

GLOBAL AND REGIONAL ORDER

# UNCITRAL FIDDLES WHILE COUNTRIES BURN

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The billions of dollars that arbitral tribunals have ordered to be paid out to investors in publicly known ISDS cases have diverted taxpayers' money away from funding public health, among other public concerns.



The Working Group III of the United Nations Commission on International Trade Law (UNCITRAL) appears to be a long way from delivering meaningful reforms to the investment arbitration regime.



As the recent history of ISDS has shown, the negative impacts will affect every country in the world.

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Five years into its review of international investment agreements, and specifically investor-state dispute settlement (ISDS), Working Group III (WGIII) of the United Nations Commission on International Trade Law (UNCITRAL) appears to be a long way from delivering meaningful reforms to the investment arbitration regime. In the meantime, ISDS continues to provide foreign investors with an exclusive mechanism through which they can directly sue host states and challenge governmental action, including non-discriminatory regulations.

This paper analyses the work of UNCITRAL Working Group III through a development lens, addressing the issues at a macro-level, the WGIII approach at an institutional level, and



specific issues of significance that are of particular concern to developing countries. It calls for a re-opening of the WGIII agenda and processes to address concerns repeatedly raised by participating States from the Global South and deliver genuine systemic reforms to the deeply flawed international investment regime.

Consistent with their origins, the vast majority of ISDS disputes have been brought by developed country investors against developing countries or transition economies. Although the investment regime has impacted on countries of the Global South most severely, the lodging of disputes against public policies in affluent countries has intensified the pressure for substantive reform.



Aligning ISDS reform with developmental objectives requires a recognition that cases, and the measures that these disputes touch on, have different implications from the perspective of sustainable development and public policy than from the perspective of investor promotion and protection.

An effective consideration of the developmental implications of ISDS therefore requires freeing the mandate given to WGIII from the narrow interpretation adopted to date and taking a serious look at alternatives to arbitration as means to settle investment disputes. The substantive concerns that underpin the crisis of legitimacy confronting the international investment regime and ISDS are currently not addressed.

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## 1

INTRODUCTION<sup>1</sup>

Five years into its review of international investment agreements, and specifically investor-state dispute settlement (ISDS), Working Group III (WGIII) of the United Nations Commission on International Trade Law (UNCITRAL) appears to be a long way from delivering meaningful reforms to the investment arbitration regime. In the meantime, ISDS continues to provide foreign investors with an exclusive mechanism through which they can directly sue host states and challenge governmental action, including non-discriminatory regulations. In many cases, this has resulted in a «chilling effect» on the regulatory process. More than 1,000 known ISDS cases have resulted in serious pressures on many countries' public budgets. The billions of dollars that arbitral tribunals have ordered to be paid out to investors in publicly known ISDS cases have diverted taxpayers' money away from funding public health, access to food and employment creation, among other public concerns.<sup>1</sup>

The failure of WGIII to make effective advances towards urgently needed reforms can be traced back to several factors, notably its narrow interpretation of the UNCITRAL mandate to cover a limited set of procedural issues, the prescriptive agendas that have limited the range of issues being discussed and side-lined a range of concerns raised by developing countries, and the procedures adopted before and during the Covid-19 pandemic. The process has come to resemble a smoke and mirrors exercise, in which the Working Group is being steered towards an overriding framework that does not resolve the crucial challenges with ISDS, while long-recognised problems associated with ISDS continue to be ignored.

Solutions currently under discussion would accommodate procedural «reforms» that include minimalist modifications to the status quo at one end of the spectrum, and the European Union's proposed multilateral investment court (MIC) to implement existing pro-investor rules at the other. If the Working Group continues to ignore the recognised deficiencies of the international investment regime, its «solutions» will effectively re-legitimise the current system

of ISDS. The dysfunctional and inequitable regime of international investment agreements (IIAs) and ISDS will have been consolidated, and demands for real reforms put to bed for some years.

Those who will suffer most from that failure are the peoples of the Global South, who have borne the brunt of the ISDS regime over the past few decades. But, as the recent history of ISDS has shown, the negative impacts will affect every country in the world and potentially fetter the ability of States to address long-standing regulatory challenges, such as eliminating social inequality, delivering essential services, ensuring access to justice, and preventing further environmental degradation. Fear of a crippling investment dispute could also deter governments from taking action necessary to address the pressing 21<sup>st</sup> century challenges of global warming, digitisation, financial crises and devastating global pandemics.

This paper analyses the work of UNCITRAL Working Group III through a development lens, addressing the issues at a macro-level, the WGIII approach at an institutional level, and specific issues of significance that are of particular concern to developing countries. It reveals the disturbing reality behind the consensus-based, government-driven approach: capital-importing developing countries, which are the main targets of ISDS cases and should have had at least as much influence over the process as the developed capital-exporting countries that primarily support ISDS, have struggled to make their concerns heard. That is due to a number of mutually reinforcing factors:

1. The terms of reference for WGIII have been narrowly applied in a way that focuses on a limited set of procedural issues, which were restricted to four areas: consistency, coherence, predictability and correctness of arbitral decisions; arbitrators and decision makers; cost and duration of cases; and third-party funding. The substantive concerns that underpin the crisis of legitimacy that the international investment regime and ISDS are facing will not be addressed.
2. Matters of importance from a policy and regulatory perspective, which have been put forward to WGIII primarily by developing countries, but ought to be of concern to all countries, have either been excluded *per*

<sup>1</sup> The authors would like to thank Lise Johnson, Head, Investment Law and Policy at the Columbia Center on Sustainable Investment (CCSI) and Cecilia Olivet, formerly Program Coordinator, Trade and Investment at the Transnational Institute (TNI) for their invaluable review and comments on the draft.

se because they are deemed to be substantive issues and therefore out of scope, or are acknowledged but are then marginalised or disappear from WGIII agenda.

3. The procedures of WGIII, crafted by the Secretariat and the Chair of the process, have helped steer the Working Group's activities in this narrowly constructed direction since even before the Group received its mandate.
4. The way the meetings and work plan have been organised have made it difficult for participating countries to caucus and develop common positions, support each other on the floor, and challenge the manipulation of the original mandate and each meeting's agenda.
5. The hybrid meetings during the Covid-19 era have further disabled delegations from the Global South and critical observers and strengthened the Chair and Secretariat control of the process.
6. The way the agenda has been managed by the Secretariat and Chair means the »elephant in the room« – the objective of establishing a MIC – has never been explicitly discussed. The proposal has been advanced more subtly through the issue-based discussion to the point where it forms part of the »open« and »variable« architecture in an envisaged multilateral instrument to implement procedural »reforms« to IIAs. Yet, the Secretariat/CIDS paper shows it was part of the anticipated outcomes from the start.
7. The most likely outcome is a lowest-common-denominator multilateral instrument that allows capital-exporting States to adopt minimalist procedural changes to ISDS and none to the fundamental systemic problems undermining States' policy and regulatory space. Some of those States may not even sign or ratify a final agreement. Despite that, UNCITRAL and the Secretariat, as well as capital-exporting States that promised they would institute reforms, will seek to proclaim a »successful« outcome.

The paper concludes by calling for a re-opening of the WGIII agenda and processes to address concerns repeatedly raised by participating States from the Global South and deliver genuine systemic reforms to the deeply flawed international investment regime.

## 2

## THE CONTEXT OF WGIII

## 2.1 ISDS LEGITIMACY CRISIS

International investment agreements (IIAs) were creatures of decolonisation, designed to protect the investments of colonial and imperial powers against newly-sovereign developing country States (Anghie, 2005, Chapter 5; Koskenniemi, 2017; Sornarajah, 2015; Van Harten, 2007, Chapter 2). Those power asymmetries are built into the rules that protect foreign investors and their investments, and can be enforced directly against their host governments in private extra-territorial tribunals. Initially, international investment arbitration was designed to complement other means of dispute settlement, particularly domestic legal processes.<sup>2</sup> It was not designed to replace the latter. The preamble to The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) of 1966, for example, provides that »... while such disputes would usually be subject to national legal processes, international methods of settlement may be appropriate in certain cases« (*ICSID Convention English.Pdf*, n.d.).

Instead, arbitration-based ISDS grew to be the norm. As the neoliberal era advanced, IIAs offered a potent means for foreign investors to constrain States' exercise of their regulatory authority. For some years, these agreements remained largely under the radar and investor-State disputes were still rare (Van Harten, 2007). The negotiations at the OECD for a Multilateral Agreement on Investment (MAI) in the mid-1990s brought these agreements, and ISDS, to the attention of the public and attracted critical scrutiny (*Multilateral Agreement on Investment*, n.d.).

That critique has intensified sharply over the past two decades. A surge of investor-State disputes over laws and policies designed to serve the public interest has brought the international investment regime, and especially ISDS, into disrepute (UNCTAD, 2012, pp. 84–92 & 132–162, 2014a, pp. 24–25, 2014b). So have the often-crippling sums of compensation awarded against governments for speculative future losses to foreign investors.

There are already over 1,000 known ISDS cases according to the United Nations Conference on Trade and Development (*Investment Dispute Settlement Navigator* | UNCTAD Investment Policy Hub, n.d.). Some developing countries have billions of dollars outstanding in pending ISDS claims. For example, a report by civil society groups indicates that in 2020 Mexico had 12 pending cases, making up a total of \$5.4 billion<sup>3</sup> in claims, while India had 13 pending cases amounting to \$8 billion in claims (Olivet et al., 2020). The report calculates that by the end of 2018, states worldwide had been ordered or agreed to pay investors \$88 billion in publicly known ISDS cases alone (*Investment Dispute Settlement Navigator* | UNCTAD Investment Policy Hub, n.d.). In 2019, an investment tribunal ordered Pakistan to pay a foreign mining company \$6 billion in compensation, two months after the International Monetary Fund (IMF) had agreed a \$6 billion bailout with Pakistan to save its economy from collapse (Masood, 2019). These massive awards of compensation by investment arbitration tribunals occur even where investments continue to operate profitably or where planned investments were never built, fuelling calls to reform the principles governing compensation (Bonnitcha & Brewin, 2020).

In effect, every ISDS award paid out by a losing state constitutes a cash transfer to private investors from the pool of public resources that ought to be invested in public collective goods. This diverts taxpayers' money away from funding for public health, access to food, and employment creation, among other public policy priorities. The private arbitral tribunals that make these decisions lack independence, accountability, and the credibility of judicial institutions.

Consistent with their origins, the vast majority of ISDS disputes have been brought by developed country investors against developing countries or transition economies. Although the investment regime has affected countries of the Global South most severely, the lodging of disputes against public policies in affluent countries has intensified the pressure for substantive reform.

<sup>2</sup> In the first 20 years (1965–1984) of the ICSID, only eighteen arbitration cases were registered with it. It was only in 2001 that the benchmark of ten new ICSID cases was registered in one year (Happ & Wuschka, 2017).

<sup>3</sup> All monetary sums in this report as in US dollars unless otherwise stated.



By 2015, demands for an end to ISDS and its replacement by a range of alternatives, or at least for fundamental systemic reform, were dominating debates on international investment law. Some States terminated their agreements unilaterally (Public Citizen Global Trade Watch, 2018) or by mutual consent (Peterson, 2015). Several States developed alternatives based on domestic or state-state dispute settlement (c.f. South African Protection of Investment Act (2015); Model Cooperation and Facilitation Investment Agreement of Brazil, as described in Government of Brazil (2019)). Other States excluded ISDS from investment chapters<sup>4</sup> or committed to oppose its inclusion in future agreements.<sup>5</sup>

Capital exporting-countries began responding to pressure for reforms by »modernising« the blunt pro-investor rules and ISDS mechanisms in older agreements. For some, this involved limited clarifications of investor-protection rules and modified procedures in their new bilateral and mega-regional agreements, such as the Australia Japan Economic Partnership Agreement 2015 and the Trans-Pacific Partnership Agreement signed in 2016. The European Union (EU) went further and championed a new institutional arrangement for a two-level investment court in its bilateral agreements with Canada<sup>6</sup>, Vietnam<sup>7</sup>, and Singapore<sup>8</sup>.

Of the international institutions with a mandate on investment, the UNCTAD initially took the lead in documenting the trends in ISDS and subjecting the scope, scale, and geopolitical distribution of claims to critical scrutiny (UNCTAD, 2012, pp. 86–89, 2014a, pp. 114–133). The challenges to IIAs and ISDS that were identified include: operating against the interests of developing states; establishing a systemic asymmetry in legal protection and an exclusive category of international dispute settlement for foreign investors; displacing domestic adjudicatory decisions and domestic law and institutions; creating conditions for regulatory chill; excluding affected communities from participating in legal

processes; permitting very large monetary awards to investors even when they breached the host State's domestic laws; lack of institutional safeguards against conflicts of interest; and other forms of unfairness in the arbitration process (UNCTAD, 2012, pp. 86–89). There were also fundamental questions as to whether the costs of investment treaties outweigh their purported benefits as tools for attracting sustainable investment, depoliticising disputes, and improving the rule of law.

The balance between calls for paradigmatic change and the adoption of pragmatic reforms shifted notably after the International Centre for Settlement of Investment Disputes (ICSID) and UNCITRAL became involved in the reform debate. Both institutions have an interest in the survival of the investment arbitration regime and both are dominated by the major capital-exporting countries (Roberts, 2018, p. 419). The UNCTAD has become marginalised in a debate it once led and its focus has shifted from a critique of IIA and ISDS to promoting reforms of »old generation« agreements and urging states to select from a menu of »modernising« options (UNCTAD, 2018, pp. 95–115).

During the four years of deliberations in the UNCITRAL Working Group, the pattern of ISDS disputes has remained the same. Of the 71 substantive arbitral decisions that UNCTAD identified in 2019, almost half were still secret (UNCTAD, 2020b, 2021). While investment tribunals appeared to be more aware of the potential for backlash as they went about their business, the published decisions still displayed divergent interpretations by arbitrators and tribunals on certain key issues (UNCTAD, 2021). Amounts awarded ranged from \$7.9 million against Hungary (double the net funds it was awarded from the EU recovery fund in 2020) to \$5.9 billion against Pakistan<sup>9</sup> (which could consume its entire IMF bailout intended to support its economic re-

<sup>4</sup> For example, the Australia-United States Free Trade Agreement (FTA), entered into force 1 January 2005, and the Australia-Japan Economic Partnership Agreement, entered into force 15 January 2015, do not include arbitration as a choice for resolving disputes. More recently, the Regional Comprehensive Economic Partnership, signed 15 November 2020, not yet entered into force, between 15 Asian States has no ISDS. Article 10.18 requires discussion on ISDS within 2 years of entry into force, and their conclusion within 3 years, but any outcome is subject to consensus. In the investment chapter of the United States-Mexico-Canada Agreement (USMCA), entered into force 1 July 2020, ISDS was eliminated between the United States and Canada after a 3 year transition period (Annex 14-C), and investment disputes involving the United States and Mexico cover limited rules and require prior pursuit of local remedies (Annex 14-D). Investment disputes between Canada and Mexico are covered by the CPTPP. (Bernasconi, 2018).

<sup>5</sup> The Australian Labour Government rejected ISDS in 2011, but the Liberal Government subsequently opted for a »case by case« approach that included acceptance of ISDS in several new agreements including the TPP/CPTPP. (Tienhaara & Ranald, 2011). In 2016 the New Zealand Government adopted a policy of no ISDS in new agreements. This was after the TPP had been signed. New Zealand secured side-letters from a number of Parties in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), but most of these co-existed with existing agreements that contain ISDS. New Zealand Ministry of Foreign Affairs and Trade, n.d.; Solomon, 2018.

<sup>6</sup> Canada European Union Trade Agreement (CETA), signed 30 October 2016, provisional application, 21 September 2017, provides in Article 8.27 for a Tribunal of first instance and in Article 8.28 for an Appellate Tribunal. Article 8.29 says: »The Parties shall pursue with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes. Upon establishment of such a multilateral mechanism the CETA Joint Committee shall adopt a decision providing that disputes under this Section will be decided pursuant to the multilateral mechanism and made appropriate transitional arrangements«.

<sup>7</sup> EU Vietnam Investment Protection Agreement, signed 30 June 2019, entered into force 1 August 2020, Articles 3.38–3.39 constitutes an investment tribunal system comprising a Tribunal and a permanent Appeal Tribunal. Article 3.41 provides that: »The Parties shall enter into negotiations for an international agreement providing for a multilateral investment tribunal in combination with, or separate from, a multilateral appellate mechanism applicable to disputes under this Agreement. The Parties may consequently agree on the non-application of relevant parts of this Section. The Committee may adopt a decision specifying any necessary transitional arrangements«.

<sup>8</sup> EU Singapore Investment Protection Agreement, signed 15 October 2018, not yet entered into force, provides in Article 3.9 and 3.10 for a tribunal of first instance and appeal tribunal. Under Article 3.12 the parties commit to a variation of CETA provision on pursuing the establishment of a multilateral dispute settlement mechanism.

<sup>9</sup> The award comprised \$4 billion principal plus pre-award interest from 2011 and post-award interest, compounded annually, as well as costs of over \$60 million. See also De Murard (2019).

forms) and \$8.4 billion against financially crippled Venezuela (*ConocoPhillips Petrozuata B.V., ConocoPhillips Hamaca B.V. and ConocoPhillips Gulf of Paria B.V. v. Bolivarian Republic of Venezuela*, 2020; *Magyar Farming Company Ltd, Kintyre Kft and Inicia Zrt v. Hungary*, 2019; *Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, Pending).

Most of these disputes were under old bilateral investment treaties (BITs), which have cruder terms that investors unsurprisingly utilise. However, that does not mean those claims would not have been brought or would not have succeeded under the new »modernised« versions. That untested assumption is not, therefore, a justification for rejecting more direct solutions- such as mutual termination or unilateral withdrawal from BITs- in favour of modified versions of deeply flawed treaties or alternative forums for determining disputes involving States and investors under existing investor-protection rules.

## 2.2 REGULATORY CHILL

The consequences of actual disputes for States' sovereignty and public finances are only part of the concern. Foreign investors often threaten ISDS claims, not in the hope of securing compensation through an award, but to stop a government from regulating in ways that the investor opposes. Governments, especially in the Global South, may be understandably risk-averse when they consider how partisan and unaccountable arbitral tribunals might interpret the relevant investment protection rules, the quantum of damages they might face, and the cost of mounting a defence, especially when the investor has access to third-party funding. This kind of regulatory chill goes to the core of state responsibilities. It can severely undermine States' constitutional obligations, subordinate their ability to regulate in the public interest and for the public good, override electoral mandates and democratic processes, erode political accountability, and corrode the rule of law.

The fiscal costs of defending an investment dispute are a major factor in the chilling effect. Governments have to prepare their response, tender for and appoint counsel, and incur operational and opportunity costs within government. They know that even if their defence succeeds, they may not be awarded costs. Any sum that is awarded may not fully compensate the country's fiscal outlay, opportunity costs, and costs from delays in implementing the measure. If costs are awarded, they may never be paid (*Damages and Costs in Investment Treaty Arbitration Revisited*, 2017).

Regulatory chill also imposes political costs on governments when they cannot respond to the social, economic, or cultural needs of their citizens. It can even impact on the judiciary. While customary international law recognises a right to pursue international remedies when the pursuit of local remedies is futile, the growing number of challenges to ordinary decisions of domestic courts and tribunals risks undermining the rule of law by making adjudicators unduly cautious (Van Harten, 2007, p.110). That, in turn, denies

effective access to justice and equitable remedies for local communities (French, Chief Justice R.S., 2014).

The development and investment asymmetries between capital-importing and capital-exporting countries mean that poorer countries and their vulnerable communities are more susceptible to the threats and impacts of regulatory chill. Concerns about regulatory chill were specifically raised by participating States in the discussion of »other issues« at the WGIII meeting in April 2019 in anticipation of them then being included on the agenda. The discussion was captured in the WGIII session report of that meeting:

»ISDS or the mere threat of using ISDS had resulted in regulatory chill and discouraged States from undertaking measures aimed to regulate economic activities and to protect economic, social and environmental rights. The inherent asymmetric nature of the ISDS system, costs associated with the ISDS proceedings and high amount of damages awarded by tribunals were mentioned as some of the elements that could undermine the States' ability to regulate...« (UNCITRAL, 2019d, para. 36)

The report also records the participating States' agreement that »the potential impact of ISDS on the regulatory policy of States should guide the work on ISDS reform«, and the expectation that such critical cross-cutting issues should form a part of any solutions developed by WGIII (UNCITRAL, 2019d, para. 37). However, the Working Group's focus on specific procedural issues works against the consideration of such systemic concerns. During the May 2021 session of WGIII, a number of developing country delegations challenged the failure of the proposed workplan to finalise the Working Group's deliberations to provide equivalent time and resources to address these concerns, as discussed below.

