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REFORMING INVESTMENT DISPUTE SETTLEMENT: A STOCKTAKING

HIGHLIGHTS

- Investor-State dispute settlement (ISDS) continues to be controversial, spurring debate in the investment and development community and the public at large. States are responding to challenges and concerns surrounding ISDS through different avenues.
- In the international investment agreements (IIAs) signed in recent years, countries have implemented a large number of ISDS reform elements as part of broader IIA reform. Nearly all IIAs concluded in 2018 contain at least one, and most contain several, mapped ISDS reform elements (annex table 1). Most of these elements resonate with reform options identified by UNCTAD since 2013.
- Five principal approaches emerge from IIAs signed in 2018: I. No ISDS, II. Standing ISDS tribunal, III. Limited ISDS, IV. Improved ISDS procedure and V. Unreformed ISDS mechanism (figure 1). Some of the reform approaches have more far-reaching implications than others. The extent of reform engagement within each approach can also vary (significantly) from treaty to treaty.
- ISDS reform is pursued across various country groupings, by countries at different levels of development and from different geographical regions. At the same time, individual countries and regions have been the driving forces behind certain approaches (e.g. Brazil, India, the European Union (EU)).
- ISDS reform is making its way into plurilateral and megaregional initiatives, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the United States–Mexico–Canada Agreement (USMCA) and the EU–Singapore Investment Protection Agreement (IPA). Also, multilateral engagement on ISDS reform is gaining prominence, including through UNCITRAL Working Group III discussions on the possible reform of ISDS and processes at ICSID for the amendment of its rules.
- Investment dispute settlement must be designed to produce just outcomes that are viewed as reflecting key societal values. Developments outside of the traditional realm of investment policymaking may provide insights for further thinking on the rebalancing of investment dispute settlement (e.g. the Sustainable Development Goals (SDGs), particularly goal 16; the UN Guiding Principles on Business and Human Rights; and the "zero draft" on a legally binding instrument released by the UN Working Group on Business and Human Rights).
- UNCTAD, as the United Nations' focal point for international investment and development, backstops ongoing policymaking processes with a view to ensuring that the IIA regime – including the way in which investment disputes are settled – works for sustainable development. UNCTAD supports sustainable development-oriented IIA reform through its three pillars of work: development of policy tools based on research and policy analysis; technical assistance, and intergovernmental consensus building.

Executive summary

Section 1: Reform options emerging from recently concluded IIAs

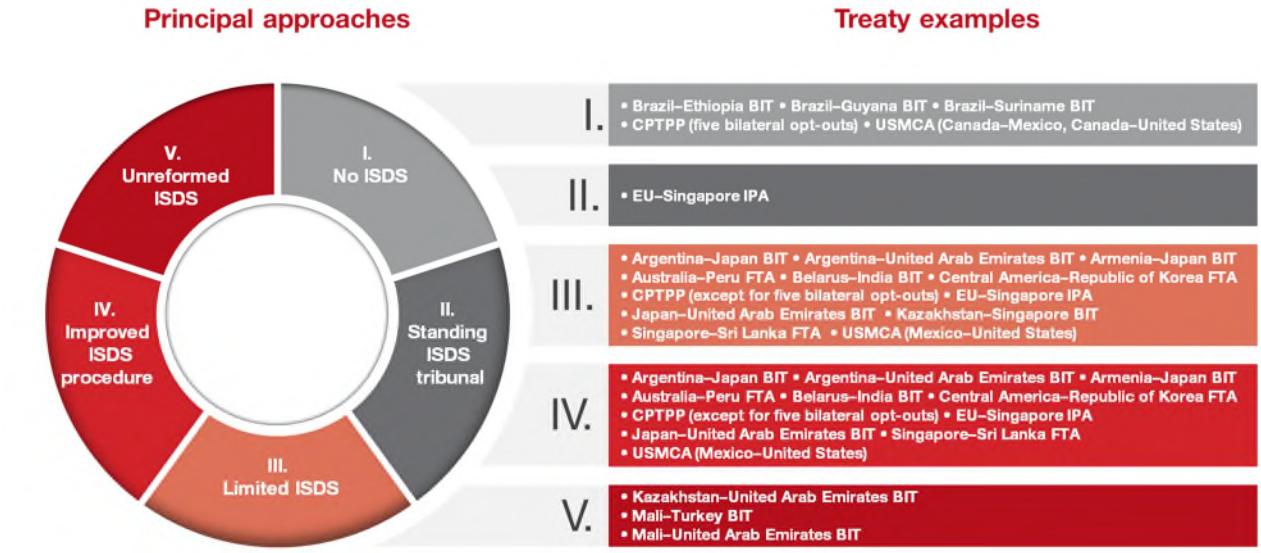
In their recent IIAs, countries have implemented a large number of ISDS reform elements as part of broader IIA reform. Nearly all IIAs concluded in 2018 contain at least one, and most contain several, mapped ISDS reform elements (annex table 1). Five mapped treaties stand out by containing 15 or more (the Australia–Peru FTA, the Central America–Republic of Korea FTA, CPTPP, the EU–Singapore IPA and the USMCA).

