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### UNCITRAL Working Group III on ISDS Reform: How Cross-Cutting Issues Reshape Reform Options

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# UNCITRAL Working Group III on ISDS Reform: How Cross-Cutting Issues Reshape Reform Options<sup>1</sup>

15 July 2019

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<sup>1</sup> This document was submitted, with the title *Reshaping the Reform Agenda: Concerns Identified and Cross-Cutting Issues* to UNCITRAL Working Group III on ISDS Reform in accordance with paragraph 83 of document A/CN.9/970 (Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its 37<sup>th</sup> session (New York, 1–5 April 2019)). That paragraph, and the discussion it reflects, invited submissions by states and other stakeholders on reform options to inform UNCITRAL’s efforts in identifying and prioritizing particular solutions UNCITRAL will develop in the next phase of its work. The submission was prepared by Lorenzo Cotula (IIED), Thierry Berger (IIED), Lise Johnson (CCSI), Brooke Güven (CCSI) and Jesse Coleman (CCSI).

1. At its 36<sup>th</sup> session (Vienna, 29 October–2 November 2018), UNCITRAL Working Group III on Investor-State Dispute Settlement (ISDS) Reform (WGIII) identified three broad categories of concern for which ISDS reform was deemed desirable:
  - Concerns relating to the lack of consistency, coherence, predictability and ‘correctness’ of arbitral decisions;<sup>2</sup>
  - Concerns relating to arbitrators and decision makers;<sup>3</sup> and
  - Concerns relating to costs and duration of ISDS cases.<sup>4</sup>
  
2. In addition, at its 37<sup>th</sup> session (New York, 1–5 April 2019), WGIII concluded that reform was desirable in order to address concerns related to the definition and the use or regulation of third-party funding in ISDS.<sup>5</sup> At its 37<sup>th</sup> session, WGIII also engaged in a discussion to identify possible additional concerns not already addressed in its deliberations. WGIII discussed the following issues:
  - Means other than arbitration to resolve investment disputes as well as dispute prevention methods;<sup>6</sup>
  - Exhaustion of local remedies;<sup>7</sup>
  - Implications for third parties, and the role of third-party participation, including participation both by the general public and by local communities affected by the investment or the dispute at hand;<sup>8</sup>
  - Investor obligations and counterclaims;<sup>9</sup>
  - Regulatory chill;<sup>10</sup> and
  - Damages.<sup>11</sup>
  
3. WGIII noted that these issues related to:<sup>12</sup>
  - Concerns that had already been identified (e.g., third-party participation, which WGIII partly linked to concerns about the consistency and correctness of arbitral decisions,<sup>13</sup> and damages, which WGIII linked, “for example,” to concerns about correctness of arbitral decisions<sup>14</sup>);
  - Tools to be considered by WGIII in Phase 3 of its mandate (e.g., means other than

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<sup>2</sup> United Nations Commission on International Trade Law (UNCITRAL) ‘Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Sixth Session (Vienna, 29 October–2 November 2018)’ (hereafter UNCITRAL, ‘36<sup>th</sup> Session Report’). Concerns include: 1) divergent interpretations of substantive standards, divergent interpretations relating to jurisdiction and admissibility and procedural inconsistency (para. 39); 2) lack of a framework to address multiple proceedings (para. 53); and 3) limitations in the current mechanisms to address inconsistency and incorrectness of arbitral decisions (para. 63).

<sup>3</sup> Including: 1) lack of apparent lack of independence and impartiality (UNCITRAL, ‘36<sup>th</sup> Session Report’ (n 1) para. 83); 2) limitations in existing challenge mechanisms (para. 90); 3) lack of diversity of decision makers (para. 98); and 4) qualifications of decision makers (para. 106).

<sup>4</sup> Including: 1) lengthy and costly ISDS proceedings and the lack of a mechanism to address frivolous or unmeritorious cases (UNCITRAL, ‘36<sup>th</sup> Session Report’ (n 1) paras. 122 and 123); 2) allocation of costs in ISDS (para. 127); and 3) concerns regarding the availability of security for cost in ISDS (para. 133).