## 2.3 THE PRICE OF FAILING TO ACT

If the UNCTRAL Working Group fails to address the many long-standing issues with ISDS, governments can expect to face similar investment disputes, or threats thereof, as they perform their public responsibilities to address the pressing new challenges of our time.

### 2.3.1 Climate change

Many governments are belatedly moving to avert a climate catastrophe. Foreign investors are seeking to defer the inevitable and demanding massive compensation for abandoning practices that threaten to leave planet Earth uninhabitable (Kyla Tienhaara, 2020). A broad range of strategies have already been subjected to investment disputes: banning ecologically destructive extraction techniques, such as fracking (*Lone Pine v. Canada*, Pending); refusal to grant (*Tethyan Copper Company Pty Limited v. Islamic Republic of Pakistan*, Pending), or non-renewal (*Bear Creek Mining Corporation v. Republic of Peru*, 2017) of mining licenses; phasing out of

coal-fired power stations;<sup>10</sup> restrictions on water extraction to limit its use and minimise ecological impacts (Bernasconi, 2009).

Other climate control policies are potentially open to challenge, including forced disinvestment by pension funds or public insurers in carbon unfriendly companies; taxes to disincentivise fossil fuel extraction; restricting agriculture to reduce methane emissions; phasing out petrol-fuelled vehicles; cancelling allegedly fraudulent offshore carbon credits; cutting subsidies to fossil fuel investments; and many clean energy initiatives.

The Energy Charter Treaty (ECT), which empowers energy companies to sue states under ISDS, has become the focus for opposition to ISDS over climate policies (*All Investment Dispute Settlement Cases – Energy Charter*, n.d.). The treaty was created in 1994 after the collapse of the Soviet bloc and entered into force in 1998, with the goal of securing energy resources in Eastern Europe (Hourticq, 2020). As of 2020 it had 53 signatories, including many Eastern European states. The rising number and value of disputes under the ECT – 135 as of September 2020 – has fuelled calls for its termination, for countries to withdraw, or for its fundamental modernisation (Baliño, 2021a; Bernasconi-Osterwalder, 2018; Eberhardt et al., 2018; *List of Cases*, n.d.). A petition calling for the European Union to quit the agreement, supported by a wide coalition of organisations, including Avaaz, Campact, Climate Action Network (CAN) Europe, Corporate Europe Observatory, Transnational Institute, WeMove and many others, has garnered over 1 million signatures (*The Energy Charter Treaty Is an Anti-Climate Agreement. Sign the Petition*, 2021).

In responding to such demands, the Energy Charter Conference initiated a »modernisation« process that goes further than WGIII by discussing reforms to substantive investor protections. The positions taken there reflect the divisions among capital exporters in the WGIII. Some powerful developed countries are resisting change or proposing minimalist reforms (Florou, 2020; Kunstyr & Svoboda, 2020; *Modernisation of the Treaty*, n.d.). Japan, which is the largest single funder of the ECT and the vice chair of the modernisation negotiations, has consistently opposed significant reforms and stressed that any »modernisation« should be minimal on both substantive and procedural aspects (Lo, 2020). While the EU promotes some protection for policy space, notably for climate change measures, its proposals do not go far enough in making the treaty conducive to or supportive of ambitious climate action, or in responding to the climate emergency (Thornton & Bernasconi, 2020). Moreover, the application of any policy space protections would be determined by a multilateral investment court.

### 2.3.2 Regulating the Digital Domain

Regulating the digital domain is another 21st century challenge that risks generating a new groundswell of ISDS claims. Big Tech corporations like Google, Amazon, Facebook, Apple, Netflix, Airbnb, Uber, and Alibaba have risen rapidly in a regulatory void that enables them to establish global market dominance and create high levels of dependency. States are moving belatedly to regulate on many fronts, including to reduce market dominance and counter anti-competitive practices; protect consumers and address worker and human rights abuses; rein in corporate control and abuses of data; stem political interference and tax evasion; and close the technological and digital divide. Again, this is a global issue, but development asymmetries mean the impacts are most severe for the Global South.

There are already predictions of a new wave of investment disputes as States seek to reassert some control over the largely unregulated tech giants. In a *Forbes* magazine commentary, Robert Ginsberg identified the potential for alleged breaches of investment rules on fair and equitable treatment, national treatment, full protection and security, and expropriation. He observed that investors could structure their investments through holding companies in countries that maximise their protections across different agreements. Ginsberg made it clear that the »offensive« purpose of these threats is to pressure governments, not just to win a dispute, and predicted that: »As the number of conflicts between US-technology companies and host governments inevitably increases, so too will the frequency with which investors use the protections under BITs as a sword and a shield« (Ginsburg, 2020).<sup>11</sup> The first known threat of an investment dispute was by Uber to Colombia in 2019 after its courts found Uber in breach of anti-competition rules (Ginsburg, 2020).

The US has already launched unilateral investigations under Section 301 of the Trade Act 1974 into a number of countries that have adopted novel digital services taxes, with threats of trade retaliation (*Initiation of Section 301 Investigations of Digital Services Taxes*, 2020). To date, these investigations have mainly alleged breaches of trade rules. The prospect that future section 301 disputes might also cite international investment rules reinforces the dangers that existing IIAs pose, even if the US maintains its recent opposition to ISDS in new agreements. It also suggests that threatened or actual State-State enforcement of pro-investor rules could produce equally problematic outcomes.

### 2.3.3 Covid-19

Covid-19 is not just a health crisis. Governments face a broad range of regulatory challenges. To identify and treat victims of the pandemic, stem its spread and protect the health of workers on the frontline, governments have requisitioned medical devices, imposed export controls, issued compulsory licenses for patented medicines and equipment, temporarily nationalised private hospitals, and

<sup>10</sup> ISDS Corporate Attacks, »Case Study: Vattenfall v Germany I« reports that »the German government reached a settlement with Vattenfall in 2010. The settlement obliged the Hamburg government to drop its additional environmental requirements and issue the contested permits required for the plant to proceed. The settlement also waived Vattenfall's earlier commitments to mitigate the coal plant's impact on the Elbe River« (*Corporate Attacks: Health, Case Study: Coal-Fired Electric Plant*, n.d.).

<sup>11</sup> Ginsburg is adjunct professor of international business at Loyola University Chicago and used to manage the foreign direct investment programme for the State of Illinois.

converted hotels to quarantine facilities. Lockdowns have required non-essential businesses to close or severely curtail their activities, while travel bans have brought international and local transportation and tourist ventures to a standstill (Bernasconi-Osterwalder et al., 2020).

Addressing the economic, fiscal, and social impacts of Covid-19 has required much broader regulatory interventions. Countries have imposed export bans to guarantee their own food security (Coke Hamilton & Nkurunziza, 2020). Restrictions on foreign investment and new screening thresholds have been adopted to protect distressed assets from predatory takeovers (OECD, 2020). Banks have been required to provide interest holidays and suspend mortgage foreclosures (Arnold, 2020). Rents, interest rates and utility bills have been frozen and/or deferred (*Tenancy Services – COVID-19 (Coronavirus) – Announcement on Rent Increase Freeze and Tenancy Terminations*, 2020). Wage subsidies and support payments have targeted specific local workers and businesses (OECD, 2021). Tax payments have been deferred, further depleting revenue to stranded economies, as they face mounting expenditure. Faced with growing debt and potential for defaults, developing-country governments have sought to restructure or defer repayments on debt and bonds and are reluctantly turning once again to international financial institutions for debt relief and bailouts (UNCTAD, 2020a).

Every country has suffered some of these impacts from Covid-19. States in the Global South have the least systemic capacity and resilience to survive these challenges, but often the greatest need to adopt such measures. That puts them at the highest risk of threatened disputes and subsequent retaliation. Lawyers and law firms have been advising their corporate clients on the use of ISDS to challenge such measures (Olivet et al., 2020). Foreign investors may allege direct or indirect expropriation without compensation, failure to meet investors' legitimate expectations and provide fair and equitable treatment, discrimination in favour of nationals, and restrictions on cross-border capital flows and transfers. If those threats materialise, developing countries will face the unconscionable prospect that meeting the needs of their people and protecting their economic and social structures from collapse could incur catastrophic ISDS awards.

In the trade context, the WTO website lists hundreds of measures notified as affecting international rules on trade in goods, trade in services and intellectual property rights. There is tacit recognition that many of these measures breach the multilateral trade rules and might not satisfy either the multi-layered requirements of the general exceptions<sup>12</sup> or stretched interpretations of the limited security exception (Public Citizen, 2019; Reinsch, 2019). That recognition has at least prompted discussions within the WTO, if not effective reforms and remedies.

In the broader investment community, there have been calls from global leaders, scholars and campaigners for an internationally coordinated response to avert an onslaught of ISDS disputes arising from the Covid-19 pandemic. Prominent international leaders James Bacchus and Jeffrey Sachs published an open letter, supported by the Columbia Center for Sustainable Investment, which urged governments to commit jointly to a moratorium on investor-State arbitration for Covid-related measures (Bacchus & Sachs, 2020; Bloomer et al., 2020). An open letter to governments signed by more than 650 organisations world-wide made a similar call (*Open Letter to Governments on ISDS and COVID-19*, n.d.).

States could respond in a number of ways. Parties could agree to terminate their investment agreements, including the legal effects of the survival clause,<sup>13</sup> or amend them to prohibit ISDS disputes in these circumstances. Alternatively, they could notify the unilateral withdrawal of their consent to ISDS, or unilaterally terminate their BITs to prevent claims in the future (Bernasconi-Osterwalder et al., 2020; Johnson et al., 2018). At the very least, State parties to IIAs could agree to issue binding or authoritative joint interpretations of rules and exceptions to protect Covid-19 related measures in a dispute (Bernasconi-Osterwalder et al., 2020).

To date, however, no international institution has been prepared to sponsor such initiatives. UNCITRAL WGIII seems the obvious place, given its home in the United Nations and current role as the most active forum for debate on ISDS. But while Covid-19 has impelled the Working Group to meet in a virtual or hybrid form, its narrow procedural agenda and decontextualised approach to its mandate has quarantined its deliberations from the reality posed by Covid-19. There has been no use of the lessons from the pandemic to test out the proposals currently being promoted, let alone to engage with its implications for investment treaties and the regime of investor-state arbitration more generally.

This section has reviewed the tensions between the threat of investor-State disputes and the policy space governments require to take measures urgently needed in order to respond to the global pandemic and other systemic crises, including the climate emergency and the challenges of adjusting to rapid digitisation. Exorbitant compensation awarded to investors in ISDS cases is feared for its constraining effects on resources and public budgets, which governments need to respond to these crises. International action is needed now to minimise the risks of ISDS claims and to safeguard sufficient regulatory space in the context of international investment rules. Yet, serious action in that direction remains scarce, including from UNCITRAL WGIII. The following two sections will review UNCITRAL's mandate, institutional dynamics, and States' positions within WGIII, as well as the main proposals currently on the Working Group's agenda, to identify the problems and what needs to be done.

<sup>12</sup> WTO Members have been unsuccessful in 48 of 50 disputes where they have invoked the General Exception (Public Citizen, 2019).

<sup>13</sup> Survival clauses are provisions that allow the extension of the protections provided under the treaty beyond its termination and thus allow for investment claims to be brought even after the treaty has been terminated.



## 3

## UNCITRAL WORKING GROUP III

To date, UNCITRAL's approach to ISDS reform has been a crucial factor in protecting the investment regime from more radical reform. This section considers institutional and State dynamics, the influence of practitioners and academics, the Working Group's mandate and its 3 phases, the work plan to finalise the work of WGIII, and how development is addressed in approaching the mandate.

### 3.1 INSTITUTIONAL DYNAMICS IN UNCITRAL WGIII

#### 3.1.1 Developing country participation

UNCITRAL is not a forum where developing countries have traditionally been active as a group, such as is the practice in other multilateral forums. For example, at the World Trade Organization (WTO) developing countries have been working through multiple group configurations.<sup>14</sup> At UNCTAD, developing countries have often been active as the Group of 77 and China.

A study of UNCITRAL's proceedings and institutional dynamics points out that law is often created by a small number of countries within the forum, along with extensive participation by professional groups and associations (Block-Lieb & Halliday, 2017).<sup>15</sup> In these processes, the voices of developing countries have often been absent or silent (Block-Lieb & Halliday, 2017). Such limited participation could undermine the legitimacy of UNCITRAL processes as a means to advance global norms, especially when dealing with issues that impact on the public interest and entail a review of public international law principles, as is the case with ISDS.

When issuing the WGIII mandate, the Commission stressed the need for governments to be represented by officials with adequate expertise and experience (UNGA, 2016). The UNCITRAL Secretariat has acknowledged that support

is needed for developing countries to take a more active role in these deliberations. A fund was created for these purposes. Yet, the availability of funding for travel does not necessarily translate into effective participation of developing countries in the different workings and processes of WGIII, especially in the context of virtual deliberations dictated by the Covid-19 pandemic and related restrictions. Participation in such negotiations cannot be measured by the number of countries represented, but must consider the extent to which developing countries are able to make effective contributions to the process. This is reliant on proactive and consistent information-sharing within the Working Group and by the Secretariat and Chair, as well as the availability of support necessary to ensure that countries can effectively sustain their participation in the formal and informal processes.

When WGIII meetings were physically organised twice a year, in New York and Vienna on a rotating basis, many developing countries faced multiple challenges. Even with travel funds it was often difficult for the relevant officials to be absent from capitals to attend. A number of countries do not have delegations in both New York and Vienna. If they do, they may not have the people available, especially with the necessary expertise to effectively cover the technical discussions of WGIII and liaise back with their capitals. Ensuring the effective participation of developing countries in such processes requires specific institutional arrangements that enable effective coordination between capital officials and diplomatic missions in New York and Vienna.

The Commission suggested that Working Group sessions could be held in locations other than Vienna and New York to increase participation by States and relevant stakeholders (UNGA, 2016). That has not happened. There have been several regional meetings outside Vienna and New York, for the Asia Pacific in South Korea, for Latin America and the Caribbean in the Dominican Republic, and one for Francophone Africa in the Republic of Guinea that excluded Anglophone African countries, notably South Africa (Government of the Dominican Republic, 2019; Government of the Republic of Guinea, 2019; Government of the Republic of Korea, 2018).

<sup>14</sup> These groups include the African Group, the group of Least Developing Countries, the African, Caribbean and Pacific Group, among other configurations.

<sup>15</sup> The authors studied particularly the UNCITRAL deliberations pertaining to transport law, insolvency law, and secured transactions. The reflections in this section are based on a presentation by the authors at the Graduate Institute in Geneva.

### 3.1.2 The role of the Secretariat and Chair

The Secretariat has played an active and pivotal role. Investment scholar Anthea Roberts observes that all the arbitral institutions »have an interest in maintaining the existence and legitimacy of the system and preserving or improving their market share« (Roberts, 2018, p. 419). Roberts notes the particular institutional imperatives of UNCITRAL to justify its law-making function and resources. The Secretariat has actively framed the process from the start (Roberts, 2018, p. 424). As noted above, the report it commissioned from two active academic members of the arbitration community in 2016, and which informed the initial WGIII deliberations, steered the outcomes towards an investment court or appeal mechanism and an »opt-in« convention to streamline the amendment of existing investment agreements along the lines of the Mauritius Convention discussed below (Potesta & Kaufmann-Kohler, 2016). Predictably, that is where Stage 3 of the WGIII process appears to be heading.

The Working Group's deliberations are primarily based on the Secretariat's notes and working papers and the questions raised in these documents. If issues are not covered by those documents, they stand little chance of being discussed, much less being advanced in the reform discussions. For example, the issue of exhaustion of local remedies was listed on UNCITRAL's website as one of the issues to be addressed when discussing dispute prevention and mitigation, along with mechanisms other than arbitration, procedures to address frivolous claims and multiple proceedings, reflective loss and counterclaims (*Working Group III: Investor-State Dispute Settlement Reform | United Nations Commission On International Trade Law*, n.d.). Given that mechanisms other than arbitration, frivolous claims, and reflective loss were each covered by a dedicated working paper prepared by the Secretariat, the subjects drew the attention of Member States and discussions were undertaken on each subject (*Working Group III: Investor-State Dispute Settlement Reform | United Nations Commission On International Trade Law*, n.d.). However, there was no working paper on exhaustion of local remedies, nor was it put on the agenda of the meeting that discussed prevention and mitigation. Consequently, it went undiscussed in the meeting and there is no clarity as to whether and when it will be addressed.

The Chair of WGIII also plays a directive role. The selection of the chair was contentious from the start. UNCITRAL makes decisions by consensus. After two days of deliberation there was no still agreement on the initial selection of a chair. In an extraordinary development, it was put to the vote. The candidate from Canada prevailed over the nominee from Singapore, who was appointed as Rapporteur (UNCITRAL, 2019d, paras 11–15). Since then, the Canadian Chair has been routinely re-appointed at each meeting, as has the Rapporteur. Publicly, the Chair conducts the meeting, puts the agenda to the participants, decides who speaks for how long, and presents the draft summary for approval. The meeting dynamics make it very difficult for States to intervene and seek changes to the process or the summary of the session, let alone for non-government observers to

do so. Behind the scenes, the Chair works with the Secretariat on various inter-sessional activities and consultations – a role that has become more influential and even less visible during the Covid-19 era.

### 3.1.3 Virtual meetings during Covid-19

The hybrid format dictated by the Covid-19-related restrictions<sup>16</sup> has triggered multiple additional questions: Is it possible to continue the negotiations in such a format? What will that mean for the inclusivity of the process, particularly in terms of developing countries' participation? What adjustments to the working methods and pace will it require (Roberts & St.John, 2020)? While the virtual format did not fully impede participation, several delegations, and not solely from developing countries, faced technical problems in connecting and being well heard. Some States registered many more delegates than they usually send to WGIII meetings, taking advantage of the low cost of online participation.<sup>17</sup> However, numbers do not necessarily lead to effective participation in this virtual format, for example when officials are expected to continue their normal duties while taking part in the Working Group deliberations.

The hybrid format has the additional drawback that country delegations do not meet face to face during the negotiating sessions, and do not have the chance to interact and build personal connections among themselves. The latter often forms the basis for cooperation and potential coalition building in negotiation processes. Developing countries often rely on these dynamics in order to enhance their voices in the negotiations and their ability to reflect their collective interests. These inter-State dynamics have endured a setback in virtual conditions, while the UNCITRAL Secretariat and the Working Group Chair assumed more powerful roles as interlocutors shaping the process, including through the outreach work done during the intersessional period.

The first two WGIII hybrid meetings held in October 2020 and February 2021 witnessed a strengthening of the role played by the Secretariat. For example, during the 39<sup>th</sup> session in October 2020, the Chair proposed delegating to the UNCITRAL Secretariat the drafting of solutions and legal language (such as model clauses or guidance) pertaining to multiple issues under discussion (UNCITRAL, 2020d). This caused discomfort among many delegations, who considered that the talks were not sufficiently advanced to allow the start of drafting and discussing text (Roberts & St.John, 2021). Such a move could lead the discussion to overly focus on technical options without proper regard to how those options fit with the broader systemic considerations and reform objectives. Delegations could effectively »miss the forest for the trees«, as noted by the International Institute for Sustainable Development (Baliño, 2021b). The Russian

<sup>16</sup> The first hybrid meeting held was the 39th session of WGIII held during October 2020.

<sup>17</sup> It has been reported that 134 States were registered to attend the meeting, and 406 State officials, including participation by several States that had not attended previously, including Botswana, the Maldives, Turkmenistan, and Zimbabwe.

delegation took the floor on this issue to characterise such a step as »excessive delegation of work to the UNCITRAL secretariat«.<sup>18</sup> Russia's representative objected that the Secretariat should not be delegated authority to carry out work on model clauses or to draft guidelines while significant differences of opinion persist among participating States. However, the Working Group did not formally reject the Chair's proposal.