Most of these elements resonate with the options identified by UNCTAD in the Investment Policy Framework for Sustainable Development (2015) and in the Road Map for IIA Reform (2015), subsequently included in the Reform Package for the International Investment Regime (2018).

Alongside ISDS-specific reform elements, many of the IIAs reviewed also include important modifications to other treaty components that have implications for ISDS reform (e.g. a refined treaty scope, clarified substantive provisions and added exceptions). These are not the focus of this IIA Issues Note, however.

Overall, five principal approaches emerge from IIAs signed in 2018 (figure 1). These include: I. No ISDS, II. Standing ISDS tribunal, III. Limited ISDS, IV. Improved ISDS procedure and V. Unreformed ISDS mechanism. Some of the reform approaches have more far-reaching implications than others. The extent of reform engagement within each approach can also vary (significantly) from treaty to treaty.

Figure 1. Taking stock of ISDS reform: Principal approaches used in IIAs concluded in 2018



Source: UNCTAD.

ISDS reform (approaches I to IV) is pursued across various country groupings, by countries at different levels of development and from different geographical regions. At the same time, individual countries and regions have been the driving forces behind certain approaches (e.g. Brazil, India, the EU). Sometimes, specific negotiating dynamics may result in a situation where the treaty practice of individual countries is not fully coherent. Also, asymmetric approaches are used in some plurilateral treaties, which results in different ISDS-related arrangements for specific treaty relationships (e.g. CPTPP, USMCA).

Section 2: Developments by country grouping and geographical region

Developing and transition economies

- In Africa, several regional instruments have adopted a cautious attitude towards ISDS and have often omitted it. Domestic developments in some African countries have also moved into this direction.
- In Asia, regional ISDS reform efforts have been limited. The future outcomes of large regional negotiations are difficult to predict. At the country level, India has been a main innovator in the ISDS area. Also, two countries (Singapore and Viet Nam) have agreed to the investment tribunal system in recent treaties with the EU.
- In Latin America, a variety of reform efforts have been embraced at the regional and country-level. Brazil has spearheaded the move towards dispute prevention and State-State mechanisms as alternatives to ISDS with its Cooperation and Investment Facilitation (CIFA) model.
- ISDS reform developments in transition economies are characterized by two diverging approaches. The South-East Europe (SEE) group of countries are in the process of moving closer to the EU's new investment policy approach. No major policy shifts have occurred on ISDS in other transition economies.