<sup>5</sup> UNCITRAL, ‘Report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Seventh Session (New York, 1–5 April 2019)’ (hereinafter UNCITRAL, ‘37<sup>th</sup> Session Report’), para. 25.

<sup>6</sup> *ibid* para. 29.

<sup>7</sup> *ibid* para. 30.

<sup>8</sup> *ibid* paras. 31–33.

<sup>9</sup> *ibid* paras. 34–35.

<sup>10</sup> *ibid* paras. 36–37.

<sup>11</sup> *ibid* para. 38.

<sup>12</sup> *ibid* para. 39.

<sup>13</sup> *ibid* para. 33; see also UNCITRAL, ‘36<sup>th</sup> Session Report’ (n 1) paras 59, 61.

<sup>14</sup> UNCITRAL, ‘37<sup>th</sup> Session Report’ (n 5) para. 38.

arbitration to resolve investment disputes as well as dispute prevention methods;<sup>15</sup> exhaustion of local remedies<sup>16</sup>); and

- “Guiding principles for developing reforms” (e.g., addressing regulatory chill, including with regards to the “inherent asymmetric nature of the ISDS system, costs associated with the ISDS proceedings, and high amounts of damages awarded by tribunals”;<sup>17</sup> not foreclosing “consideration of the possibility that claims might be brought against an investor where there was a legal basis for doing so”<sup>18</sup>).
4. Based on these observations, WGIII resolved to consider the issues listed in paragraph 2 above as part of its exploration of possible reforms to address the concerns that have been identified (rather than as additional concerns at the current stage).<sup>19</sup> In effect, WGIII framed these aspects as *cross-cutting issues* to be considered in Phase 3 of its mandate.
  5. WGIII reiterated that this conclusion “did not preclude other concerns to be identified and dealt with at a later stage of the deliberations.”<sup>20</sup> It also noted that any work by WGIII would need to take into account developments in investment treaties, so that the solutions developed by WGIII are flexible enough to adapt to a rapidly changing international policy context.<sup>21</sup>
  6. To support WGIII in the implementation of this approach, Table 1 illustrates how consideration of the cross-cutting issues affects the contours of the concerns WGIII has identified and of possible options for reform. Separate submissions to WGIII discuss in greater detail: implications for third parties and issues concerning third-party participation;<sup>22</sup> regulation of third-party funding (and draft text to accomplish this objective);<sup>23</sup> and a multilateral framework on termination and withdrawal of consent, which illustrates how the UNCITRAL process could be used to provide space for other means of dispute settlement.<sup>24</sup>
  7. The issues identified in Table 1 are relevant to WGIII’s discussion of reform options, including those identified as more structural in nature, those that can be applied to the current ad hoc ISDS system or those that straddle these lines. As illustrated in Table 1, considering the cross-cutting issues will help ensure that, as WGIII proceeds to the next phase of its reform discussions, it broadly surveys the range of potential options and takes a holistic view of their implications. In practice, it would mean that:
    - The cross-cutting issues are fully integrated in WGIII’s work and reflected in its project schedule(s);
    - WGIII sessions devoted to reform options for the concerns identified further consider how the cross-cutting issues affect the concern at stake and related reform options;
    - WGIII periodically revisits whether developments in its deliberations warrant additional concerns to be specifically identified and addressed;

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<sup>15</sup> *ibid* para. 29.

<sup>16</sup> *ibid* para. 30.

<sup>17</sup> *ibid* paras. 36–37.

<sup>18</sup> *ibid* para. 35.

<sup>19</sup> *ibid* para. 39.

<sup>20</sup> *ibid*

<sup>21</sup> *ibid* para. 40.

<sup>22</sup> CCSI, IIED and IISD, ‘Third Party Rights in Investor-State Dispute Settlement: Options for Reform (Submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform, 15 July 2019).’

<sup>23</sup> CCSI, IISD and IIED, ‘Draft Text Providing for Transparency and Prohibiting Certain Forms of Third-Party Funding in Investor-State Dispute Settlement (Submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform, 15 July 2019).’