The second hybrid meeting saw further moves towards work on textual suggestions for the reform options, encouraged in particular by the Chair (Roberts & St.John, 2021). This entails an intensification of the process and additional work during informal sessions held in between the formal Working Group meetings. Thus, contrary to expectations and despite the limitations that come with virtual engagement, the negotiating process in WGIII has accelerated, rather than slowing down, during the pandemic period. This creates the potential for challenges to the Working Group's transparency, inclusiveness, and effective participation of delegations (Baliño, 2021b). These concerns tend to affect developing country participants more than their developed country counterparts, and consequently have implications for the legitimacy of the resulting outcomes (Paolo B. Yu III, 2021). There were issues, for example, over the method by which the draft workplan was initiated and prepared with participation from a small number of mainly developed countries.

These procedural issues have significant implications for the underlying nature of the process and its direction, especially for ensuring that it remains effectively State-led and enough space is allocated to discuss the various structural and systemic issues concerning ISDS reform. Institutional challenges leave many countries struggling to catch up, while the discussions are swiftly moving forward. That limits their ability to effectively insert their voices and positions into the negotiations and to take a proactive role in shaping the process. That, in turn, undermines confidence in the process and its potential outcomes.

### 3.1.4 Active contributions by practitioners and academics<sup>19</sup>

UNCITRAL is a multi-stakeholder forum where consultations with practitioners, especially legal experts, is a long-standing practice of the Secretariat. In the context of the WGIII mandate on ISDS, two groups of non-State actors have emerged and have had a significant influence on the process. The »Academic Forum« involves academics active in the field of ISDS, and aims to provide a space »to exchange views, explore issues and options, test ideas and solutions, and make a constructive contribution to the ongoing discussions on possible reform of ISDS« (*Academic Forum – CIDS*, n.d.; UNCITRAL, 2018a, para. 6). The »Practitioners Group« provides lawyers active in the field of ISDS as counsel or

arbitrators with »a forum to exchange views, explore issues and options, test ideas, and make meaningful contributions to the ongoing discussions on possible reform of ISDS, including in UNCITRAL's Working Group III« (UNCITRAL, 2018a, para. 9). Neither forum has formal standing with WGIII and they do not formally participate in its sessions, although individuals associated with these forums participate in WGIII sessions and reference their links with the relevant forum (UNCITRAL, 2018a, para. 9).

At the same time, the UNCITRAL Secretariat has explained that, in exercising its discretion to seek assistance from outside experts, it contacts experts from both the Academic Forum and the Practitioners Group, and it solicits their contributions when preparing the background documents it presents to the WGIII (UNCITRAL, 2018c, footnote 1, 2018e, 2018d, 2018f). Thus, background documents, which form the basis for discussions throughout the meetings of WGIII, are usually prepared with contributions from the two groups. The extent and nature of these contributions remain untransparent. While these notes and accompanying documents do not necessarily present comprehensive exhaustive coverage of the issues,<sup>20</sup> they do carry weight in shaping the way the discussions proceed.

The composition of the »Academic« and »Practitioners« groups, together with the lack of clarity about the extent of their contribution to the Secretariat documents, have raised concerns among public interest groups participating in WGIII. For example, the representative of Friends of the Earth-Europe, taking the floor during the Working Group meeting in Vienna in November 2018, asked delegates to »make sure that the research which influences the ... discussions is free of conflicts of interest...«, adding that they »understand that many active arbitrators and legal counsels in arbitrations are members of [the] Academic Forum and there is no mechanism for disclosure of financial interests [in the arbitration system]«.<sup>21</sup> The Academic Forum subsequently published a disclosure register of its members' financial interests in ISDS, which showed almost half the 126 members who responded had played some formal role in an investment arbitration as of February 2019 (*Disclosure Register for ISDS Academic Forum*, 2019).

Public interest groups constitute a small fraction of the overall non-State participation in the meetings of WGIII. Some civil society groups who have long worked on ISDS had their request for an invitation to attend the meetings rejected.<sup>22</sup> It has also been observed that »the vast majority (85%) of the invited non-governmental organizations participating as an observer in the first two sessions of WGIII are directly or indirectly linked to the private arbitration industry (or

<sup>18</sup> Intervention by the Russian delegation during the morning session of WGIII 29th session on Friday 9th October, 2020.

<sup>19</sup> This section is based on a paper by one of the authors, Mohamadieh (2019)

<sup>20</sup> It has been stated in the Secretariat's notes that: »The topics discussed in the background documents are not intended to reflect a comprehensive set of issues regarding ISDS that the Working Group has discussed, or may yet wish to discuss. Additional concerns may have to be addressed« (UNCITRAL, 2018b, para. 2).

<sup>21</sup> Presentation by Friends of the Earth – Europe during UNCITRAL WG III meeting, Vienna, 30 November 2018.

<sup>22</sup> Ibid, Bart-Jaap Verbeek

broader transnational business interests), with only 14% representing wider public interests».<sup>23</sup>

The institutional dynamics within a forum selected to host certain discussions or negotiations are important because they can carry structural bias towards or against effective participation by certain constituencies, whether States or non-State participants. The selection of the UNCITRAL WGII, the manner in which its mandate has been implemented, and the active role of the Secretariat and Chair have clearly influenced the political dynamics of the deliberations. That has affected which voices are dominant and heeded, which questions are posed and from whose perspective, and how the discussion is linked to complementary reforms in other forums.

### 3.1.5 The mandate<sup>24</sup>

In 2017 the Commission conferred a broad mandate on Working Group III to consider possible reform of ISDS (UNGA, 2016, para. 264).<sup>25</sup> The UNCITRAL process acknowledged that current criticisms of the investment law regime »reflect concerns about the democratic accountability and legitimacy of the regime as a whole«, and the main objective of undertaking reforms was »to restore confidence in the overall system« (UNCITRAL, 2017b, 2017b, paras 45–47; UNGA, 2016, para. 243). The Working Group had broad discretion in discharging that mandate. Participating non-governmental organisations urged UNCITRAL »to take a holistic view of the system, especially of whether it was achieving its purported objectives, when considering and designing any ISDS reform.« (UNCITRAL, 2018b, para. 97). It has done the opposite.

The Working Group's deliberations were fettered from the start by three factors. First, the Secretariat had conducted a preliminary study in conjunction with two academics from the Centre for International Dispute Settlement (CIDS) who were active participants in and supporters of ISDS. Described as a preliminary analysis of the issues to be considered if ISDS reform was pursued at the international level and map the main options available, the study honed in on proposals to replace the existing IIAs with a permanent in-

vestment tribunal and/or an appeal mechanism (UNCITRAL, 2017a, paras 1–4). The proposed reform had three main blocks: design of an International Tribunal for Investments; design of an Appeal Mechanism; and a multilateral Opt-In Convention to extend those mechanisms to existing IIAs (UNCITRAL, 2017a, para. 5). That study informed a questionnaire circulated and analysed by the Secretariat to which only five capital-exporting developed countries appear to have responded (UNCITRAL, 2017a, paras 8–67). This background suggests a level of pretermination, at least by the Secretariat, from the start.

The second factor was intrinsic to UNCITRAL as a consensus based international organisation (UNGA, 2017, para. 259). The mandate required the WGIII process to be government-led, consensus-based and fully transparent with high-level input from all governments. That should have enabled developing countries, as the predominant targets of ISDS arbitration, to ensure their concerns were at the top of the agenda and prevented institutional capture. However, »consensus« decisions are made in UNCITRAL when there is no explicit objection. Delegations from the Global South privately report feeling under pressure from investors and donors, including those that fund their presence at WGIII and regional meetings. As a result, they may not voice their concerns or oppose proposals from the Chair, and not insist that their concerns are on the agenda and properly recognised in the meeting record.<sup>26</sup> It was not until the discussion of the workplan to finalise the Working Group's deliberations in May 2021 that developing countries insisted that issues they had raised were given more prominence, with some success (UNCITRAL, 2021a, para. 16).

However, the Commission also said that any solutions were to take into account the ongoing work of relevant international organisations and be undertaken »with a view to allowing each State the choice of whether and to what extent it wishes to adopt the relevant solution(s)« (UNGA, 2016, para. 264). This flexibility has opened the space for capital-exporting countries to promote a mechanism that would allow them to opt for only minimal reforms to the status quo.

The third factor was the narrow scope of ISDS reform that leaves the major causes of the legitimisation crisis confronting the investment regime intact. The Secretariat's note to the Commission on a possible reform agenda recognised that recent »strong and growing criticisms« of ISDS »in various parts of the world« raised diverse concerns. But it reduced these concerns to a small subset of procedural matters (UNCITRAL, 2017b, para. 11). The Commission's discussions on the mandate called for the Working Group to »cover the widest range of issues and possible solutions«, not excluding any specific options. However, it considered the call to reform substantive aspects of IIAs, as well as procedural aspects of ISDS, was »less feasible« because it was more complex and controversial (UNCITRAL, 2017b, para. 257;

<sup>23</sup> Ibid.

<sup>24</sup> This account draws in part on (Kelsey, 2019a; Kelsey et al., 2019)

<sup>25</sup> The mandate reads »The Commission entrusted Working Group III with a broad mandate to work on the possible reform of investor-State dispute settlement. In line with the UNCITRAL process, Working Group III would, in discharging that mandate, ensure that the deliberations, while benefiting from the widest possible breadth of available expertise from all stakeholders, would be Government-led, with high-level input from Governments, consensus-based and fully transparent. The Working Group would proceed to: (a) first, identify and consider concerns regarding investor-State dispute settlement; (b) second, consider whether reform was desirable in the light of any identified concerns; and (c) third, if the Working Group were to conclude that reform was desirable, develop any relevant solutions to be recommended to the Commission. The Commission agreed that broad discretion should be left to the Working Group in discharging its mandate, and that any solutions devised would be designed taking into account the ongoing work of relevant international organizations and with a view to allowing each State the choice of whether and to what extent it wished to adopt the relevant solution(s)«.

<sup>26</sup> Private communications to authors



UNGA, 2016, para. 14). That was interpreted in a way that excluded even the interface between substantive and procedural matters from the WGIII agenda.

Subsequent interventions from a number of participating States contested that approach, pointing out that substantive rules on investor protection and ISDS are inseparable in key respects. For example, one year into the WGIII process the Indonesian delegation tabled a paper that directly challenged the exclusive focus on procedure:

»This paper aims to present Indonesia's perspective on concerns regarding ISDS. The proposed ISDS reform discussions under UNCITRAL is [sic] built upon a substance-procedure dichotomy. In light of this dichotomy, Indonesia sees that it may actually defeat the purpose of having a meaningful ISDS mechanism as it is difficult to separate between substance and procedure. Indonesia is of the view that procedural law is inherently substantive and vice versa. Substantive and procedural provisions in the international investment agreements (IIAs) are intertwined in nature.« (UNCITRAL, 2018h)

### 3.2 THE WORKING GROUP'S THREE PHASE PROCESS

The mandate set out a three-stage process. During Phase 1, participating States identified and considered concerns about ISDS. The broad wording of the mandate would have allowed the Working Group to grapple seriously with the entanglements between procedural issues and substantive investment rules, despite reservations about addressing substantive rules directly. Instead, the discussion focused on a number of matters relating to arbitral process and outcomes and arbitrators/decision-makers, which had been identified in the Secretariat's background paper (UNCITRAL, 2017e, para. 20, 2018g, paras 22–24).

Phase 2 considered whether reform was desirable in light of the concerns about procedure identified in Phase 1. Its deliberations concentrated on three specific categories of concerns, pertaining to (1) consistency, coherence, predictability and correctness of arbitral decisions; (2) arbitrators and decision-makers; and (3) cost and duration of ISDS cases. Third-party funding was later added as a fourth concern. This phase was completed in April 2019. The Working Group then began the final phase in which governments were to develop any relevant solutions on these matters to recommend to the Commission.

The UNCITRAL Secretariat's scoping paper, issued at the initial stages of WGIII deliberations in September 2017, also recognised that States might wish to expand the Working Group's consideration to »other relevant issues« (UNCITRAL, 2017c, para. 19). Especially when speaking to the links between ISDS reform and development, several developing States raised a number of further issues for consideration. These included means other than arbitration to resolve investment disputes and dispute prevention methods, the

exhaustion of local remedies, third-party participation, counterclaims and investor obligations, calculation of damages and regulatory chill (UNCITRAL, 2018b, paras 26–40). The Working Group agreed that these issues would be taken into account as tools to address the identified concerns and would form a part of solutions that are to be developed by WGIII (UNCITRAL, 2018b, para. 39).

However, most of these »other concerns« were deemed to be covered by the issues already identified, or more relevant to the tools to be adopted in the solutions phase, or as guiding principles for developing reforms (Cotula et al., 2019; UNCITRAL, 2019d, paras 26–40). Despite developing countries' expectations that these concerns would nevertheless be specifically addressed in the context of the formal agenda, they have largely been side-lined. Most have not had designated discussion time, either in sessions or during intersessional discussions.

Phase 3, the quest for solutions to the four procedural concerns, is veering towards a non-solution, with a menu of options for each and a framework instrument for their implementation in existing and future investment agreements. At the end of the WGIII process, and assuming they can agree on an outcome, States may be able to adopt (or not adopt) procedural reforms of their choice across a spectrum that ranges from a barely-altered status quo, to an appellate system grafted onto the current system, to a full-blown two-level multilateral investment court.

### 3.3 WGIII WORK PLAN AND ITS IMPLICATIONS

The Commission decides the allocation of time and resources for WGIII, based on a submission prepared by the Secretariat and approved by the Working Group members. The Working Group's proposal to the Commission for more time and resources was not adopted in 2020, reflecting the lack of consensus among Member States on the way forward. Consideration of the future allocations was deferred to the Commission's meeting in 2021.

The Chair, Secretariat and Rapporteur initially developed the draft of a work plan to justify more resources and an intensified schedule of meetings, with inputs from a small number of mainly developed countries. Delegations were not prepared to adopt the proposed draft during the Working Group's meeting in February 2021. A dedicated two-day online session was then scheduled for May 2021 to finalise the work plan. The draft was shared with all delegations for review and comment in the run up to that meeting, although feedback received from delegations was not published by the Secretariat. Delegations' responses to the revised proposals at the May online session reflected the divergent positions presented in the Working Group over the previous three years and indicated that a consensus outcome, especially one that addresses the principal issues for developing countries, was increasingly unlikely.

The Chair described the work plan as »flexible«. Yet the identification of the topics for consideration and allocation of time and resources to them, and modalities of formal and information meetings and drafting groups to undertake the work, would inevitably circumscribe the possible outcomes. That reality shaped the debate at the May 2021 meeting. During the second day of the meeting the Chair circulated a revised draft schedule of work for discussion, asking for any additional comments within a week. The plan would then be revised and presented to the Commission to approve the allocation of time and resources. If there was no agreement among delegations, the document would be in the name of the Chair and Rapporteur.

The disagreements centred on the selection of topics, sequencing of decisions, modalities, and timelines.

The draft work plan was divided into 8 streams, each of which was allocated a proportion of the available WGIII time and resources, split into 60 formal working days and 78 other meetings days or informal work days to complete specific tasks, including drafting groups. The original aim was to conclude by 2025 (UNCITRAL, 2021b, paras 3–5). The revised draft proposed to extend that to 2026.

One of the 8 categories was vaguely entitled »ISDS Procedural Reforms«. That was initially allocated around 18% of the overall meeting time, both formal and informal working days, or 20% of the formal working group time where decisions could be taken. The Chair explained that the umbrella term was expected to include consideration of new rules on frivolous claims, multiple proceedings, shareholder reflective loss claims, counterclaims, security for costs, third-party funding and treaty interpretation, with the possible addition of procedural rules with respect to regulatory chill, exhaustion of local remedies, denial of benefits, consolidation, allocation of costs »and so forth« (UNCITRAL, 2021b, para. 9). In other words, the long list of »other concerns« or »cross-cutting issues« that developing countries had sought to get on the WGIII agenda were clustered together and not granted specific time for deliberations.

That approach contrasted starkly with the allocation of time and resources for reforms advocated by capital exporters. A MIC and/or appellate body together accounted for close to one third of the formal Working Group days and the total time. Very specific issues, such as Code of Conduct and the Advisory Centre, had their own allocations, in addition to time already spent on them so far.

Developing countries had to invest significant negotiating capital in order to reclaim and defend a space in the work plan for these »other concerns« or »cross-cutting issues« that they had been promised would form part of the ongoing deliberations. Several developing countries took the floor to request that those issues be explicitly reflected in the work plan and given enough time and resources for discussion. For example, South Africa reminded the Working Group that »while there was agreement in WGIII that these issues will be taken into account as the working group develops tools to address various concerns, they are rarely being addressed in an integrated manner as discussions on reform options evolve« (*WGIII – Resumed 40th Session – 5 May – Floor*, 2021). South Africa added that they »do not consider general considerations of these issues to be adequate without dedicated time for such discussion, both in terms of time and resources«.

The Secretariat of the African Continental Free Trade Area pointed to genuine and long-standing appetite for reform on these matters, which deserved dedicated, earmarked time for discussion. More broadly, Kenya stressed the need for concerns of developing countries to be considered seriously given that capital importers bear most of the challenging consequences of the ISDS regime and repeated the call for reforms to address substantive as well as procedural concerns.

The Moroccan delegation, supported by Nigeria, raised concerns that the tight time frame dedicated to these cross-cutting issues and damages could mean sacrificing quality and the ability of officials to engage with capital. Morocco also questioned whether clustering these concerns with multiple other issues as »ISDS Procedural Rules

Table 1:

**Revised Proposed UNCITRAL WGIII Work Plan circulated by the UNCITRAL secretariat on 5 May 2021**

	ADR Mechanisms and Dispute Prevention	Selection and Appointment of Arbitrators	Code of Conduct	ISDS Procedural Rules Reforms	Multilateral Advisory Centre	Appellate Mechanism	Multilateral Permanent Investment Court	Multilateral Instrument	Total
<b>Working Group days</b>	7	4	4	12	6	9	8	10	60
<b>Other Meetings days</b>	8	7	4	13	7	12	12	15	78
<b>Subtotal</b>	15	11	8	25	13	21	20	25	138

Reforms» was adequate given the complexity of each issue (*WGIII – Resumed 40th Session – 5 May – Floor*, 2021). They proposed that certain issues, such as exhaustion of remedies and assessment of damages, should be treated as separate issues with their own time allocation, just as the selection and appointment of arbitrators was. These practical suggestions were set aside by the Chair as something that could be considered by the Working Group later on.

The Chair defended the proposed approach, saying the plan looked at the tools rather than the concerns themselves, and the category of »ISDS Procedural Rules Reforms« was broad enough to encompass the »cross-cutting issues«. There was no sign that the Chair would use the flexibility that he said was available in the work plan to accede to developing countries' demands that equivalent time and resources be allocated to examining and finding effective solutions for these concerns. The revised version on day two allocated three days of intersessional work to explore the topic in detail, and one formal Working Group meeting at which delegations could give the Secretariat specific instructions on cross-cutting issues to consider. How this process would feed into deliberation on solutions remained unclear.

The second major issue involved modalities, especially the 78 informal meetings proposed to further discussions on specific reform options for consideration, as shown in table 1 above. These are supposed to be meetings where no decisions are taken, yet some may involve drafting groups or expert groups and are likely to be driven by proponents of particular positions. The Chair indicated that interpretation in these meetings will be decided case by case depending on the availability of funding. The reports for other delegations will be written by the meetings' hosts. The Honduras delegation warned that developing countries' participation in these informal processes might be replaced by a greater role for the Secretariat and Academic Forum. Which countries offer to organise these sessions, with what agenda, resources, interpretation, and time zones will therefore influence whose voices are heard loudest and which options would be on the table.

The intensity of the meetings' pace and overall work was a third major concern, as it could jeopardise the effective participation of many delegations, particularly developing countries. Many delegations said this intensity was unrealistic for several reasons, including the limitations on the officials' time and competing workloads, technical difficulties that undermine the right to be heard, availability of translation and interpretation, need to brief and seek instructions from capital, and competing UNCITRAL priorities.<sup>27</sup> Honduras made the point that rushed and incomplete deliberations in which delegations were unable effectively to participate would be perceived as lacking in legitimacy and transparency (*Audio Recordings*, n.d.).

