTAD's Roadmap for IIA Reform recognises ADR as a complementary, rather than an independent, avenue for reform of investor-State dispute settlement: while ADR cannot resolve all issues that arise in investment disputes, it can contribute to reducing the number of cases. ADR mechanisms may allow for an early resolution of disputes. They are of a consensual nature requiring acceptance of the solution by both parties, and so they can help retain the investor-host State relationship. ADR's informal and flexible character can help save time and money. However, ADR may also fail to resolve the issue, which in turn increases costs and the time required to put an end to the dispute. ADR may also not always be feasible and acceptable to the host State. In light of its consensual nature, no enforcement is possible if one of the parties does not respect the solution proposed.

Actions to encourage the use of ADR are possible at the national and international level. At the national level, countries may consider ways in which to strengthen dispute prevention and management policies, for example, through information sharing between State agencies to monitor sensitive sectors or industries for early signs of potential disputes; empowering a particular agency to lead in the pursuit of amicable settlements; creating investment ombudsmen or investment agencies to lead in resolving conflicts with investors at an early stage. At the international level, IIAs integrate provisions on dispute prevention and management in the ISDS mechanism. Existing conciliation proceedings can be strengthened. Mediation provisions can be added or ADR can be made a compulsory step before the commencement of ISDS proceedings, for example, through the establishment of obligatory negotiation periods, during which consultations and negotiations must be pursued. A further option identified by UNCTAD's Roadmap for IIA Reform is State-State mediation and conciliation prior to the initiation of ISDS proceedings. At the international level also, IIAs may include provisions for ADR, and dispute prevention and management,

16 Free Trade Agreement between the United States of America and the Republic of Korea (signed on 30 June 2007, entered into force 15 March 2012); United States-Panama Trade Promotion Agreement (signed on 28 June 2007, entered into force 31 October 2012).

17 See <www.state.gov>.

18 See <http://trade.ec.europa.eu>.

19 Free Trade Agreement between the European Union and the Republic of Singapore (negotiations concluded 17 October 2014) <http://trade.ec.europa.eu>.

20 Cooperation and Facilitation Investment Agreement between Brazil and Mozambique (signed 30 March 2015); Cooperation and Facilitation Investment Agreement between Brazil and Angola (signed 1 April 2015).

for example, referring to the establishment of investment ombudsmen in each contracting party, entrusted with monitoring and addressing investor concerns relating to bureaucratic obstacles to doing business, hearing complaints and preventing, managing and resolving disputes. Brazil's recent Cooperation and Facilitation Investment Agreements (CFIAs) are cases in point (for example, Brazil-Mozambique CFIA and Brazil-Angola CFIA of 2015).[20] Extensive ADR references are also present in the EU TTIP proposal.

3 REPLACING THE EXISTING ISDS SYSTEM WITH OTHER DISPUTE SETTLEMENT MECHANISMS

This third set of reform options in UNCTAD's Roadmap for IIA Reform focuses on replacing the current system of ad hoc or institutionalised mechanisms for investor-State arbitration and using other approaches. The options envisaged include the creation of a permanent international investment court, State-State dispute settlement and reliance on national judicial systems of the host State. The option of replacing ISDS has been pursued in some Australian IIAs (for example, the Australia-United States FTA of 2004[21] which does not include ISDS); in the recently concluded Brazilian CFIAs (for example, the Brazil-Angola CFIA of 2015 which replaces ISDS with a dispute prevention system and State-State dispute settlement); and in the EU TTIP proposal,[22] which replaces traditional investment arbitration with a standing international investment court. These options will now be considered in turn.

3.1 A Standing International Investment Court

This option retains investors' right to access ISDS, but replaces the system of multiple arbitral tribunals with a standing international investment court. The EU's TTIP proposal of 12 November 2015 envisages the creation of such a permanent international investment court. An international investment court would be made up of judges, appointed or elected by States, rather than selected by the parties; and it can also have an appeals facility. The afore-cited EU TTIP proposal also considers such an appellate mechanism.

An international investment court could help strengthen the ISDS system's legitimacy in a number of ways. These include, potentially improved consistency and predictability in the interpretation of IIAs, and the possibility of correcting errors of law in the decision issued at first instance. Such a court could impose higher independence and impartiality requirements on adjudicators — or judges — through tenure and exclusivity of function. Permanent judges and their appointment on a rotation basis would further help prevent conflicts of interest. Such an international investment court could be competent for all investment disputes under an IIA, both in investor-State and in State-State cases. It could possibly also give legal standing or procedural rights to other affected stakeholders.