<sup>24</sup> CCSI, IIED and IISD, ‘Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements (Submission to UNCITRAL Working Group III on Investor-State Dispute Settlement Reform, 15 July 2019).’

- The cross-cutting issues are duly considered in any activities organized in connection with the work of WGIII, such as seminars, colloquia or online discussions that are formally or informally linked to WGIII;
- WGIII and the UNCITRAL Secretariat are endowed with adequate resources to consider the cross-cutting issues and their implications for reform options, including development of any technical analysis necessary to support WGIII's deliberations.

**Table 1. Cross-cutting issues: Illustrative implications for Phase 3 of WGIII’s mandate**

Concerns identified → Cross-cutting issues ↓	Concerns pertaining to the lack of consistency, coherence, predictability and correctness of arbitral decisions	Concerns pertaining to arbitrators and decision makers	Concerns pertaining to cost and duration of ISDS cases	Concerns pertaining to third-party funding
<b>Means other than arbitration to resolve investment disputes as well as dispute prevention methods</b>	<p>Consider alternatives to ISDS, such as domestic courts, ombudsmen, alternative dispute resolution and state-to state dispute settlement</p> <p>Consider limits on the causes of action that can be pursued through ISDS (e.g., to denial of justice)</p> <p>Consider rules on referral to other courts and/or expert bodies and on staying ISDS disputes while related proceedings are pending that might narrow or resolve issues relevant to the ISDS claim or defence</p>			
<b>Exhaustion of domestic remedies</b>	Consider requiring exhaustion as a means of clarifying and crystallizing the scope of legal and factual issues for resolution at the international level, potentially reducing scope for inconsistent or incorrect decisions	Consider requiring exhaustion for all or some causes of action to more clearly allocate primary responsibility for deciding different issues of law and fact between different domestic and international adjudicators, each with different sociocultural backgrounds, areas of expertise and powers of review	Consider the effect on duration of ISDS proceedings and duration of overall proceedings from initiation of claim through post-award challenges	Consider the effect of exhaustion on the nature and availability of third-party funding of claims
<b>Implications for third parties<sup>25</sup></b>	<p>Consider participation by actors specifically affected by the investment or the dispute, beyond <i>amicus curiae</i> submissions, in order to promote correct interpretation and application of all relevant norms</p> <p>Consider dismissal or reframing of claims where affected third parties cannot be joined, so as to prevent inconsistent and incorrect interpretations of their rights</p>	<p>Consider ways to ensure decision makers have expertise in key relevant areas of law, including outside of investment law and in issues raised by community–investor disputes</p> <p>Consider processes for referral to other courts and/or expert bodies and stays of proceedings pending resolution of third parties’ rights</p>	<p>Consider arrangements to ensure that enhanced third-party participation does not unduly increase cost or duration<sup>26</sup></p> <p>Consider rules on dismissal where impacts on affected third parties give rise to risks of multiple proceedings</p> <p>Consider how addressing issues relating to third parties may affect overall cost and duration, including by avoiding or consolidating claims</p>	Consider whether/how disclosure or other rules regarding third-party funding would govern participation by and/or funding of third parties

<sup>25</sup> Further discussion of implications for the rights of third parties is in the separate submission CCSI, IIED and IISD, ‘Third Party Rights in Investor-State Dispute Settlement: Options for Reform’ (n 23).

<sup>26</sup> This may involve, for example, case management rules including strict deadlines and limiting size of party and third-party submissions. However, WGIII emphasized that “ensuring due and fair process as well as guaranteeing the quality and correctness of the outcomes should not be sacrificed for the sake of speedy resolution of ISDS” (UNCITRAL, ‘36<sup>th</sup> Session Report’ (n 1) para. 117).