Capital-exporting countries were most concerned about the sequencing of an outcome. The paper to the May 2021 meeting suggested that reform options could be »approved in principle« as they were developed, then formally adopted as part of the proposed final text. The Chair said this would allow any necessary adjustments when the whole project is complete, but not the reopening of discussions on agreed solutions (*Audio Recordings*, n.d.). The phrase »approved in principle« was later replaced by the ambiguous notion of »consideration by the Commission«.

The US, Australia, Japan, Israel, and Chile objected that concrete solutions should be agreed to as soon as possible, with an »early harvest of low hanging fruit«.<sup>28</sup> The Chair's approach was likened to a »single undertaking«, a term in trade talks that means that nothing is agreed until everything is agreed. Presumably, they anticipated that trade-offs would be demanded by supporters of the MIC in end-game bargaining. Conversely, the EU and Switzerland were clearly concerned that allowing piecemeal agreement on reforms would work against agreement on a more comprehensive consensus outcome. Russia repeated its call to focus on matters where agreement was feasible. These disagreements among capital-exporting countries suggest there is little prospect that they will agree on an outcome, even as a »menu« they can select from in a multilateral instrument.

The »early harvest« approach is also problematic for developing countries, as it increases the risks that the issues that have been allocated the most time will be closed. Remaining issues, especially those of concern to developing countries, which might be more complex in nature, have not been discussed so far, and lack equivalent time and resources, will remain unresolved. Such an approach would also prevent a holistic assessment of the interlinkages between the different reform options, how they influence each other, and the meaningfulness of the final package of adopted reform.

Unless there are significant changes following feedback after the May 2021 meeting – the chances of which seem remote – the real time to be dedicated to the long list of »cross-cutting« issues will be minimal, on top of the lack of any dedicated time or resources to date. The process over the remaining four years at present offers no real prospect of any significant reforms, even within the narrow ambit of ISDS »procedure«.

### 3.4 DEVELOPMENT AS ARTICULATED IN WGIII

In 2018, the UN Secretary General warned that IIAs often have the unintended consequences of constraining regulatory space or imposing large financial penalties through arbitral awards, and called for reform policies that align agreements with countries' national development strategies

<sup>27</sup> Sri Lanka, Honduras, Bahrain, South Africa, AfCFTA, India, Morocco, Argentina, Indonesia, Russia, Nigeria, Jamaica spoke to these issues.

<sup>28</sup> A phrase used by the Israeli representative

(Office of the Secretary General, 2018, para. 62). Multiple submissions by Member States participating in WGIII have echoed that call (UNCITRAL, 2019b, para. 4). For example, Morocco's stated objective is that ISDS reform leads to »responsible international investment that will promote achievement of the Sustainable Development Goals« (UNCITRAL, 2019b, para. 4). Indonesia's submission emphasised that the »ISDS reform process should reflect an effort to strike a balance between the rights and obligations of all relevant stakeholders, protecting investors and their rights while preserving a State's policy space and right to regulate foreign investments in its territories« (UNCITRAL, 2018h, para. 6). Mali's submission reflected support for a »comprehensive investor-State dispute settlement reform that fosters sustainable development by, inter alia, safeguarding the right of States that receive investments to establish regulations aimed at promoting the development goals« (UNCITRAL, 2019l, para. 1).

Similarly, South Africa stressed that »ISDS reform must be consistent with broader sustainable development objectives« and that »[p]romoting and attracting investment should not be an end in itself, but a step towards realising the broader objectives of the SDGs and the human rights obligations« (UNCITRAL, 2019g). It cautioned countries to »not rush into assuming that ISDS policies must be a part of their investment agreements« and reminded countries to »be mindful of the origins of ISDS« (UNCITRAL, 2019g). South Africa emphasised that ISDS »was never seen as a substitute for domestic legal dispute settlement, but as a stopgap in cases of extreme maladministration carried out by governments« (UNCITRAL, 2019g). The proper starting point or question »is whether ISDS mechanisms are desirable or necessary in the first place« (UNCITRAL, 2019g).

South Korea's submission to WGIII in July 2019 reflected on »diverse opinions from academia and civil society«, including proposals from several South Korean civil society groups working towards »a more democratic and human rights-friendly investment policy, based on the United Nations' Sustainable Development Goals and Millennium Development Goals« (UNCITRAL, 2019k). The Group of 77, which is the largest intergovernmental grouping of developing countries in the United Nations, presented WGIII with a collective statement that pointed to »the impact of ISDS on the development process« (Edrees, 2018). The Group stressed the importance of sustainable development, fairness, transparency, respect for the right to regulate and the flexibility of States to protect legitimate public welfare objectives, as well as the need to appropriately address the rights and responsibilities of foreign investors (Edrees, 2018).

The United Nations rapporteurs on the rights to development, human rights and transnational corporations, indigenous peoples, safe drinking water and sanitation, foreign debt and international financial obligations, a democratic and equitable international order, and a sustainable environment echoed this call for fundamental reform in a joint letter to United Nations Member States participating in WGIII in March 2019 (Deva et al., 2019). Their detailed letter stressed

that the Sustainable Development Goals (SDGs) and the full realisation of human rights must be at the centre of any discussions of international economic governance. Despite being circulated and addressed by non-government observers at the meeting of WGIII in New York, the rapporteurs' intervention has been ignored.

### 3.5 STATE DYNAMICS IN UNCITRAL WGIII

Anthea Roberts, an Australian academic and independent participant in that State's delegation, has identified three main camps in the WGIII process. She categorises them as: »incrementalists«, wishing to retain the existing dispute resolution system with modest reforms to address specific concerns; »systemic reformers«, who advocate for institutional innovations, notably a multilateral investment court and/or appellate body; and »paradigm shifters«, who reject the utility of an international process for investor-initiated disputes against States and favour a range of alternatives (Roberts, 2018).

That is an accurate description of States' positions, if WGIII is treated as a neutral arena. Those categories look different when they are contextualised with reference to States' status as predominantly capital importers or exporters, or as home states of foreign investors and target states for ISDS cases, or as rule makers and rule takers in IIA negotiations. Viewed through those lenses, the power imbalances in the Working Group process become a defining feature of its deliberations.

#### 3.5.1 Capital-exporters' positions

The categories of »incrementalists« and »systemic reformers« are principally capital-exporting countries that are competing over the preferred form of procedural repositioning, while leaving the substantive investment rules and fundamentals of investment arbitration intact.

The Russian delegation has been the most vigorous proponent of the status quo on the floor of the WGIII meetings, despite the massive \$50 billion award against it in the *Yukos* arbitration (Munsterman & Meyer, 2020). Russia posited a number of working principles, including »preservation of the advantages of the current ISDS system, such as its decentralized nature, flexibility and neutrality«, its depoliticised nature, the need to take into account any consensus on specific initiatives, and the potential effectiveness of proposed solutions (UNCITRAL, 2019o). Because UNCITRAL decisions need to comply with the principle of consensus, Phase 3 should focus on those aspects of the four categories of concern in which there was the least divergence of views. Some solutions to those issues should be soft-law instruments; others would need to be enshrined in relevant treaties. Russia strongly implied that it would block any consensus on a MIC (UNCITRAL, 2019o, para. 5).

A second core group of »incrementalists« has been led by Japan, Chile and Israel, with others such as Mexico and Peru,



whose positions broadly align with the US investment model BIT and its recent iteration in the Trans-Pacific Partnership Agreement (TPP). They have promoted a suite of options that enables them to adopt limited procedural reforms to »first generation agreements« (UNCITRAL, 2019m).

The »systemic reformers« – essentially the EU, supported by Canada and Mauritius – have consistently framed their procedural »modernisations« in ways that support a permanent standing body, the MIC, discussed further below (UNCITRAL, 2017d).

As a capital-exporter, China has an interest in broadly maintaining the current ISDS regime and wants to ensure the arbitration institutions it has been developing continue to act as the seat of arbitration in disputes that involve Chinese investors. While endorsing the development of multilateral rules, and lending support to an appellate mechanism, China has not endorsed the EU's institutionalised MIC (UNCITRAL, 2019h).

The US, previously the dominant rule-maker in international investment law and at UNCITRAL, has been unusually reserved. Initially, the US delegation's interventions seemed to support a TPP-based approach,<sup>29</sup> although it has not tabled any papers (Roberts, 2018, p. 430). The delegation's contributions became blander under the Trump Administration. USTR Robert Lighthizer considered ISDS was an unjustified attack on US sovereignty,<sup>30</sup> a position reflected in the US Mexico Canada Agreement that removed ISDS in relation to Canada and restricted it for Mexico (*Agreement between the United States of America, the United Mexican States, and Canada 7/1/20 Text | United States Trade Representative*, n.d., n. X).

The Biden administration has indicated that it does not support ISDS either (*Hearing to Consider the Nomination of Katherine C. Tai, of the District of Columbia, to Be United States Trade Representative, with the Rank of Ambassador Extraordinary and Plenipotentiary*, 2021, questions 4, 29,

64). The implications of this for UNCITRAL WGIII are unclear. At the May 2021 Working Group Session to discuss the work plan, the US reverted to the »incrementalist« position (*Audio Recordings*, n.d.). The US may be content with a menu of options that enables it to choose and vary its preference for different countries. However, a decision by the US not to adopt any outcome of the WGIII process, or to make extensive reservations, would have a major impact on ISDS reform, given the number of IIAs involving the US, and the prevalence of US investors as ISDS claimants.

### 3.5.2 Developing country positions

The voice of the Global South has been comparatively muted at the Working Group meetings. Developing country participants have no single position. Most of those who have tabled papers and spoken in plenary sessions are unhappy with the direction the WGIII process has taken. Some delegations that support fundamentally different models from traditional ISDS – those which Roberts terms »paradigm shifters«, such as India<sup>31</sup> and Brazil – have rarely made interventions, because the agenda has not given them space to advocate genuinely alternative models (Government of Brazil, 2019).

South Africa sought to make the case for paradigm change. The substantial first-principles paper it presented in July 2019 opened with a challenge to the ideological presumption that underpins IIAs: that the »free market, individual property and free flow of capital« are means for development and the State's role is to preserve the institutional framework for redistributing resources to foreign corporations. Protecting the human rights of people whose lives are disrupted and sometimes destroyed by foreign investors' »development projects« must be considered part of the government's legal obligations. Yet ISDS, as a legal mechanism located outside the State, protects foreign investors while people and communities that are harmed have no clear pathways to claim justice and reparation. Local companies are victimised, too (UNCITRAL, 2019g, paras 5–10).

South Africa positioned itself among those developing countries that have withdrawn from bilateral investment treaties that were impacting on their ability to serve the public's interests, in its case replacing them with domestic legislation:

»[The] current international investment regime is detrimental to public budgets, regulations in the public interest, democracy and the rule of law ... [M]ore and more countries are trying to address the ISDS asymmetry by changing or exiting from the international investment regime and are pushing for a binding United Nations Treaty on multinationals with respect to human rights.« (UNCITRAL, 2019g, para. 13)

<sup>29</sup> For example, see the interventions of the US during the 34th session of WGIII held between 27 November and 1st of December 2017, when the US stressed that tools could be negotiated in treaties as a way to address challenges with ISDS such as duration and cost (28.11.2017 at 16:47), available at (*UNCITRAL Speakers Log*, n.d.); and when the US noted that in relation to each of the concerns that had been raised in the WG meetings, individual governments have and could address them through the content of their individual treaty practice (30.11.2017 at 9:58), available at: (*UNCITRAL Speakers Log*, n.d.). As another example, in its intervention during the WGIII meeting in January 2020 when an appeal mechanism was discussed, the US delegate argued that greater control of the meaning of treaties can be achieved through tools existing in treaties (*UNCITRAL Speakers Log*, n.d.).

<sup>30</sup> Eg. Speaking to the US Senate Finance Committee on 21 June 2017: »It's an issue that is troubling to me... on a variety of levels. It's a balancing act. Our investors have a right to have their property protected. On the other hand, there are, in my judgment, at least sovereignty issues. I'm always troubled by the fact that non-elected, non-Americans can make a decision that a United States law is invalid. This, as a matter of principle, I find that offensive. That's what can happen very often in this area... The most troubling aspect of all this is that it attacks our sovereignty.« Quoted in (Public Citizen, 2018).

<sup>31</sup> India made several interventions in the May 2021 session, expressing concerns about process and the need for consensus (*Audio Recordings*, n.d.).

Consequently, they believe that procedural reform cannot be divorced from substantive concerns that are located in the wider context of sustainable development:

»Countries need a broad, pragmatic, balanced, and comprehensive mechanism that takes into account a complexity of cross-border investments and is flexible enough to deal with a variety of disputes involving diverse and potentially conflicting rights, interests and obligations.« (UNCITRAL, 2019g, para. 26)

Reform discussions on ISDS must »consider an expansive range of reform proposals« that provide a real alternative to ISDS. The submission identified six fundamental principles for reform: protection of fundamental and human rights; policy space to regulate; a level playing field of rights and obligations; inclusivity; respect for the rule of law; and protection of responsible investment (UNCITRAL, 2019g, paras 29–35).

Other developing country delegations also sought to shape a very different agenda for WGIII. Indonesia has exited old-style bilateral investment treaties and promotes a new style of investment agreement. In setting out options for reform, Indonesia adopted a nuanced approach to ISDS:

»Excluding ISDS provisions might not be a wise approach, particularly if the main intention is to attract foreign investments. Therefore, Indonesia rather considers a more balanced approach in the context of modernizing its investment treaty template to include more safeguards in both substantive and ISDS provisions. Some safeguards that Indonesia considers important include the definition of investment (asset-based definition with certain exceptions and limitations), covered investment (requiring an admission text in accordance with domestic laws), articles on right to regulate, measures against corruption, corporate social responsibility (CSR), exclusion of claims, general and security exceptions, balance of payments (BoP), prudential measures, and public debt.« (UNCITRAL, 2018h, para. 16)

While a number of these items are included in recent »modernised« agreements, usually in weak or pro-investor forms, Indonesia encouraged an all-inclusive reform process that balances competing rights and obligations:

»The ISDS reform process may benefit from the inclusion of all relevant stakeholders, public and private, representing business and non-business interests in the deliberative process to ensure balance and create outcomes that can be broadly accepted by states, investors and third parties alike. The ISDS reform process should reflect an effort to strike a balance between the rights and obligations of all relevant stakeholders, protecting investors and their investments while preserving a state's policy space and right to regulate foreign investments in its territories.« (UNCITRAL, 2018h, paras 5–6)

Morocco is another developing country that regularly takes the floor, seeking to advance the framework of its new model BIT. In March 2019, Morocco called for consensus-based, comprehensive multilateral reform that would help achieve the Sustainable Development Goals, and that would address the concerns of all, including developing countries suffering the negative consequences of the IIA regime. The result should achieve »a fair and equitable ISDS system« that all countries, in particular developing countries, could rely on. A key objective for Morocco was to protect the jurisdiction of national courts from external review. Hence it proposed:

»A prohibition on submitting disputes to arbitration if the competent national courts have already delivered a final judgment in respect of the dispute that has the force of *res judicata* ... .« (UNCITRAL, 2019b, para. 14)

Morocco also called for a reformed ISDS regime that allows States to bring a case against the foreign investor for violating national legislation or international treaties and prevent investors from invoking investment treaty provisions »in such a manner as to impose an obligation on the State that would render it unable to amend its own laws and national legislation.« (UNCITRAL, 2019b, para. Annex 2, 9)

Thailand's position seemed more pragmatic. Acknowledging there is no one-size-fits-all solution, and that new solutions could bring new problems, Thailand sought the consideration of all possible options that listened to all views, built on existing efforts in UNCTAD and ICSID, and were adaptable to combine with future work and options (UNCITRAL, 2019c, para. 3). Even then, Thailand observed that a »solution which is not widely accepted by the majority of States will be difficult to sustain in the long term« (UNCITRAL, 2019c, para. 9). In calling for the development of model clauses, Thailand echoed Indonesia's point and argued that the Working Group:

»... should keep an open mind on possible reforms on substantive issues. Substantive and procedural aspects of the ISDS system are often closely intertwined, and reforms in both areas can go hand-in-hand.« (UNGA, 2016, para. 259)

Other developing countries have made statements that advocate a similar holistic approach to ISDS reform and seek to balance the interests of investors, States and affected communities in the international investment regime. Overall, however, interventions from the Global South have been less frequent and have remained marginalised by the narratives and proposals from the capital-exporting countries that have dominated the WGIII deliberations.

## 4

## ASSESSING THE PROPOSED SOLUTIONS

The further the WGIII reform exercise has advanced through its three stages, the more remote it has become from assessing proposals against the first principles that informed its mandate. It also faces the reality that there is no consensus on the specifics of reform. The quest for a »successful solution« has become a pragmatic exercise in which the underlying issues, and even the narrow objectives originally adopted by WGIII, risk being lost from sight within an overriding framework that resolves nothing.

When Anthea Roberts assessed the prospects for compromise across the three categories of »incrementalists«, »strategic reformers« and »paradigm shifters«, and the positioning of »yet-to-declare« States in 2018 she concluded there was no prospect of consensus on a single solution, even in the limited form that operates in UNCITRAL (Roberts, 2018, p. 419). Roberts predicted a pluralist outcome, where multiple approaches co-exist and allow States to pick and choose from a suite of reform options in a single instrument that they can adopt or not, an outcome that closely resembles the outcome proposed in the paper the Secretariat commissioned from CIDS in 2016 (Roberts, 2018, p. 431).

In **Part III**, this paper critically examines the issues that arise from three of the Working Group's proposed options – alternative dispute resolution, an appeal mechanism, and a MIC – and the legal frameworks being proposed to deliver them.

### 4.1 NARROW CONCEPTUALISATION OF ALTERNATIVE DISPUTE SETTLEMENT WITH AN EMPHASIS ON MEDIATION

The notion of »alternative means to dispute settlement« has been approached in the context of WGIII working papers with a focus on mediation and conciliation (UNCITRAL, 2020a). For example, the UNCITRAL Secretariat's paper »Dispute prevention and mitigation – Means of alternative dispute resolution« presents mediation and conciliation as »an alternative to both investment treaty arbitration and resort to national courts« (UNCITRAL, 2020a). There is an increasing number of references to these methods in recent investment treaties, mostly as a precondition to arbitration

and sometimes as a stand-alone mechanism for resolving disputes.<sup>32</sup>

More comprehensive approaches to discussing alternative means to dispute settlement in WGIII could weave in broader options, such as the role of domestic courts and State-to-State mechanisms. Several participating States and non-State observers active in WGIII have spoken of, and provided submissions on, these mechanisms. Furthermore, recent treaty practice, monitored in UNCTAD's research, shows that several States have chosen to move away from arbitration or to limit reliance on arbitration in their investment treaties (UNCTAD, 2019). Civil society groups participating in WGIII have conceptualised »means other than arbitration to resolve investment disputes« to encompass alternatives to ISDS, such as domestic courts, ombudsmen, alternative dispute resolution (ADR) and State-to-State dispute settlement (International Institute for Environment and Development et al., 2019). They emphasised the need to consider limiting the causes of action that can be pursued through ISDS (e.g., to denial of justice) and rules on referral to other courts and/or expert bodies, and on staying ISDS disputes while related proceedings are pending (International Institute for Environment and Development et al., 2019).

The role of domestic courts and exhaustion of local remedies were captured in a preliminary note produced by the UNCITRAL Secretariat on possible options for reform (UNCITRAL, 2019i). This preliminary note presents an overview of all possible reforms proposed by participating States during the deliberations of WGIII and in their submissions. State-to-State mechanisms were discussed with reference to preliminary consideration of issues in a dispute, including through technical consultations, decisions taken by the respective State authorities, setting up a joint review committee by the treaty parties, and establishing a review or appellate mechanism or a State-to-State body to which an application could be made if the claim could not be settled at the technical level in a given time period (UNCITRAL, 2019i, 2019j).