However, creating a permanent investment court raises significant challenges and may require time. Countries need to consider key elements concerning its establishment, including the need to build consensus among a number of countries. Other issues to consider relate to the court's organisation and institutional set-up; eventual transition from a bilateral court to a more universal structure, a possibility envisaged under

21 Free Trade Agreement between Australia and the United States of America [2005] ATS 1 (signed 18 May 2004, entered into force 1 January 2005).

22 The proposal is available at <http://trade.ec.europa.eu>.

the EU TTIP proposal; and questions concerning the court's competence and the inclusion of an appeals facility.

Finally, there is the perception that such a court would work best in a plurilateral or multilateral context. Multilateral consensus-building could help, by seeking solutions for making the new court to fit the fragmented global IIA system, currently made up of more than 3,000 IIAs, especially bilateral investment treaties. Multilateral consensus-building could also help respond to the fact that a standing investment court may start at a smaller scale, with an opt-in mechanism for States wishing to join.

3.2 State-State Dispute Settlement

State-State dispute settlement is provided for in most IIAs, and it is also the method of the World Trade Organization (WTO) for resolving international trade disputes. However, the reform option discussed here concerns State-State proceedings that replace investor-State dispute settlement, rather than add a further avenue for recourse. States would need to decide on the forum competent to hear the dispute. Among the options are the International Court of Justice, ad hoc tribunals or an international investment court as envisaged above.

According to UNCTAD's Roadmap for IIA Reform, replacing ISDS with State-State dispute settlement could increase countries' confidence in the international investment regime and address current legitimacy concerns. For instance, State-State proceedings could help filter out frivolous claims. However, this option also comes with important challenges. One example is the potential politicisation of investment disputes and State discretion in pursuing claims. State-State proceedings could be cumbersome and lengthy because of bureaucracy issues in the disputing treaty partners. Small and medium-sized enterprises could be placed at a disadvantage in relation to large companies, that could more easily convince their home State to bring a claim. Furthermore, the company's home State may not always be easy to identify in the case of complex multinational enterprises, with multiple affiliates and complicated ownership structures. State-State dispute settlement may have an impact on States' administrative and institutional resources, and will raise questions about what are appropriate remedies and enforcement.

To date, very few State-State investment disputes are known,[23] but lessons can be drawn from State-State dispute settlement in the WTO. In that case, policymakers need to bear in mind the differences between the two legal systems and the specific characteristics of investment disputes. Overall, although replacing ISDS with State-State proceedings can help address some of the legitimacy issues of ISDS, it also raises a number of significant challenges that would have to be addressed before taking this path.

23 See, for example, *Chevron Corp (USA) and Texaco Petroleum Corp (USA) v Ecuador* UNCITRAL PCA Case No 2009-23; *Kaliningrad Region v Lithuania* ICC Arbitration Case No 14651/JHN (Final Award, 2009); *Italy v Cuba* Ad Hoc Arbitral Tribunal (Final Award, 15 January 2008).

3.3 Domestic Judicial Systems of the Host State

This option removes investors' access to international tribunals and allows them access to the domestic court system only. UNCTAD's Roadmap for IIA Reform draws attention to the fact that this option is more useful for countries with robust legal systems and good governance. Arguments in favour and against reliance on domestic judicial systems can be borrowed from the earlier discussion on local remedies' requirements.

4 CONCLUSION

In its present form, ISDS raises serious concerns and there is a strong case for reforming the existing system. Individual reform options all have their advantages and disadvantages. Some are easier to implement than others and all of them pose their own challenges.

Among those more difficult to implement are multilateral solutions. At the same time, multilateral solutions would also go farthest in systemically improving investment dispute settlement. This is even more so as comprehensive reform would require taking into account not only existing IIAs that entail investment dispute resolution but also ISDS instruments, such as the ICSID Convention and UNCITRAL's Arbitration Rules.

Comprehensive reform would also require targeting substantive and procedural aspects of IIAs. Originally, procedural rules — ISDS — were created to allow for the enforcement of substantive IIA provisions and, consequently, their reform must not be viewed in isolation. Instead, ISDS reform must go hand in hand with improvements to the substantive provisions that are being applied and interpreted in dispute settlement.

UNCTAD's Roadmap for IIA Reform offers a menu of option and actions that span all these issues. The UNCTAD Roadmap for IIA Reform covers substantive and procedural dimensions of IIAs; it suggests actions for reform at the national, bilateral, regional and multilateral levels of policymaking. With its Roadmap for IIA Reform, as well as its other products and functions, UNCTAD supports a reform of investment governance that is in line with today's sustainable development imperative.

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