Concerns identified → Cross-cutting issues ↓	Concerns pertaining to the lack of consistency, coherence, predictability and correctness of arbitral decisions	Concerns pertaining to arbitrators and decision makers	Concerns pertaining to cost and duration of ISDS cases	Concerns pertaining to third- party funding
<b>Counterclaims</b>	<p>Consider providing greater clarity regarding issues on which arbitral jurisprudence is divided (e.g., nature of the required connection between claim and counterclaim)</p> <p>Consider how use of counterclaims can address issues of inconsistency across otherwise separate proceedings</p> <p>Consider how to ensure consistency and coherence across legal regimes, including by allocating decision-making authority across those regimes</p>	<p>Consider ways to ensure decision makers have expertise in key relevant areas of law, including investor legal compliance issues</p> <p>Consider processes for referral to other courts and/or expert bodies and stays of proceedings for resolution of counterclaims</p>	<p>Consider arrangements to ensure that counterclaims do not unduly increase cost or duration<sup>27</sup></p> <p>Weigh costs and benefits of permitting counterclaims with costs and benefits of requiring those claims to be pursued in different fora</p>	<p>Consider whether/how disclosure or other rules regarding third-party funding would govern state receipt of funding in the context of counterclaims</p>
<b>Regulatory chill</b>	<p>Consider removing or restricting access to ISDS through, e.g.:</p> <ul style="list-style-type: none"> <li>- Requiring exhaustion of local remedies</li> <li>- Limiting some or all causes of action or issues to state-to-state dispute resolution<sup>28</sup></li> <li>- Including state-to-state filters that claims must pass through before going to ISDS</li> </ul>			
	<p>Consider arrangements to increase consistency and predictability (e.g., an appeal mechanism), in order to mitigate regulatory chill concerns</p> <p>Consider providing greater clarity regarding rules for dismissing frivolous claims and related costs</p>	<p>Consider clarifying rules on deference to factual and legal determinations and policy preferences of domestic (or other) government bodies or adjudicators</p>	<p>Consider issues concerning calculation of damages, as well as legal and arbitration costs, in order to reduce the incentive to sue for monetary damages, reduce the overall financial cost of ISDS and mitigate its impact on public decision making</p> <p>Consider making “costs follow the event” the default rule</p> <p>Consider requiring security for costs</p> <p>Consider sanctions against counsel for frivolous or abusive claims</p> <p>Consider strengthened pleading standards</p>	<p>Consider transparency of third-party funding and funding arrangements in order to understand the role of third-party funding in ISDS and its impact on certain categories of claims</p> <p>Consider whether to prohibit funding or otherwise limit the types of claims that can be funded<sup>29</sup></p>

<sup>27</sup> Commentary in the previous footnote applies *mutatis mutandis*.

<sup>28</sup> This could draw on the approach used in the renegotiated North American Free Trade Agreement. A convention could be used whereby states could substitute state-to-state dispute settlement for ISDS for some or all causes of action, for some or all treaties. A discussion of how this could be done is in the separate submission CCSI, IIED and IISD, ‘Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements’ (n 25).

<sup>29</sup> See separate submission CCSI, IISD and IIED, ‘Draft Text Providing for Transparency and Prohibiting Certain Forms of Third-Party Funding in Investor-State Dispute Settlement’ (n 23).

<p>Concerns identified → Cross-cutting issues ↓</p>	<p>Concerns pertaining to the lack of consistency, coherence, predictability and correctness of arbitral decisions</p>	<p>Concerns pertaining to arbitrators and decision makers</p>	<p>Concerns pertaining to cost and duration of ISDS cases</p>	<p>Concerns pertaining to third-party funding</p>
<p><b>Calculation of damages</b></p>	<p>Consider arrangements to increase consistency and predictability as regards the burdens of proof and the legal standards for assessing damages</p> <p>Consider increasing consistency with norms regarding damages assessments in other relevant areas of law and policy</p>	<p>Expand availability of review for errors of fact and law in damages assessments</p>	<p>Consider clarifying the evidence required and the methods used for the calculation of damages, so as to reduce the overall financial cost of ISDS</p> <p>Consider rules on early disclosure of nature of damages claims and support for those claims</p> <p>Consider clarifying rules on cost shifting, interest and recoverability</p>	<p>Consider clarifying the evidence required and the methods used for the calculation of damages, as well as legal and arbitration costs</p> <p>Consider caps on the amount or percent of damages and/or interest a third-party funder may recover (to the extent such funding is permitted)</p>