<sup>32</sup> Six hundred and twenty-seven out of the 2,577 IIAs mapped by UNCTAD include either voluntary or compulsory conciliation and mediation. See *Mapping of IIA Content | International Investment Agreements Navigator* | UNCTAD Investment Policy Hub, n.d. See also Nitschke, 2020.

Nearly two years later »means of dispute resolution alternative to arbitration« has barely referenced the role of domestic courts and State-to-State dispute settlement. That has the effect of restricting ISDS reform to changes within the existing system of investment dispute settlement and diverting the discussion away from a more fundamental rethink of the system.

## 4.2 MEDIATION AND ITS LIMITATIONS FROM A DEVELOPMENTAL AND POLICY SPACE PERSPECTIVE

The relevance of mediation as a choice for dispute settlement, particularly from the point of view of investors, has been bolstered by the addition of the United Nations Convention on International Settlement Agreements Resulting from Mediation (i.e., the Singapore Convention) that focuses on the enforcement of international settlements that result from mediation (*The Convention Text*, n.d.). The Singapore Convention is the product of negotiations undertaken in UNCITRAL Working Group II (UNGA, 2017, paras 238–239, 2019). It provides a framework and a set of multilateral standards to facilitate cross-border enforcement of settlements emerging from mediation, including between an investor and a host government, in a similar way to which the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards does in the case of international arbitration. If a country joins the Singapore Convention, it makes it easier for investors to enforce settlements to which the country is a party in other jurisdictions that are also parties to the Convention (*The Convention Text*, n.d., art. 3).<sup>33</sup> The Convention focuses on the enforcement of agreements that result from mediation.

Confidentiality is often considered an advantage and prerequisite in mediation, particularly considering the reputational costs known to be associated with ISDS disputes (Titi & Fach Gómez, 2019, pp. 35–36). Increasing reliance on confidentiality-centred mediation within the context of ISDS would entrench the same problems that the reform sought by WGIII system aims to address. Furthermore, the role of mediation as an alternative to arbitration could have different implications depending on the nature of the disputed issues. For example, there is ample difference between a dispute concerning the valuation of a direct uncompensated expropriation and a dispute arising out of action taken by a government for environmental, human rights, or other public interest objectives (Güven, 2020). The latter raises important issues pertaining to affected-party

rights, developmental and public policy considerations, and the role of domestic legal processes. Part of the problem of the current ISDS regime has been its failure to attend to these specificities.

While mediation is often characterised as a »win-win« situation, whether a party effectively »wins« as a result of mediation depends on what it could potentially have achieved through other means of dealing with the dispute. The encouragement of early settlements through mediation or other confidential means risks increasing the number of »wins« that investors accrue without having to make their case, especially if there is a significant imbalance between the economic power of the investor and that of the host State. This could exacerbate the current challenges resulting from the existing model of ISDS, and potentially intensify the chilling effect on the regulatory process. Resorting to mediation and conciliation as an option for reforming ISDS would need to effectively address problems of the lack of transparency, imbalance between the parties, and selection of mediators and conciliators, as well as potential implications for the regulatory and public policy processes. Otherwise, mediation could perpetuate the same pitfalls of ISDS based on arbitration.

## 4.3 AN APPEAL SYSTEM AND THE DANGERS OF ENTRENCHING BAD LAW

An appeal mechanism is one of the prominent reform options being discussed in WGIII. A note by UNCITRAL's Secretariat referred to multiple options for providing recourse to appeal (UNCITRAL, 2019n). One option is a model appellate mechanism that could be used in three main ways: for inclusion in investment treaties by Parties, for use on an ad hoc basis by disputing parties, or as a facility made available under the rules of institutions handling ISDS cases. Another is providing recourse to appeal as part of a permanent multilateral appellate body, which could either complement the existing arbitration regime, or constitute the second tier in a multilateral investment court. Discussions in the Working Group do not show a majority is inclined towards any of these options, and significant variance among participating countries persists.

Among the issues linked to the establishment of an appeals system are: the nature and scope (particularly whether it would cover errors of law and fact, as well as calculation of damages), the standard of review that would be adopted, the relation between the first instance and appeals, how investment treaty parties relate to the appeals process, the effect of the appeal (i.e. whether it would bind parties to the dispute or also bind subsequent arbitral tribunals), enforcement of the appeal decisions, financing of an appeals mechanism, and the impact on cost and duration of the dispute settlement process. Depending on rules pertaining to standing, an appeals system could also have implications for affected-party rights, including possible access for non-disputing parties.

<sup>33</sup> See Art. 3 General Principles of the Singapore Convention, which provides, 'Each Party to the Convention shall enforce a settlement agreement in accordance with its rules of procedure and under the conditions laid down in this Convention.' Accordingly, each party to the Convention undertakes the commitment to enforce a settlement agreement covered under the Convention. Reservations provided under Art. 8.1 of the Convention are narrow, allowing a State Party to reserve its right to not have to enforce a settlement between its government and an investor and to take a reservation based on reciprocity. See Ng (2019) and Ponniya et al. (2019).



During the 40<sup>th</sup> session of the Working Group, multiple issues of a systemic nature relating to appeals were raised. These included the potential impact that an appellate mechanism might have on the development of investment law; how to avoid systematic appeals or abusive use of an appellate process through frivolous appeals; the increased cost and duration of ISDS as a result of institutionalising an appeal mechanism; and how an appeal mechanism would interact with the legal framework for setting aside awards which is the role of domestic courts (UNCITRAL, 2021a, para. 23). Design features also have systemic implications. For instance, an appeal that is treaty- and case-specific has very different consequences from a multilateral appellate body that applies to different treaties. Whether a decision by an appellate body would bind the disputing parties only or have broader effects would also have critical, and potentially negative, long-term consequences for the substance of international investment law. The proposal for a menu of options that would allow States to adopt different approaches to jurisdiction, procedure and institutional forms for appeals, potentially varying for each of their agreements, would compound these problems.

As is well documented, the underlying normative framework for investment promotion and protection, currently including over 3,200 investment agreements, is fragmented and in many instances imbalanced. That framework focuses on investor protection, fails to address investor responsibilities, and lacks effective consideration of issues pertaining to sovereign regulatory space. Increasingly, significant differences are also emerging between old treaties and some newer ones that make reference to the right to regulate, sustainable development, human rights, and investor obligations, albeit weakly. These divergences might widen in the future. At the same time, there is limited indication from States that they intend to systematically get rid of old treaties.

The WTO Appellate Body is often used for comparative purposes when discussing an appeal mechanism for ISDS. Yet, under the WTO dispute settlement system both first instance panels and the Appellate Body apply an underlying body of law that is uniform for all concerned States. Developmental considerations are built into the design of the treaties and mechanisms for undertaking commitments under different WTO treaties, although the extent to which they do so is inadequate.

Given this fragmentation and the lack of any pretence of balance in the underlying normative framework, developing more stable investment law through means of an appeal mechanism would not necessarily produce positive reform. A centralised appeal system that institutes the doctrine of precedent would require the same approach in cases with similar scenarios and facts. That could in effect take the role of managing the meaning of treaties out of the hands of States Parties and put it in the hands of the appeal institution.<sup>34</sup> This might make it harder to align this normative framework with sustainable development. It could even consolidate an imbalanced body of investment law and create more challenges in organising the relation of invest-

ment law to other bodies of law. In such circumstances, an appeal mechanism might lead to a more consistent body of law, but one that reflects severe imbalances between competing rights and that potentially restricts the right to regulate. Consequently, the objectives of »consistency, coherence and predictability« could end up trumping other priorities, including the States' obligations pertaining to human rights and the environment, as well as the host State's development objectives.<sup>35</sup> So long as WGIII focuses only on procedure, it is difficult to keep the consequences of these potential changes for substantive law in view.

Unpacking, understanding and potentially addressing these systemic issues must be an integral part of any such discussions. Yet, Working Group III has moved to considering textual suggestions pertaining to different appeal options without convergence on the desirability of an appellate mechanism, let alone a preferred type. So long as these matters are not decided, it is not possible to discuss the systemic implications that could potentially arise from adding an appeal level to ISDS.

#### 4.4 A MULTILATERAL INVESTMENT COURT

It is well documented that one of the main reasons why UNCITRAL emerged as a space for discussions on ISDS reform was the European Union's desire to find a multilateral arena in which to pursue the idea of a multilateral investment court as an alternative to ad hoc ISDS (Langford et al., 2020, p. 172; UNCITRAL, 2019a). Although the proposal for a MIC has been directly discussed in only one of the WGIII sessions, and then only briefly, it has been subtly but systematically embedded throughout the different sessions and issues under discussion (UNCITRAL, 2020c). For example, the drafting of options for reform, such as an appellate mechanism, includes model texts that could operate in the context of a standing body. This way of weaving the option of the MIC throughout the discussions on various items on the Working Group agenda does not allow the necessary space to examine the systemic implications of a new multilateral body that is dedicated to serving investors bringing disputes against States. This technique has provided a practical way for the EU to advance discussions on the MIC, while limiting the space for those who oppose the MIC to raise systemic issues and explicitly record their opposition to the idea.

<sup>34</sup> The delegate representing the United States made a similar point during the discussion on appellate mechanism held at the WGIII 38<sup>th</sup> session held between 20 and 24 January in Vienna (*Audio Recordings*, n.d.).

<sup>35</sup> See Johnson & Sachs (2018), where it is argued that minimizing the risk of inconsistency of ISDS arbitral decisions with *broader societal objectives and commitments*, including the Sustainable Development Goals (SDGs), international treaty commitments, or other areas of domestic or international law requires reversion to state-to-state dispute settlement.

The proposed MIC retains major aspects of the current traditional ISDS system: it would be an exclusive system for investors to sue the host State in relation to any measure or public policy issue that is considered to undermine their investments and that have not been carved out from the scope of the applicable IIA.<sup>36</sup> The EU proposed that »[t]he non-disputing party to the treaty in question should also be able to participate in the dispute« and »[i]t should also be provided that third parties, for example representatives of communities affected by the dispute, be permitted to participate in investment disputes« (UNCITRAL, 2019a, 2019a, para. 29). However, the proposal does not clarify whether parties affected by cases brought to the court, such as communities affected in a case that deals with natural resources or land to which indigenous communities have rights, would automatically have standing. Furthermore, it is not clear how the proposal would address the right of the host States to bring counterclaims against the investor, nor whether host States and communities impacted on by the investment could bring direct claims against investors, and if so, in which circumstances (e.g. *An Open Letter To The Chair Of UNCITRAL Working Group III And To All Participating States Concerning The Reform Of The Investor State Dispute Settlement: Addressing The Asymmetry Of ISDS*, 2019).

#### 4.4.1 The MIC proposal and its limitations

The proposed court could entrench several of the major flaws in the current ISDS system. The EU's proposal suggests that the Court could be funded through States parties' financial contributions and/or user fees, while noting that »care should be taken not to tie these fees directly to the remuneration of the adjudicators« (UNCITRAL, 2019a). It is an open question as to whether States would be willing to fund an institution that only gives benefits (access to adjudication of claims) to private investors. Alternatively, financing the Court through users' fees could raise possibilities of conflict of interest, whereby the court's adjudicators and possibly its secretariat might be inclined to promote the bringing of ISDS disputes in order to sustain the institution. An institutionalised court designed for foreign investors might also tend towards increasing its own power by ruling expansively on its jurisdiction and in favour of the claimants, making the investor bias inherent in today's private arbitration system even more intense in such a standing body (Sornarajah, 2016).<sup>37</sup>

The EU's submission to WGIII also noted that a standing mechanism would »be better positioned to gradually develop a more coherent approach to the relationship between investment law and other domains, in particular domestic law and other fields of international law« (Sornarajah, 2016, p. 10). This same point could be raised as a reason for caution regarding the idea of a MIC, especially that such a

court could create new law or set precedent that favours the interests of investors.

For example, if the court addressed the relation of investment law to other bodies of law, such as human rights law, there would be fears that its jurisprudence would look to find coherence through an investment lens at the expense of a human rights lens. The standard of review to be applied in cases dealing with human rights or other public interest issues, and the degree of deference that the international adjudicator grants to national decision-makers when dealing with such cases, will affect the extent to which it upholds human rights or the right to regulate (Henckels, 2013; Vadi & Gruszczynski, 2013). The decisions of a MIC composed of investment experts mandated to apply investment law could give the upper hand to investment protection over human rights and public interests.

The EU's proposal also leaves unclear or unaddressed several issues of great relevance to achieving meaningful reform of ISDS that is aligned with developmental considerations.<sup>38</sup> For example, the negotiating directive to the European Commission and the EU's submission to WGIII do not address the relationship of the proposed body to the system of domestic remedies, including the possibilities for exhaustion of local remedies before proceeding to a multilateral court. Consequently, the new body could continue to marginalise domestic legal systems. The directive and submission do not clarify, either, the relationship of the proposed body to the existing ISDS system based on ad hoc tribunals, although general statements by the European Commission have noted that »[t]he ultimate aim is to establish a single permanent body to decide investment disputes, thus moving away from the ad hoc system of investor to state dispute settlement (ISDS) which is currently included in around 3200 investment treaties in force today ...«.<sup>39</sup>

These issues are closely intertwined with the potential for attaining reforms that are »balanced«, fulfil the principle of »fairness«, and address developmental considerations. They are also essential for substantive reforms that respect the »right to regulate« and are aligned with the sustainable development agenda. Yet, the current proposal for the MIC is not geared towards redressing core imbalances of the ISDS system, such as changing the fact that only investors can bring claims. Rather, it has the potential to inflate the market available for arbitration cases without correcting the underlying challenges of the existing system.

<sup>38</sup> This is based on the information provided in UNCITRAL, 2019a, European Commission & Government of Canada, 2016, and European Commission, 2017.

<sup>39</sup> According to statements by the European Commission: »[t]he ultimate aim is to establish a single permanent body to decide investment disputes, thus moving away from the ad hoc system of investor to state dispute settlement (ISDS) which is currently included in around 3200 investment treaties in force today ... [It] would be open for all interested countries to join and would adjudicate disputes under both future and existing investment treaties. For EU level agreements, it would also replace the bilateral Investment Court Systems included in EU level agreements with FTA partners« (European Commission & Government of Canada, 2016).

<sup>36</sup> This section is partly based on Mohamadi (2019).

<sup>37</sup> See also: Dreyfuss (2016), where the author notes that »An Investment Court may be similarly prone to resolve disputes in ways that aggrandize its role, which is to say, to reach decisions that will induce investors to assert more claims«.

While a standing body could address certain challenges emanating from the current ad hoc manner of establishing arbitral tribunals, which often leads to conflicts of interest and a distorted set of incentives among the arbitrators, its potential to entrench multiple aspects of the problems with ISDS seriously outweighs the potential benefits. Moreover, the presumed benefits could be achieved through alternative and often much simpler ways of reform, without the potential challenges of building a multilateral institution that is geared towards providing a forum for the exclusive use of one category of economic players. Several of these alternatives, which have been raised and are practiced by participating States, are discussed in **Part IV**.

#### 4.4.2 Developing countries' positions on the MIC and appellate body

In its detailed engagement with the arguments for a MIC and appellate body, the South African delegation concluded it was possible for such an institution to address the correctness of decisions, but it would fail to meet the stated goal of producing coherence, which is to contribute to the predictability and legal certainty of an emergent jurisprudence (UNCITRAL, 2019g, para. 77). South Africa's critique addressed both the practical problems with the MIC (such as the grounds for appeal, whether it would determine facts anew or remand a dispute back to the original tribunal, interim and interlocutory relief, working procedures, time limits, etc) and broader problems of the legitimacy of such a body (including where it would be headquartered, appointment processes, diversity, judicial independence while maintaining state's roles, enforcement, and relationships to domestic courts).

While a number of other countries also raised these issues, South Africa went further, observing that institutional improvements would not solve substantive inequities and imbalances in the system (UNCITRAL, 2019g, paras 77–80). The MIC, or any other appellate body, might instead expand the scope of investor guarantees in a more permanent way (UNCITRAL, 2019g, para. 81). Restrictions on access for investors to the system were needed as safeguards to prevent regulatory chill. Domestic courts had to be involved on matters of national law, not just for proper guidance but to avoid agreements being interpreted in ways that are incompatible with national laws, including constitutions. The consequences of the proposal for pressing policy challenges such as climate change, data protection, and intellectual property rights reform would be very real, especially for the Global South:

»A MIC, in contrast with domestic law systems, would give investors possibilities to claim compensation. This would make government reforms prohibitively expensive, cause regulatory chill, and thus impede crucial measures.« (UNCITRAL, 2019g, paras 99–102)

The paper concluded that proceeding with the MIC would impede, rather than instigate, real reform:

»Taking into account the issues that are likely to arise, the MIC proposal seems aimed at keeping many of the key features intact, effectively locking in ISDS. Overall, the MIC proposal amounts to cosmetic reforms, not touching on the fundamental problems of the system. Effectively, the MIC seems to preserve and confirm the ISDS system. An investment court would exacerbate and entrench this unbalanced and harmful system.« (UNCITRAL, 2019g, para. 103)

South Africa therefore called for the Working Group's deliberations to move beyond ISDS and a court system to a dialogue that addresses deeper substantive concerns about investment rules, within a wider context that explores various alternatives and refers to other instruments, such as the UN binding treaty on business and human rights.

Morocco has offered a different developing country perspective. Morocco rejected an ad hoc appellate tribunal, saying it would encourage the proliferation of appeal courts and further fragment the system, and supported the idea of a neutral, standing appellate mechanism as a way to achieve consistency in interpretation, greater predictability and rectification of errors in awards (UNCITRAL, 2019b, para. 4). However, the scope of Morocco's proposed reforms and its vision for a standing appellate court go much further than the EU's MIC.

In a submission in 2019, Morocco recorded its concerns about the »legal imbalance« and »substantive imbalance« in ISDS. »Legal imbalances« include the investor's monopoly on recourse to arbitration, when the State has no such power, and the investor's ability to abuse that access as a bargaining chip to pressure governments – regulatory chill. »Substantive imbalances« include the one-sided rules that grant investors »absolute protection through a set of obligations imposed on the host State«, while the foreign investor's obligations are »modest or completely non-existent«. Other imbalances include broad interpretation of terms by »arbitral tribunals that lack the guarantees, accountability and transparency of national judicial systems« and definitions of unclear phrases like »legitimate expectations of investors« that may conflict with »the country's political outlook or encroaches on its sovereign right to amend its own national legislation, particularly in the areas of health, the environment, security and cultural diversity« (UNCITRAL, 2019b, paras 4, Annex II).

Morocco has also emphasised the need for deference to national courts. It would exclude final judgements of national courts from an appellate body's jurisdiction, whether the dispute relates to investment contracts or the application of national law. While the applicable law of an appeal should be both international law and the national law of the host state, the investment tribunal should be bound by interpretations of domestic law by the national courts or agreed upon by the parties. Conversely, despite the obvious variations in the legal provisions and applicable law, Morocco considered that final awards should constitute precedents and case law for similar issues raised in BITs.

The seemingly deliberate omission of the MIC as a stand-alone item on the WGIII's agenda until the final stage work plan means that the interventions from these and other developing countries have never been properly explored.

#### 4.5 ADJUDICATORS, DIVERSITY AND REVIEWS<sup>40</sup>

Those who promote the MIC and an appellate mechanism commonly cite the World Trade Organization's (WTO) two-tiered system of ad hoc panels and a standing Appellate Body as a model. The analogy is flawed in several ways and ignores numerous problems with the WTO's dispute system, especially from a development perspective.

For a start, the history, nature and content of multilateral trade and bilateral investment agreements are very different. The WTO is the exclusive domain of sovereign states who enter into reciprocal bargains that only they can enforce, whereas private foreign investors are the recipients of substantive and directly enforceable rights in investment treaties. The WTO dispute settlement system applies compulsorily to all its Members in relation to covered agreements, which apply to them all.

The governance and structure of the WTO dispute mechanism, as well as its rules, reflect the primacy of Members' sovereignty. The entire WTO Membership sits as the Dispute Settlement Body (DSB) (*WTO | Legal Texts – Marrakesh Agreement*, n.d., art. IV.3). Under the Dispute Settlement Understanding (DSU) all decisions that the rules and procedures require the DSB to take must be made by consensus (*WTO | Dispute Settlement Understanding – Legal Text*, n.d., art. 2.4). Any amendments to the DSU must also be by consensus (*WTO | Legal Texts – Marrakesh Agreement*, n.d., art. X.8). There is no equivalent comprehensive, unitary regime for investment treaties and realistically there will not be, especially if governments can choose from a menu of reform options, as is being proposed in WGIII.

Aside from these differences, there are also important lessons to be learned from the WTO. Developing countries have long criticised its dispute settlement system. Their concerns include the extended duration of hearings and failure to meet deadlines; adjudicators who exceed their powers and usurp the right of Members to interpret rules; lack of retrospective compensation to the date a proven breach began; abuse of retaliatory powers by powerful States and their failure to comply when they lose; the high cost of and dependency on foreign legal experts; no award of costs to successful complainant or respondent States; unrepresentative and pro-North panellist and Appellate Body members; the dispute settlement secretariat's unaccountability and improper influence; and the need for special and differential treatment and flexibility for developing countries and Least Developed Countries (Raghavan, 2000).

The WTO provides a particularly pertinent lesson on the appointment and selection of adjudicators, which was discussed at the January 2020 session of the Working Group (UNCITRAL, 2020c). Developing countries have consistently stressed the need for diversity of adjudicators, whatever adjudication process is used. Diversity is not just about geography or gender, nor is the goal simply to increase the opportunities of people from under-represented countries for their personal advancement or national pride. Development diversity is a pre-requisite to achieving justice, ensuring that adjudicators can interpret core legal concepts through a development lens and that appropriate understandings of law and culture are brought to the matters under dispute, something rarely seen to date. Those insights are, in turn, essential to improving the quality and legitimacy of decisions.

Achieving development diversity therefore requires much more than ensuring independence, impartiality, qualifications, and experience, and adopting a code of conduct, which have dominated the WGIII discussion of arbitral appointments. Unless diversity in its fullest sense is actively embraced, the dominance of a slightly broader arbitral elite is likely to continue in a self-perpetuating cycle, especially if appointments to a standing investment court were for a six- or even nine-year term.

Experience at the WTO shows that formal commitments to diversity do not solve the problem (Johannesson & Mavroidis, 2017, p.46, 2017, fig. 3,4). The DSU that governs the dispute process at the WTO has a diversity requirement and Appellate Body members are supposed to be broadly representative of the Membership (*WTO | Dispute Settlement Understanding – Legal Text*, n.d., art. 8.2, 8.10, 17.3). Despite that, panellists are overwhelmingly from the Global North. So are more than half the Appellate Body members appointed so far (*WTO | Dispute Settlement – Appellate Body Members, Biography*, n.d.). This longstanding problem reflects systemic bias in the appointment criteria and processes, institutional design, and operation of the WTO's dispute settlement system.

A related problem is that too much power over appointments has been vested in an unaccountable secretariat (Kanth, 2020; Monicken, 2019). The WTO Secretariat recommends the first instance panellists, and disputing states can only object to them for compelling reasons. Recent academic research concluded that the Secretariat has more influence over reports than panellists, which in turn has influenced the development of a *de facto* system of precedent and limited dissent (Pauwelyn & Pelc, 2019). Developing countries' concerns about institutionalised bias at the Secretariat level have largely been ignored (Raghavan, 2000).

A further, institutional problem is that developing countries were unable to obtain agreement to fix the dispute settlement regime, established in 1995, once its systemic development asymmetries became apparent. A full review of the dispute settlement rules and procedures was to be completed within four years after the WTO entered into force, followed by a decision as to whether to continue,

<sup>40</sup> See Kelsey, 2020a, 2020b



modify, or terminate those rules and procedures. That review has never been concluded because there is no consensus on reform (WTO DSB, 2019). At the same time, the US has (ab)used the WTO's consensus decision-making rules to paralyse the Appellate Body by blocking the appointment of new adjudicators, holding the system to ransom until other Members deliver on the US's demands for reform.

If these problems have arisen in the WTO, which is supposed to be a Member-driven institution, how would the promise of diversity, or the many other promises being made to developing countries during the WGIII process, play out in a multilateral investment court or a standing appellate mechanism? There is a very real risk that developing countries that agree to such a system in the expectation of major changes to the current ISDS regime would be unable to secure future reforms if the promised transformation fails to materialise.

## 4.6 A MULTILATERAL »SOLUTION«

The UNCITRAL Secretariat prepared a paper for the March 2020 session of WGIII that explored means to reach a consensus without needing agreement among the participating delegations on specific reforms (UNCITRAL, 2020b). Because that meeting was cancelled due to the Covid-related restrictions, this paper was discussed during the October 2020 session. The focus of that discussion was the design of the potential delivery mechanism, in other words, the instrument through which all or some of the reform options which are being considered by WGIII would be presented to States for adoption (UNCITRAL, 2020d). The following section explores these options and what they might imply for meaningful multilateral reforms to ISDS.

### 4.6.1 A multilateral investment institution

One option the Secretariat briefly considered was based on an influential paper by two members of the Academic Forum, Stephan Schill and Geraldo Vidigal. They advocated for a »comparative institutional design analysis« that seeks »inspiration« from existing international adjudicatory approaches (Schill & Vidigal, 2020, p. 317). That comparison led them to propose a Multilateral Institution for Dispute Settlement on Investment that would bring the array of existing and proposed investment dispute settlement mechanisms – »reformed« ISDS, inter-State arbitration, a permanent investment court, and strengthened domestic remedies – under a single institutional umbrella. The Multilateral Institution could be seen as a proxy for the MIC, which the paper describes as the »centripetal force to reduce the negative consequences of fragmentation«, including by conducting reviews, determining challenges to arbitrators, and issuing preliminary rulings and binding interpretations of »shared norms« (Schill & Vidigal, 2020, p. 331).

The authors acknowledge that their decontextualised approach fails to address the underlying concerns about ISDS and side-lines core »first order principles«, such as the rule of law, democracy, protection of human rights and promotion

of sustainable development (Schill & Vidigal, 2020, pp. 317, 323). That seemed not to matter. Far from addressing even the procedural concerns that WGIII has focused on – inconsistencies, incoherence and unpredictability, cost and delays – their »flexible« design would allow States to choose their approach to investment disputes. The effect would be to legitimise and institutionalise current ISDS mechanisms, with the addition of an investment court, within a single organ.

The paper conceded that such a proposal was politically unrealistic, given the positions delegations have taken in WGIII. Such a body would also be seen as threatening by existing arbitral forums that each have their distinctive legal mandates and would compete to become the supreme investment arbitration institution.

The Secretariat's paper set aside this notion of an uber-arbitral institution. It focused instead on two models of multilateral agreement that could simultaneously enable amendments to existing investment agreements without needing to revisit them one by one and prescribe new rules for incorporation into future treaties. While purporting not to take a position on the desirability of such an approach, the paper clearly favours an overriding instrument as a means to deliver an agreed outcome and bridge the deep divisions among delegations who have taken the floor at WGIII meetings. There is a simplistic elegance in a single instrument that appears to address problems of fragmentation, inconsistencies, incoherence, and unpredictability. However, that single instrument would host a menu of options that States could pick-and-mix – a »solution« that seems likely to intensify, entrench and even institutionalise the existing problems.

The two models the Secretariat considered were the Mauritius Convention on Transparency through which parties can apply the Commission's Transparency Rules to their existing investment agreements, and the Multilateral Legal Instrument developed in the OECD/G20 Base Erosion and Profit Shifting (BEPS) project for parties to amend their international tax treaties by a single legal instrument.

### 4.6.2 The Mauritius Convention as a model instrument for implementation

The first example of a single instrument through which to adopt the agreed outcome from WGIII is The United Nations Convention on Transparency in Treaty-based Investor-State Arbitration. Known as the Mauritius Convention, it provides a vehicle to apply the Transparency Rules adopted by UNCITRAL in 2013 to all existing IIAs without needing to amend them individually. These are general rules of application relating to transparency in ISDS disputes where the host state and home state of the investor are both Parties. Their application is subject to negative list reservations for specific treaties or arbitration rules other than UNCITRAL, and a Party can declare that it will not provide a unilateral offer of application in situations where it is a respondent to a claim.

The agreement applies to disputes arising from investment treaties in force in April 2014 where both Parties agree, and automatically to disputes initiated under UNCITRAL Arbitration Rules under agreements concluded between Parties to the Convention after that date, unless they agree otherwise. Adopted in 2014, the Convention entered into force in October 2017. It has been signed by 23 states but so far ratified by only 7.

The Mauritius Convention was promoted as a model for implementing agreed ISDS reforms in the paper commissioned by the Secretariat from academic-arbitral lawyers Gabrielle Kaufmann-Kohler and Michele Potestà (Kaufmann-Kohler & Potestà, 2016). However, its precedent value is limited by three factors: the subject matter of »transparency« is much narrower and less controversial than the WGIII mandate; the Convention provides for the implementation of rules that its parties have previously agreed, when no such rules are yet agreed in WGIII and may never be; and only a small number of UNCITRAL Member States signed the Convention, with even fewer having ratified.

#### 4.6.3 The Multilateral Tax Instrument as a model

The second possible model for implementing the WGIII reforms is The Multilateral Instrument to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (BEPS) – referred to as the Multilateral Instrument or MLI. This agreement was concluded in November 2016 as part of the OECD/G20 BEPS project and entered into force in July 2018. The goal was to streamline the process for making consequential amendments to some 3000 bilateral tax treaties by creating »a global consensual treaty override to apply the result of the [BEPS] simultaneously to all the tax treaties where the countries involved agree« (Avi-Yonah & Xu, 2017, p. 158).

Consistent with the Vienna Convention on the Law of Treaties, the MLI is a subsequent treaty between parties that amends an earlier treaty on the same subject matter. However, it does not automatically apply a single set of provisions to all the tax treaties of those who adopt it. Academic commentators have described its principles as embodying »idealism«, while the flexible implementation of its provisions reflects the pragmatism needed to secure an overall package (Avi-Yonah & Xu, 2017, p. 162). Even then, the US refused to sign.

The MLI has three categories of provisions: minimum standard provisions that all signatories must meet without reservation, which already have consensus support within BEPS agreements; recommendations for treaty amendments, which are also based on consensus outcomes from the BEPS project and have been incorporated into the OECD model tax treaty; and measures that signatories can adopt even though those measures did not enjoy consensus support (Brauner, 2019, p. 442; OECD, 2016).

As with the Mauritius Convention, the jury is out on how effective the MLI will be, even on its own terms. An aca-

demic analysis by Avi-Yonah and Xu notes that developing countries might find elements of the rules appealing, but »the absence of the United States is important, and other OECD members have agreed to only a limited set of provisions« (Avi-Yonah & Xu, 2017, p. 216).

Another academic commentator, Yariv Brauner, provides some highly relevant observations on the politics of the agreement. The US and Brazil both refused to join the MLI for political reasons. Other States which reserved on many MLI provisions, including Canada, the UK, China, and Germany, nevertheless benefitted from participating: »The relative flexibility of the regime facilitates their power, while the institutionalisation gives the regime legitimacy, and them opportunities to promote aspects, such as mandatory arbitration, that they could not otherwise have done« (Brauner, 2019, p. 443). The ability of powerful states to take reservations to measures they dislike poses the »symbolic and therefore political question« of whether such an agreement »may be viewed by less powerful states as being representative of an unbalanced power of the OECD and its dominant members over the agenda«, and generate suspicion of and resistance to the whole project (Brauner, 2019, p. 443).

Colombia proposed the MLI model in June 2019 as a means of implementing the »menu« approach advocated by Chile, Israel and Japan, and providing »flexibility, transparency and clarity« (UNCITRAL, 2019f, para. 22). Some minimum standards would be required, subject to negotiation, and an ability to opt out of non-minimum standards. A proposed structure listed many of the topics discussed in WGIII as minima, including an appellate body but not costs and duration, and some »other concerns« such as counterclaims and exhaustion of local remedies.

The MLI may be a more relevant model for WGIII, because the questions it addresses are politically more complex and contentious than transparency. Whereas the Mauritius Convention required adoption of the whole agreement, the MLI has flexibility for most provisions. But the MLI still implemented content that was already agreed on in BEPS. There is no such agreement in WGIII. Any minimum standards or other options that might be agreed for inclusion will reflect the lowest common denominator, being the status quo or »modernised« texts in agreements like the TPP.

#### 4.6.4 An »Open Architecture« Instrument Won't Solve the Problem

In 2020 WGIII conducted several webinars (under Covid-19 strictures) that further explored the »open« or »variable« architecture approach of the MLI. Anthea Roberts, Taylor St John and Wolfgang Alschner proposed a flexible architecture that has three limbs: a framework convention, separate opt-in protocols, and a central forum (Roberts et al., n.d.). The protocols would contain soft and hard law instruments on interpretive mechanisms and procedural rules, supported by dispute settlement options that span domestic courts, alternative dispute resolution, state-state dispute settlement, ISDS and a MIC, with an appellate mechanism for the latter

three. Developing countries would be supported through capacity building, advice and representation (Roberts et al., n.d.). Parties would be required to upgrade their existing agreements to meet minimum standards based on »today's best practices« or a »normative consensus« that is derived from recent IIAs (Roberts et al., n.d.). Other protocols would reflect the degrees of convergence and divergence on procedural rules.

There are several reasons why an MLI-style »open« architecture would fail to deliver on the UNCITRAL mandate. First, States would have a wide range of options. They could: determine which investment agreements to list as covered; adopt diverse ways of implementing the minimum standards; adopt negative reservations to some of the rules; opt in and opt out of non-minimum standard provisions; apply divergent dispute resolution mechanisms; and only apply the instrument to investment agreements if the other parties had made »matching« commitments. This fragmented array of diverse positions, adopted by different States variably across new and old international investment agreements, would deepen rather than solve the problems of coherence, consistency, correctness, cost, duration etc.

Secondly, if the »protocols« of the instrument proposed are limited to issues on which there is a high degree of consensus among the Working Group, that would presumably limit them to the four identified procedural issues. Most of the »other issues« raised by developing States have not yet been discussed in WGIII, so there is no evidence of a consensus about the concerns, let alone about the solutions. The substantive issues that never made the agenda would be considered »out of scope«.

Thirdly, the examples of »best practice« that Roberts et al used are from controversial recent agreements, such as the TPP, USMCA and several EU FTAs (Roberts et al., n.d., pp. 13, 15, 36). This approach would embed those texts as minimum standards for the future. There is no suggestion of using India or Morocco's model BITs, Brazil's Cooperation and Facilitation Investment Agreements, or South Africa's domestic Protection of Investment Act 2015. Those and other States will likely be expected to accept the new norm.

At the geopolitical level, this »variable architecture« is not politically neutral. Some capital-exporting States may not sign or ratify the instrument. When both parties to an IIA do so, but support different approaches, foreign investors will prevail on their home states to insist on their preferred option. Even if developing countries have some legal rights to object, they may not have the political capacity to resist.

It is not surprising that this approach currently seems the most likely outcome for WGIII, assuming any agreement is reached. UNCITRAL is not a neutral forum. Its institutional imperatives require it to conclude a »successful« outcome, whatever the contradictions or failure to deliver on its mandate. With no prospect for consensus around a unitary dispute mechanism, or even a Mauritius-style agreement that is adopted as whole, the Secretariat needs alternatives

to keep governments on board and justify its law-making functions and resources. The notion of »open« or »variable« architecture, with a single instrument providing a menu of options, allows UNCITRAL to deliver an outcome, while the nominally »government-driven process« allows the Secretariat to disavow responsibility for its deficiencies.

The EU would not be unhappy, either. While it would not achieve the ideal of a global investment court, an MLI-style instrument would legitimise its MIC. That would work fine for the EU, which has included a MIC-like mechanism in the investment chapters of its recent free trade agreements. But it would create major problems for countries that conclude agreements with the EU and have not adopted this multilateral instrument or have done so, but chosen other options, especially where they have accepted different arrangements in other IIAs. These are most likely to be developing countries, which will remain vulnerable to problems of coherence, consistency, correctness, controls over cost and duration, alongside all the other flaws of IIAs that have not been addressed.

The dysfunctional and inequitable regime of IIAs and ISDS would have been consolidated and re-legitimised and demands for real reforms put to bed for some years.

#### 4.6.5 Is a progressive multilateral instrument possible?

The Columbia Centre on Sustainable Investment and Centre for the Advance of the Rule of Law at Georgetown Law have taken the concept of a multilateral instrument and redirected it to serve sustainable development and address substantive and procedural matters that WGIII has ignored. Their Framework Convention on Investment and Sustainable Development promotes a »flexible, multilateral mechanism both for reform of existing IIAs and for broader work to align international investment law with the principles of sustainable development« (Porterfield et al., 2020).

The structure of their Framework Convention would comprise: a statement of objectives and principles; institutional arrangements that combine a conference of the parties, a secretariat and a dispute settlement mechanism; and procedures for adopting subsequent protocols on specific provisions to implement the objectives. New mechanisms would support governance of IIAs that advance sustainable development and protect governments' policy space against regulatory chill and the costs of exercising their authority. They would also develop and implement rules that support positive practices and outcomes.

Different elements would positively facilitate investment that supports the SDGs, including assistance for States in assessing the impacts of proposed investment projects. A cooperative approach to governance of transnational investors and investment could integrate approaches to human rights, climate change, tax evasion and other means of regulating transnational corporations more effectively at the national and international levels.

Following the Mauritius and MLI approaches, the Framework would be flexible in scope, participation, and timing, with opt-in and opt-out mechanisms grafted onto minimum substantive reforms. These reforms could include changes to substantive IIA provisions that UNCITRAL WGIII is not addressing.

As a strategic advocacy tool, the Framework Convention exposes the pro-investor bias of the UNCITRAL process and the failure of the current proposals to address the power and development asymmetries that beset the current IIA regime. However, when viewed as a viable alternative it suffers similar flaws to the multilateral instrument proposed by proponents of the status quo, with far less chance of being implemented. In particular, the »variable geometry« still allows capital-exporting countries to pick and choose which measures to adopt and, if there are robust and effective minimum standards, whether to participate at all. There is a further risk that promoting optimistic but unrealistic alternatives will dissipate the momentum for real reform.



## 5

## ISSUES CRUCIAL TO REFORM ALIGNED WITH SUSTAINABLE DEVELOPMENT CONSIDERATIONS

This section explores multiple other reforms to ISDS that would increase the potential for meaningful changes that are aligned with sustainable development considerations. These include the role of domestic courts, the role of State-to-State mechanisms, investor obligations and affected-party participation. While these issues have been brought up in the discussions of WGIII by several participating States and civil society observers, they have not been effectively integrated into deliberations thus far. It remains unclear how they will be engaged with under the rest of the workplan.

### 5.1 THE ROLE OF DOMESTIC COURTS AS AN ALTERNATIVE TO ARBITRATION<sup>41</sup>

ISDS permits foreign investors to circumvent a country's courts, regardless of whether they offer justice, and allows foreign investors to avoid the ordinary laws and courts that govern everyone else. In customary international law, private parties must exhaust local remedies before their grievances can lead to an international claim against a country. That rule shows respect for the country's institutions and gives the country a chance to fix problems before they are brought to an international tribunal. It also recognises that the foreign national's choice to enter a country carries a responsibility to accept domestic laws and institutions. Customary law allows an international tribunal to waive the duty if a foreign national shows that local remedies were not reasonably available or would be obviously futile to pursue (Van Harten, 2007, pp. 110–113).

In most IIAs, and many FTAs, foreign investors have been excused from this duty completely before resorting to ISDS. This remarkable step has opened up dubious lawyering options for investors, especially by those most able to finance ISDS litigation (that is, large multinationals and the ultra-wealthy). Investors with the sole discretion to decide on the reliability and suitability of local remedies might: sidestep the courts altogether; bring an ISDS claim if they lose in domestic courts, including a challenge against that court's decision and/or award; bring disputes to both forums in parallel; or seek an international order of compensation against the country, thus avoiding limits on judicial awards

of compensation in domestic law, while also pursuing other remedies – such as the striking down of a law – in domestic courts.

These practices contradict the oft-stated goal of investment agreements and ISDS to enhance the rule of law. A primary means for doing so is to preserve the role of domestic legislative, judicial, and administrative processes in creating, applying, and enforcing legal commitments. The focus should be to strengthen these institutions. An investment court model, much like ISDS, would generate a substitute system for the settlement of investment disputes that risks disincentivising and undermining this type of reform at the domestic level, especially in the absence of a duty to exhaust local remedies and show deference to the domestic institutions.

A common objection to such a proposition is the claim that domestic courts are usually overburdened and often not efficient in addressing investment cases where the investor is looking for a fast decision.<sup>42</sup> Consequently, the requirement to exhaust local remedies is often opposed on the grounds that it would lead to delays in the resolution of the disputes and consequently could increase costs. While these critiques may apply to many domestic courts, they also apply to international investment arbitration, which is evident in the fact that issues of duration and cost are some of the concerns under discussion at WGIII. Thus, the fact that domestic systems might need improvement should not be a barrier to discussing their role in settling disputes between the investor and the host State.

Considering the interface between domestic courts and arbitration is an essential step for the redesign of the investment dispute settlement regime. Building effective legal and other domestic institutional systems and capacities is central to any notion of sustainable development and the rule of law. Otherwise, arbitration would continue to evolve into a completely parallel legal system that marginalises the role and contribution of domestic courts in the realm of investment law (UNCITRAL, 2019g, para. 44).

<sup>41</sup> This section is based on Kelsey et al., 2019 and Mohamadieh, 2020.

<sup>42</sup> According to UNCTAD, among the main arguments made against local litigation requirements are '[c]oncerns that some host States cannot guarantee an efficient and well-functioning domestic court system' (UNCTAD, 2017).

For those purposes, reform of ISDS could include targeted initiatives to strengthen domestic systems.<sup>43</sup> UNCTAD pointed out that increased reliance on domestic courts, coupled with support for States whose legal systems are less developed, can strengthen the rule of law and consistency in jurisprudence, and remedy some deficiencies that are used to justify ISDS (*World Investment Report 2015: Reforming International Investment Governance*, 2015, p. 149). This is part and parcel of fulfilling Sustainable Development Goal 16 which calls for »provid[ing] access to justice for all and build[ing] effective, accountable and inclusive institutions at all levels«. Moreover, customary international law allows a foreign national to avoid exhaustion of local remedies by showing that such remedies are not reasonably available. It should not be onerous to show when weak or corrupt courts genuinely fail this test, relieving the investor of the duty to use them (Kelsey et al., 2019, p. 9).

The Working Group has agreed that requiring investors to exhaust local remedies before bringing their claims to investment arbitration is a tool to be considered in reforming ISDS (UNCITRAL, 2019d, p. 7). Besides this option, domestic courts could also be considered as a full alternative to arbitration for all claims or certain subject-matter disputes. Furthermore, domestic courts could contribute towards addressing challenges faced in the interpretation of domestic law by arbitral tribunals by serving as a reference point for those tribunals on interpretation of domestic law. This is important, especially as arbitral tribunals could be over-influenced by commercial rather than public policy considerations, tipping the balance in favour of private rather than public interests (UNCITRAL, 2019g, para. 45).<sup>44</sup> These different approaches to the role of domestic courts have not been comprehensively addressed in WGIII, despite the fact that several countries' submissions have referred to the role of domestic courts, including, but not limited to, the requirement of exhaustion of local remedies (UNCITRAL, 2018h, para. 12, 2019b, para. 14, 2019g, para. 12).

There are multiple investment agreements where domestic courts are the only recourse available for investors. For example, the Australia-United States Free Trade Agreement 2005, the Australia-New Zealand Investment Protocol 2013, and the Australia-Japan Economic Partnership Agreement 2015 do not include investor-State arbitration as a choice for resolving investment disputes. Under these treaties, in case of a dispute foreign investors must resort to domestic courts. Alternatively, investors going abroad can insure their investment against political risks by purchasing public or private insurance, rather than relying on ISDS.

In the renegotiation of The North American Free Trade Agreement (NAFTA) (renamed the United States-Mexico-Canada Agreement (USMCA)), ISDS was eliminated between the United States and Canada. After a transition period of three years for investors already established in the foreign jurisdiction, the investors will have to revert to domestic courts or seek consideration of their issue through the State-to-State mechanism. Between the United States and Mexico, new dispute settlement rules require exhaustion of local remedies through initiating domestic remedies and seeing them through until a final decision or until thirty months have passed with no decision (*Analysis of the NAFTA 2.0 Text Relative to the Essential Changes We Have Demanded to Stop NAFTA's Ongoing Damage*, n.d.; *Canada-United States-Mexico Agreement (CUSMA)*, 2020, Annex 14-D; Bernasconi, 2018).

South Africa is another country that chose to move investment disputes away from international arbitration and to its domestic courts. Under its Protection of Investment Act (2015), which was set in place after it terminated its IIAs, investors have the usual recourse to domestic courts, as well as the option of referring any investment dispute with the government to a mediation process facilitated by the South African Department of Trade and Industry (Leon & Muller, 2017; Protection of Investment Act, 2015, 2015, sec. 13).

A further alternative allows countries to reserve certain disputes for the domestic courts, such as those involving taxation, natural resources, obligations in treaties with Indigenous Peoples, or other issues pertaining to crucial public interest considerations and non-discriminatory regulatory interventions (Kelsey, 2019b). This could require a filter to identify such cases, such as agreement by the States Parties to the investment treaty or an autonomous mechanism they establish (Menon & Issac, 2018). For example, the Australia-China FTA provides for a State-to-State filter, whereby both States could agree that a potential ISDS claim is about a non-discriminatory regulatory issue and should not proceed to arbitration (Polanco, 2019, p. 89).

UNCTAD's mapping of IIAs reveals that only 82 of the 1,616 agreements examined require exhaustion or pursuit of local remedies before proceeding to international arbitration (*Mapping of IIA Content | International Investment Agreements Navigator | UNCTAD Investment Policy Hub*, n.d.). Some countries clarify the interface between domestic and international remedies in more detail. For example, under the 2018 India-Belarus BIT, the investor is required to pursue domestic judicial or administrative remedies related to the measure for at least five years from when it became aware of the measure, after which an investor may pursue ISDS (*Treaty Between The Republic Of Belarus And The Republic Of India On Investments*, 2018, arts. 15.1 & 15.2). A fork-in-the-road clause requires the investor who initiates arbitration to abandon any ongoing domestic proceedings with respect to the same measure. The agreement also prohibits an arbitral tribunal from reviewing the merits of a decision given by a domestic judicial authority (*Treaty Between The*

<sup>43</sup> Domestic reforms could include considering the utility of conferring certain courts, such as those dealing with administrative issues, exclusive competence to deal with investment disputes, or establishing specialized courts to deal with such disputes.

<sup>44</sup> For example, the unrestricted mandate of arbitrators has led to cases where arbitral tribunals have also questioned decisions by the higher courts of several countries, such as in ISDS cases against India and Ecuador. See *White Industries v. India*, 2010 and *Chevron and TexPet v. Ecuador (II)*, 2009.

*Republic Of Belarus And The Republic Of India On Investments*, 2018, arts. 13.4).

There are multiple issues to consider in designing the interface between the role of domestic courts and international arbitration in investment dispute settlement, particularly if designing a hybrid dispute settlement system that integrates a role for both. For example, it is not enough to provide the investor with the option of recourse to domestic courts through a »fork-in-the-road« clause. Such clauses make it unlikely for investors to direct disputes to domestic courts, and thus would contribute very little to redesigning the ISDS regime (Bisiani et al., 2016, p. 61). A more express and unequivocal provision of exhaustion of local remedies would require that the investor »shall« exhaust local remedies before initiating international arbitration and would determine the legal nature of the remedies to be exhausted, whether administrative or judicial (Brauch, 2017; Southern African Development Community, 2012, art. 28, para. 4(a)).

It is possible to address procedural issues, such as duration and costs that could arise as a result of a requirement to exhaust local remedies, by imposing time limitations or establishing particular domestic procedures, such as single-instance court proceedings. However, if these time limits are too short, the requirement to exhaust local remedies or attempt a settlement in the host State's domestic courts would yield no meaningful outcomes.

Another particular concern for governments arises when treaty tribunals set themselves up as courts of appeal vis-à-vis a host State's domestic courts (Schreuer, 2005, referenced in: Wehland, 2019). Different tribunals have exhibited different approaches to judgments of local courts (*Fouad Alghanim & Sons Co. For General Trading & Contracting, W.L.L. and Fouad Mohammed Thunyan Alghanim v. Hashemite Kingdom of Jordan*, 2017; *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States*, Award, 1999). That not only compounds problems of uncertainty, but also impacts on the rule of law and the legitimacy of arbitration, and has a potential chilling effect on the domestic courts as described earlier. It is essential that a redesigned investment dispute settlement system does not marginalise domestic courts.

## 5.2 STATE-TO-STATE MECHANISMS FOR INVESTMENT DISPUTE SETTLEMENT<sup>45</sup>

Strengthening the involvement of State authorities has been integrated as one of the reform options considered by WGII. In July 2019, the Secretariat prepared a table of reform proposals made by participating States, which included proposals from the EU, Costa Rica, Brazil, South Africa and Bahrain for establishing or strengthening State-to-State processes (UNCITRAL, 2019j). This could include technical consultations among States, decisions by the respective

State authorities, establishing a joint review committee by the treaty parties, or a mechanism for State-to-State review if the claim cannot be settled at the technical level within a specific timeframe (UNCITRAL, 2019j). However, the Secretariat's paper only refers to these as means for preliminary consideration of issues in a dispute; it did not address State-to-State dispute settlement as an alternative to investor-State arbitration, even though that is what both Brazil and South Africa had proposed. Although the Secretariat's paper for the March-April 2020 session cites South Africa's paper as urging parties to strengthen such processes as an alternative to investment arbitration, it again focused on State-to-State cooperation as a pre-cursor to investor-State arbitration (UNCITRAL, 2020d, paras 29, 34–42).

Reliance on State-to-State prevention and dispute settlement mechanisms has been expanding in State treaty practice. The delegation from Brazil tabled a paper in June 2019 explaining the system for dispute prevention it has adopted under its investment facilitation and cooperation model (CFIA) (Government of Brazil, 2019). The institutional core of the CFIA's prevention pillar is a joint committee and an ombudsman. The »joint committee for administration of the Agreement« is composed of government representatives of both Parties designated by their respective governments. The agreement also establishes »focal points« or »ombudsmen«, which have as their main responsibility the provision of support to investors from the other Party (Hees et al., 2018).

The Brazilian approach was influenced by the experience of the Office of Foreign Investment Ombudsman (OFIO) of the Republic of Korea, which provides investment aftercare to support investors who face grievances in their day-to-day business to ensure the investment environment is appropriate. The Brazilian Direct Investment Ombudsman (DIO) was established within the Foreign Trade Board. It coordinates a focal point network comprised of main agencies and entities of the public administration at the national and subnational levels, including the investment promotion agencies. It handles complaints related to the Federal Government and to Brazil's different States (Figueiredo de Oliveira, 2020). In a submission to WGIII, Brazil notes that »[i]n extensive consultations with Brazilian multinational companies, the government realized that investors were more interested in the improvement of the institutional framework for investment with foreign governments than in after-the-fact remedies that would provoke long and expensive litigation« (UNCITRAL, 2019e).

Brazil also provides for State-to-State dispute settlement as one element of the model it adopts under the CFIA. The CFIA does not include ISDS. For example, the Brazil-India bilateral investment treaty (2020) provides that »[a]ny dispute between the Parties which has not been resolved after being subject to the Dispute Prevention Procedure may be submitted by either Party to an ad hoc Arbitral Tribunal, ... [or] ... to a permanent arbitration institution for settlement of investment disputes« (*Investment Cooperation And Facilitation Treaty Between The Federative Republic Of Brazil And*

<sup>45</sup> This section is partly based on: Mohamadieh, 2020.

*The Republic Of India*, 2020, art. 19.1). The treaty says the purpose of the arbitration is to decide on the interpretation of the treaty or the observance by a Party of the terms of the treaty, but the arbitral tribunals cannot award compensation (*Investment Cooperation And Facilitation Treaty Between The Federative Republic Of Brazil And The Republic Of India*, 2020, art. 19.2).

Another example is the South Africa's Protection of Investment Act of 2015, which provides for the possibility of State-to-State arbitration after exhaustion of domestic legal remedies, with the States' consent required on a case-by-case basis (Protection of Investment Act, 2015, 2015). The Southern African Development Community (SADC) also decided to amend its Finance and Investment Protocol in 2016 to exclude the ISDS clause, leaving State-to-State dispute settlement as the only option (SADC, 2016). Furthermore, the process of reforming the dispute settlement mechanisms under the Organization of Islamic Conference (OIC) investment agreement includes a proposal to adopt a State-to-State mechanism. As proposed, this mechanism would be operational after the exhaustion of local remedies, should the investor not be satisfied and claim there is a denial of justice. At that stage, a State-to-State mechanism could be resorted to in order to arrive at an amicable settlement and avoid the movement towards arbitration (Kane, 2020).

The proposition by the EU for a MIC, which is being addressed through WGIII, integrates the possibility of using the proposed court for State-to-State dispute settlement (UNCITRAL, 2019a, para. 6). This reflects a recognition by the EU that States are increasingly choosing to rely on State-to-State dispute settlement as a substitute for ISDS.

State practices and multilateral intergovernmental experiences show that State-to-State led mechanisms, including State-to-State dispute settlement, could be viable options and do not necessarily have to be tainted with politicisation. States do not need to establish a standing body in order to advance State-to-State dispute settlement in investment cases and there may be drawbacks to doing so. As discussed earlier, while the World Trade Organization (WTO) dispute settlement system is State led in terms of its design, assignment of adjudicators, bringing cases and overseeing decisions, it is beset with power asymmetries. If States want to move away from ad hoc case-by-case appointments, without an institutionalised structure, they could establish treaty-specific dispute settlement commissions appointed, ex-ante to the emergence of cases, by State Parties to that treaty.

The suggestion that State-to-State dispute settlement and ISDS live side by side in a multilateral instrument poses crucial questions about the role of each and the relationship between the two. This includes, for example, how one decision in a State-to-State dispute settlement might influence an ISDS case that deals with the same issues and whether the former would be binding in subsequent State-to-State or investor-State cases.

### 5.3 INVESTOR OBLIGATIONS AND ISDS

Recognition that not all investors and investments add value when it comes to developmental and sustainability objectives has become part of the mainstream narrative. Yet the place of investor obligations under investment agreements has been largely left on the margins of discussions pertaining to reforming investment rules, including in WGIII.

Historically, securing binding and enforceable obligations on investors has been an issue of crucial importance for developing countries. Negotiations on a code of conduct for transnational corporation (TNCs) were sought during the 1970s and 1980s as part of the project towards a New International Economic Order, with the aim of establishing a multilateral framework on the rights and responsibilities of TNCs and host State governments (Sauvant, 2015; UN Economic and Social Council, 1988). Failure has been attributed to multiple factors; the lack of interest, and sometimes objections, by developed countries to establishing obligations for their multinational corporations was arguably the most influential factor leading to the end of the negotiations (Sauvant, 2015).<sup>46</sup>

Recently, negotiations on an international legally binding instrument on business and human rights have been launched under the auspices of the United Nations Human Rights Council (UNHCR, n.d.). The UN Guiding Principles on Business and Human Rights, adopted by consensus at the UN Human Rights Council in 2011, provide a clear statement that business enterprises can have an impact on virtually the entire spectrum of internationally recognised human rights, although in practice, some human rights may be at greater risk than others in particular industries or contexts (OHCHR, 2011, commentary on principle 12). The Guiding Principles instructed that businesses »should avoid infringing on the human rights of others and should address adverse human rights impacts with which they are involved« (principle 11), including to »avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur« and »seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts« (principle 12) (OHCHR, 2011).

Recent OECD research on the qualities of foreign direct investment (FDI) has focused on »assessing the contribution of foreign investment to sustainable development and identifying policies to maximise positive impacts and minimise potential negative impacts«, with reference to five qualities: productivity and innovation, employment and job quality, human capital and skills, gender equality, and carbon footprint (OECD, 2019; Sauvant & Mann, 2017). During the OECD investment roundtable held in March 2019, OECD

<sup>46</sup> Some of the factors referred to include including the complexity of the negotiations and changes in the underlying political and economic circumstances and interests of developed and developing countries.



governments accepted a proposal to start intergovernmental work on business responsibilities and investment treaties.<sup>47</sup>

The 2020 OECD Investment Treaty Conference (postponed due to Covid-19) intended to address how governments approach issues of business responsibilities in their trade and investment treaties. The consultation paper for the conference pointed to a »powerful convergence of thinking about both the respective roles of governments and business in addressing business conduct that generates adverse impacts, as well as on the content of business responsibilities« (Gaukrodger, 2020, p. 104). The paper described responsible business conduct as »a broad concept that focuses on two aspects of the business-society relationship: (i) the positive contribution businesses can make to sustainable development and inclusive growth; and (ii) avoiding adverse impacts on others and addressing them when they do occur« (Gaukrodger, 2020). It identified a number of related issues for discussion, such as policy space for governments, provisions that buttress domestic law and its enforcement in areas such as labour, environment, anti-corruption, and human rights, and provisions that speak directly to investors, such as establishing conditions for access to investment treaty benefits (Gaukrodger, 2020).

Reflecting this trend, States are increasingly addressing investor obligations in their treaty practice. For example, the Nigeria-Morocco investment agreement (2016) imposes a number of human and social obligations on investors and incorporates an enforcement mechanism whereby the investor can be held civilly liable in its home state for damages caused in the host state (*Morocco – Nigeria BIT*, 2016, arts. 15 & 20). Labour chapters in some recent FTAs, such as the TPP, provide stronger and potentially enforceable legal obligations on states and rights of workers to access judicial forums, but these obligations have no legal cross-over with the investment chapter, and no effect on investor protections enforced through investment arbitration.

Most treaties that address corporate responsibilities are currently limited to hortatory language addressed to either States or investors (Gaukrodger, 2020). For example, Brazil's investment agreement with Malawi provides a section on »Corporate Social Responsibility«, which requires that »Investors and their investment shall strive to achieve the highest possible level of contribution to sustainable development« and »shall develop their best efforts to comply with ... voluntary principles and standards for a responsible business conduct and consistent with the laws adopted by the Host Party«, including human rights of those involved in the companies' activities (*Investment Cooperation And Facilitation Agreement Between The Federative Republic Of Brazil And The Republic Of Malawi*, n.d.). Without clauses expressly linking investor obligations with access to investment treaty benefits, including access to international dispute settlement mechanisms, situations will persist where

investments that violate human and environmental rights or breach domestic laws remain potentially protected under investment treaties.

Whether the obligations of investors in relation to human rights, the environment and corporate social responsibility warranted further consideration was briefly discussed under the heading of »other concerns« at the 37<sup>th</sup> session of the Working Group in April 2019. The report of the meeting observed that this was closely related to the question of allowing counterclaims by States as well as claims by third parties against investors (UNCITRAL, 2019d, para. 34). It went on to blandly record »a general understanding that any work by WGIII would not foreclose consideration of the possibility that claims might be brought against an investor where there was a legal basis for doing so« (UNCITRAL, 2019d, para. 35). Consequently, investor obligations have not re-appeared on the Working Group's agenda and their fate in the revised work plan is very uncertain.

## 5.4 AFFECTED PARTY PARTICIPATION<sup>48</sup>

A striking procedural flaw in ISDS is the exclusion of non-investors from the adjudication of claims. Only the foreign investor that brings the claim and the respondent State have a right to legal standing. Yet, when foreign investors sue States, they often make allegations and raise issues that affect others who have no legal right to participate. That is not just unfair. It also means the tribunal cannot consider all the relevant facts and arguments and may issue decisions and relief that prejudice those whose voices are not heard.

Various actors may be left in this unfair situation, such as an individual accused of involvement in corruption, a domestic investor in competition with foreign competitors, a sub-national government alleged to have violated the treaty, communities whose land claims overlap with those of the foreign investor, or private parties engaged in domestic litigation with the foreign investor (*AbitibiBowater Inc., v. Government of Canada, Notice of Intent to Submit a Claim*, 2009, paras 8–9; *Bernhard von Pezold and Others v. Republic of Zimbabwe, Procedural Order No. 2*, 2012, para. 62; *Eureko B.V. vs. Republic of Poland, Dissenting Opinion*, 2005, para. 11; *St. Marys VCNA, LLC vs. Government of Canada, Notice of Intent to Submit a Claim to Arbitration*, 2011, paras 1, 33–34).<sup>49</sup> Under the current ISDS

<sup>48</sup> This section draws on Kelsey et al., 2019, pp. 4–6.

<sup>49</sup> See, also *Chevron and TexPet v. Ecuador (II), Second Partial Award on Track II*, 2018, para. 7.39–7.44, where the tribunal rejected Ecuador's cross-claims on the ground that the government did not have standing to assert the claims, which dealt with environmental harm that affected Ecuadorian citizens. Yet a key issue was whether Chevron could use ISDS to attack a domestic court ruling against Chevron and in favour of private plaintiffs who had suffered from the environmental harm. See, *Chevron and TexPet v. Ecuador (II), Second Partial Award on Track II*, 2018, para. 9.20–9.97, Part X. See also *Chevron v. Ecuador, First Interim Award on Interim Measures*, 2012, paras 11 & 16; *Chevron v. Ecuador, Second Interim Award*, 2012, para. 3; *Chevron v. Ecuador, Third Interim Award on Jurisdiction and Admissibility*, 2012, para. 4.59–4.71; Johnson & Güven, 2017.

<sup>47</sup> The roundtable involves over sixty countries including G20, OECD and other governments.

system, none of these parties has a right to standing in the legal proceedings. To reply effectively on issues relating to their rights or interests, the affected party needs to have access to the relevant evidence put before the tribunal, an opportunity to test the evidence, an opportunity to make claims and submit evidence, and so on. As the proceedings unfold, it may emerge that the party can provide facts that the investor and government could not or did not provide. Where the person has been denied the right of standing, an ISDS tribunal risks making a decision that harms someone without having heard from him or her. That is deeply unfair.

Developed countries have been reluctant to allow third-party participation. In the (never-concluded) Transatlantic Trade and Investment Partnership (TTIP) negotiations, the EU proposed a right for anyone with a direct interest in an ISDS proceeding to intervene, but that was limited to supporting the position of the claimant investor or the respondent State (*Transatlantic Trade and Investment Partnership, Commission Draft Text*, n.d., art. 23). This proposal did not find its way into other EU FTAs (*Comprehensive Economic And Trade Agreement (CETA), Entry into Force 21 Sep 2017*, 2017; *Free Trade Agreement between the European Union and the Republic of Singapore, Entry into Force 21 Nov 2019*, 2018; *Free Trade Agreement between the European Union and the Socialist Republic of Viet Nam, Entry into Force 2020.08.01*, 2020).

A number of agreements and procedural rules allow arbitrators to give *amicus* or limited »third person« status (*Comprehensive And Progressive Agreement For Trans-Pacific Partnership*, 201 C.E., art. 9.23(3); *Free Trade Agreement between the European Union and the Republic of Singapore, Entry into Force 21 Nov 2019*, 2018, Annex 9-G, art. 3; Levine, 2011, p. 29; Salazar, 2012, pp. 4–8). However, tribunals are not required to give standing to persons who have a direct interest in the proceedings (Blackaby & Richard, 2010, pp. 253, 259–266; Wieland, 2011, pp. 334, 344–345, 359–360). In those rare cases where tribunals have granted *amicus* status, the rights of participation have been severely limited (Wieland, 2011, pp. 341–344). The *amicus* party has no right to access all relevant documents before the tribunal, leaving them to draft a submission without knowing what the investor and government have told the tribunal (*Infini-to Gold Ltd. V. Costa Rica, Procedural Order No. 2*, 2016, paras 43–45). This is especially invidious for *amici* whom the tribunal requires to bring their submissions within the scope of the existing dispute, make contributions distinct from the other parties, and not favour one »side« or the other (*Gabriel Resources Ltd. And Gabriel Resources (Jersey) v. Romania, Procedural Order No. 19*, 2018, paras 50, 62; *ICSID Convention, Regulations And Rules*, n.d., Rules 37(2)(a) & (b); *Infini-to Gold Ltd. V. Costa Rica, Procedural Order No. 2*, 2016, para. 38). Additionally, tribunals have directed *amici* to limit their input to narrow issues of fact or law (*Gabriel Resources Ltd. And Gabriel Resources (Jersey) v. Romania, Procedural Order No. 19*, 2018, paras 60, 66). In other areas of law, *amicus* is used to give individuals and groups an opportunity to participate in a proceeding where they otherwise have no right of full standing. That procedural

option can be very helpful, but its purpose is very different from ensuring that affected parties are heard and able to protect their rights and interests.

Although non-party participation is a procedural issue, it was not selected as one the focuses for WGIII. As the notes of the meeting in New York in 2019 show, the issue was raised by several developing countries as an »other concern« warranting attention (UNCITRAL, 2019d, paras 31–33). Participation by affected communities and individuals, as well as public interest organisations to present arguments on investors' obligations on matters like the environment and protection of human rights, were considered important »as a matter of legitimacy of the ISDS system.«

The interventions made it clear that delegations were seeking the right for affected persons and communities to participate, not simply to make submissions or present *amicus* briefs. That important distinction was not clearly captured in the formal record. Instead, the discussion reverted to considering third-party submissions, and even suggested the issue could be dealt with as part of the »inconsistency and incorrectness of awards« (UNCITRAL, 2019d, para. 33).

South Africa argued this point strongly in its submission to the WGIII in July 2019: allowing »affected individuals or communities to bring claims against investors means allowing natural or legal persons with a direct and present interest to intervene in the proceedings« and is an essential step to »making it a forum that protects the rights of all people – not just those of multinationals« (UNCITRAL, 2019g, paras 52–54). Several civil society observers echoed the call for ISDS to safeguard the rights of all affected parties, including by giving them a right of standing to the extent of their affected interest (International Institute for Environment and Development et al., 2019). Those calls have so far gone unheard.

## 6

## CONCLUSION: UNCITRAL FIDDLES WHILE COUNTRIES BURN

This paper has exposed the reality behind the consensus-based, government-driven approach that is meant to form the foundations for deliberations in UNCITRAL WGIII. The views of predominantly capital-importing developing countries that are the main targets of ISDS cases should have had at least as much influence as the developed capital-exporting countries that primarily support ISDS, if not more. That has not happened, due to a number of mutually reinforcing factors.

The terms of reference for WGIII have been narrowly applied in a way that focuses on a limited set of procedural issues, which were restricted to four issues: consistency, coherence, predictability and correctness of arbitral decisions; arbitrators and decision makers; cost and duration of cases; and third-party funding. The substantive concerns that underpin the crisis of legitimacy confronting the international investment regime and ISDS will not be addressed.

Other matters of importance from a policy and regulatory perspective, which have been put forward to WGIII primarily by developing countries, but ought to be of concern to all countries, have either been excluded *per se* because they are deemed to be substantive issues and out of scope or are acknowledged and then marginalised or disappear from WGIII agenda. Expectations that »other matters« raised by developing countries (such as alternative dispute resolution, dispute prevention, participation by affected communities beyond third party submissions, investor obligations and counterclaims, and protecting State's policy autonomy against regulatory chill) would form part of the discussions about solutions have largely remained unfulfilled. The debate over the workplan at the May 2021 session showed how developing countries have struggled simply to keep many of their issues on the record. There is currently little prospect that they will secure any effective »solutions« to them from the WGIII process.

The procedures of WGIII, crafted by the Secretariat and the Chair of the process, have helped steer the Working Group's activities in this narrowly constructed direction since even before the Working Group received its mandate. Since then, the Secretariat's background papers have continued to frame the agenda and deliberations. In this constricted environment, the Chair and the Secretariat have effectively determined what topics are to be discussed in what order

at which meetings, the written record of the meetings, and the next steps in the work plan. The Secretariat's extensive technical papers circumscribe the topics for discussion, which the developed countries then dominate.

The way the meetings and work plan have been organised have made it difficult for participating countries to caucus and develop common positions, support each other on the floor, and challenge the manipulation of the original mandate and each meeting's agenda. The online meetings during the Covid-19 era have further disabled delegations from the Global South and critical observers and strengthened the Chair and Secretariat control over the process. Developing countries also struggle with time zones, poor quality internet, difficulty making timely and in-person interventions, and isolation from other members and observers.

The way the agenda has been managed by the Secretariat and Chair means the »elephant in the room« – the objective of establishing a MIC – has never been explicitly discussed. The proposal has been advanced more subtly through the issue-based discussion to the point where it forms part of the »open« and »variable« architecture in a potential multilateral instrument to implement procedural »reforms« to IIAs. Yet, the Secretariat/CIDS paper shows it was part of the anticipated outcomes from the start.

The wide divergence of positions between capital-exporting States suggests it will be difficult to secure agreements among them even on the Working Group's limited procedural issues. The proposal for a framework instrument that allows States broad flexibility to decide what changes they might make to their existing and future investment agreements is intended to finesse the problem of consensus. As a consequence, any agreed outcome will maintain a menu of provisions that may or may not address the concerns identified at the start of the WGIII process and that may be applied across a range of investment dispute mechanisms.

There has also been minimal activist pressure from campaigners against ISDS on the outside, due in large part to the selection of the little-known UNCITRAL as the forum for ISDS reform. Internal pressure from observers within the meetings, who are not aligned to the arbitral industry or corporate lobbies, has been constrained by restrictions on who is accredited, their prescribed role, the strategically

designed agenda, priority for States' interventions, and the Chair's limitations on speaking time.

## 6.1 THE CURRENT STATE OF PLAY

After five years of WGIII deliberations, it is clear that its current approach will not deliver meaningful reform unless there is a substantial realignment of the agenda, procedures and power dynamics within the Working Group.

At this stage the most likely outcome is a lowest common denominator solution that allows UNCITRAL and the Secretariat to proclaim »success«. The »open architecture« approach to a multilateral instrument, which is emerging as the favoured outcome, would allow capital-exporting States to adopt minimalist procedural changes to ISDS and none to the fundamental systemic problems undermining States' policy and regulatory space. Some of those States may not even sign or ratify a final agreement. So, in addition to the likely reforms being unduly moderate and ineffective, there may not be enough buy-in from foreign investors' home States to make any difference at all for countries on the receiving end of ISDS claims.

## 6.2 RECOMMENDATIONS

If the international investment regime is to become supportive of development and overcome its legitimacy crisis, UNCITRAL WGIII needs to recall and act upon the original impetus for reform: deep-seated concerns about the democratic accountability and legitimacy of the international investment regime as a whole, especially of ISDS, and its implications on the policy and regulatory space countries require to address developmental challenges as well as current transformational challenges, particularly in regard to the climate crisis and preparedness to face global pandemics.

While the UNCITRAL process cannot solve all contentious issues, if it is to alleviate the legitimacy crisis confronting the international investment regime to a significant degree then its work plan must genuinely address these core concerns. The participating States must also act as responsible members of the United Nations, committed to coherence in their policy and legislative choices and international commitments, in a way that contributes to fulfilling their promises on the development agenda.

Aligning ISDS reform with developmental objectives requires a recognition that cases, and the measures that these disputes touch on, have different implications from the perspective of sustainable development and public policy than from the perspective of investor promotion and protection. This is especially so in cases arising out of governmental action for environmental, human rights, or other public interest objectives, where major public policy considerations and important issues pertaining to third-party rights have to be weighed against private interests. It cannot be assumed that investor-State arbitration provides the most effective avenue

for dealing with any disputes that might arise, even if some procedural changes to arbitration end up being adopted. An effective consideration of the developmental implications of ISDS therefore requires freeing the mandate given to WGIII from the narrow interpretation adopted to date and taking a serious look at alternatives to arbitration as means to settle investment disputes.

A revised Working Group work plan that meets these standards would:

1. Enable a process whereby developing countries, as the principal targets of ISDS disputes, can set a new agenda that elevates their concerns and reform priorities to set the minimum standards for any new Agreement;
2. Audit the process, agenda and proposals against United Nations Member States' commitments to and obligations under the Sustainable Development Goals, which include respect for human rights, governance structures that ensure inclusive participatory processes and equal access to justice, and encouraging sustainable new investment for development purposes in states that need it.
3. Link any UNCITRAL Agreement on investor-state dispute settlement to instruments being developed in other parts of the UN system, such as the proposed international legally binding instrument to regulate, in international human rights law, the activities of transnational corporations and other business enterprises, as well as advancements in tackling investor obligations through treaty practice (UNHCR, n.d.).
4. Ensure transparency and inclusiveness in the process as a matter of substance, not just of form.

It will no doubt be argued that it is now too late for Working Group III to deliver on its original mandate in this way. In response, participating States and the Commission itself need to recognise that failure to move beyond narrow procedural reforms to ISDS on their selected categories of issues and address the fundamental challenges that confront the regime will not resolve the crisis the investment regime faces. At the same time, it will create an additional wedge in the process towards delivering on the SDGs, instead of ensuring that the system that underpins international investment governance supports and enables sustainable development.

By purporting to offer a »solution« to the deficiencies in the current ISDS regime, the UNCITRAL process would legitimise the deeply problematic rules and forms of the international investment regime. The fundamental systemic problems will remain unaddressed at a time when major crises of climate change, pandemics, geopolitical conflicts, debt defaults, and social upheaval create new opportunities for foreign investors to capitalise on the partisan and deeply flawed investment regime.

There is a risk that a purported »solution« may be used to silence ongoing calls from most developing countries and



civil society observers to address the power imbalance and development asymmetries that are endemic to both the substance and procedure in the current IIA regime. But, however confident its architects may be that they have diverted and defused demands for more radical reforms to the international investment regime, the realities of the imbalanced and unjust investor-State disputes that have created this crisis will not go away.

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## ANNEX: SUMMARY TABLE

The discussion in this paper is not meant to be an exhaustive account of the issues tackled by WGIII. It has focused on systemic proposals that would have the most significant implications for ISDS regime reform. The following table summarises the points raised regarding those elements, as well as a number of issues raised by delegations that the Working Group has not addressed.

While this paper focused on discussing procedural issues pertaining to ISDS reform given the focus of WGIII on these issues, it is evident that meaningful and effective reform of

the international investment regime requires reform of the substantive investor protection rules in a way that approaches these substantive rules and ISDS procedures as part of an integrated whole. Treating reform of substantive pro-investor rules in international investment agreements as too hard, and addressing only ISDS procedures by which those rules are applied to States, essentially fails to recognise that substance and procedure are intertwined. Furthermore, a reform of ISDS that rules the substantive issues out of scope will lack effectiveness, credibility, and legitimacy.

Selected issues concerning ISDS reform	Related risks <i>(the following is a non-exhaustive list of risks, focusing on the most challenging risks from a systemic perspective)</i>	Proposals from a developmental and public interest perspective
<b>Selected issues currently addressed by WGIII</b>		
Alternative dispute settlement	A narrow approach that limits the notion of alternatives to mediation and conciliation, both of which are often approached as a mere pre-condition to arbitration, would restrict ISDS reform to changes within the existing system of investment dispute settlement, and divert the discussion away from a more fundamental rethink of the system.	Expand discussions of alternative dispute settlement to include serious consideration of the role of domestic courts and State-to-State mechanisms
Mediation	Increasing reliance on confidentiality-centred mediation could entrench the same problems that ISDS currently suffers. These include increasing the number of “wins” that investors accrue without having to make their case and undermining affected-party rights and public interest considerations where cases relate to public policy issues.	Address lack of transparency in mediation, the imbalance between the parties to a mediation process, selection of mediators and conciliators, and potential implications for the regulatory and public policy processes.
An appeal system	An appeal system will be an additional layer to the investment arbitration system, and will not fundamentally carve out public interest related cases from the realm of arbitration. Depending on the design of the appeal (including whether a decision by an appellate body would bind the disputing parties only or have broader effects), an appeals system could affect the development of investment law, potentially consolidating an imbalanced body of law and creating more challenges in reconciling investment law with other bodies of law.	Avoid approaching the idea of instituting a centralised appeal system as an acceptable reform option for ISDS. Carefully address its potential impacts, including systemic risks associated with an appeals system, such as subordinating the jurisdiction and oversight function of domestic courts and developing jurisprudence that entrenches pro-investor biases when interpreting investment rules. Effectively address issues pertaining to participatory rights in an appeals mechanism, including possible access for non-disputing parties, potential for systematic or abusive use of an appellate process, and the increase in cost and duration of ISDS as a result of institutionalising an appeal mechanism.
A multilateral investment court	The proposal retains major aspects of the current traditional ISDS system and risks inflating the market available for arbitration cases without correcting the underlying challenges of the existing system. The MIC remains an exclusive system that provides investors only with the ability to sue the State in relation to any measure or public policy issue and is unclear in regard to its relationship with domestic courts. The MIC proposal does not guarantee the right of standing of affected non-disputing parties or the right of the host States and communities impacted by the investment to bring direct claims against investors. The MIC could entrench several of the major flaws in the current ISDS system: a court, especially one funded through user fees, might tend towards increasing its own power by ruling expansively on its jurisdiction and in favour of the claimants, thus continuing the investor bias inherent in today’s private arbitration system. It could thus create new law or set precedent that favours the interests of investors. The relationship of the proposed body to the existing ISDS system based on ad hoc tribunals remains unclear, risking the creation of an additional and parallel adjudicative system without correcting the existing ad-hoc arbitration based ISDS regime.	Avoid the idea that creating a new multilateral body dedicated to serving as an exclusive platform for investors to sue the State would constitute ISDS reform.

Selected issues concerning ISDS reform	Related risks <i>(the following is a non-exhaustive list of risks, focusing on the most challenging risks from a systemic perspective)</i>	Proposals from a developmental and public interest perspective
<b>Issues at the time of writing this paper unaddressed at UNCITRAL WGIII</b>		
The role of domestic courts as an alternative to arbitration	Keeping the role of domestic courts out of the discussions of ISDS reform will maintain the marginalisation of domestic laws and institutions within the international investment regime.	Reform and strengthen domestic judicial systems to support effective, accountable, and inclusive institutions in line with the SDGs, and prioritise domestic courts as the appropriate forum to handle investment disputes. Restrict oversight of domestic courts by extra-territorial tribunals, except in extreme cases of denial of justice.
State to State mechanisms for Investment Dispute settlement	Leaving State-to-State mechanisms as means for settling investment disputes outside the reform discussions would marginalise the recent choices and practices of major developing country economies who choose to rely on State-to-State mechanisms and dispute settlement.	Enhance the role of States, as masters of their own treaties, in interpreting and clarifying their treaties, including through establishing and strengthening the role of State-to-State mechanisms in handling investment disputes. A multilateral standing body is not needed in order to advance State-to-State dispute settlement in investment cases.
Investor obligations and ISDS	Without effectively addressing investor obligations, investment law will remain imbalanced and risk offering privileges to investors that violate human and environmental rights, as well as various domestic laws.	Ensure that investor obligations are effectively incorporated into investment treaties and their performance is linked with access to investment treaty benefits. There must also be coherence between investment treaties and laws and evolving norms and laws concerned with investor obligations and duties of business more generally.
Affected party participation	<p>The exclusion of non-investors from the adjudication of claims means that investors have an unfair influence over the investment dispute settlement regime. Access to justice is fundamental for all those whose lives and interests are at stake.</p> <p>Tribunals cannot consider all the relevant facts and arguments, and may issue decisions that prejudice the rights of those left unheard.</p>	Affected parties, whether governments, local communities, or other individuals, should have a right to participate in investment disputes beyond being an <i>amicus</i> party. Their rights ought to include right of standing to the extent of their affected interest, access to the relevant evidence, an opportunity to test the evidence, an opportunity to make claims and submit evidence.
Regulatory Chill	The threat or initiation of costly, prolonged investment disputes that may result in a crippling award of damages gives foreign investors leverage to pressure States to terminate or not to pursue measures that are in the public interest. The resulting regulatory chill undermines State's responsibilities, democracy, the public good and the rule of law.	A holistic approach must be taken to address the leverage of foreign investors over states, including unbalanced pro-investor protections, the high costs of proceedings, the risk of massive awards with compound interest and lack of investor responsibilities. Foreign investors should have the same rights, responsibilities and remedies as local investors, subject to domestic law in domestic courts that maintain a margin of appreciation for state responsibilities, and to constitutional and related legal norms.



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