Developed economies

- Procedural improvements and ISDS limitations are frequent treaty features in recent IIAs signed by developed countries. At the same time, developed countries take different approaches to IIA reform.
- The EU is proceeding with plans for establishing a multilateral investment court. Recent EU member States' bilateral investment treaties (BITs) with third countries include certain procedural improvements, aligned with the EU's broader investment policy approach. New policy documents have set a timeline for the termination of intra-EU BITs, which will remove access to the ISDS mechanisms contained therein.
- In North America, Canada and the United States are reassessing and readjusting their approaches. Their recent treaties display a wide spectrum of ISDS reform approaches, from improved procedures to omission of ISDS.
- Other developed countries such as Australia have selectively included ISDS (with procedural improvements) on a treaty-by-treaty basis. New Zealand selectively excluded compulsory ISDS under CPTPP (with several parties) and announced opposition to ISDS in future FTA negotiations. Japan has adopted procedural reform features in some recent treaties.

Section 3: Plurilateral and megaregional developments

ISDS reform is making its way into plurilateral and megaregional initiatives, such as the CPTPP, USMCA and the EU–Singapore IPA.

- In the CPTPP, signatories have adopted an ISDS mechanism with procedural improvements. Some variety in ISDS approaches among CPTPP signatories was created by side letters signed by several countries on a bilateral basis. The bilateral side letters (1) removed or modified ISDS provisions between specific countries or (2) terminated pre-existing IIAs (replacing overlapping ISDS commitments). Overall, this created asymmetric ISDS arrangements under CPTPP, with ISDS opt-outs done in parallel to the creation of many new treaty relationships offering ISDS.
- Compared to the North American Free Trade Agreement (NAFTA), the USMCA's investment chapter (Chapter 14) significantly curtails ISDS. Recourse to ISDS will not be available between Canada–United States and Canada–Mexico (however, access to ISDS in the Canada–Mexico relationship is available under the CPTPP). Between Mexico and the United States, the USMCA includes a 30-months local remedies requirement and strictly circumscribes the substantive provisions subject to ISDS.
- A key feature of the EU's investment policy approach, first set out in 2015, is the two-tier investment court system. It consists of a first instance tribunal and an appeal tribunal. Party-appointed arbitrators (selected by the disputing parties) are replaced by tribunal members appointed by State Parties, assigned to specific cases on a rotational basis. The new institutional set-up for dispute settlement between investors and States has since been implemented with slight variations in the Canada–EU Comprehensive Economic and Trade Agreement (CETA), the EU–Singapore IPA and the EU–Viet Nam IPA. Any pre-existing BITs between the EU member States and the relevant third country, including the ISDS mechanisms contained therein, are set for termination.

Section 4: Multilateral developments

Multilateral engagement on ISDS reform is gaining prominence. According to the three-phase mandate provided by the UNCITRAL Commission in July 2017, Working Group III is tasked i) to identify and consider concerns regarding ISDS; ii) to consider whether ISDS reform was desirable; and iii) if it were to conclude that reform was desirable, to develop any relevant solutions to be recommended to the Commission.

The explicit focus on ISDS – procedural aspects of dispute settlement – of the Working Group's mandate means that certain broader aspects that affect the legitimacy of the system (such as balanced substantive IIA rules) and some of the other possible solutions (e.g. replacing ISDS with domestic dispute resolution or State-State proceedings) are not a central part of the deliberations. UNCITRAL deliberations have been receiving considerable attention, from policymakers as well as the broader investment and development community. For example, in March 2019, several independent human rights experts published a letter outlining concerns related to the current scope of deliberations in the Working Group.

The ICSID Secretariat recently published proposed amended arbitration rules (under the ICSID Convention and the Additional Facility). The current process to amend the rules was commenced by the Secretariat in 2016 with a particular focus on the time and cost of ICSID arbitration proceedings. Aiming at comprehensive changes to modernize the rules, the proposed amendments address topics such as third-party funding, publication of awards, initial procedures, security for costs, disqualification of arbitrators, timing of awards and expedited proceedings. A vote on the amendments is expected in 2019 or 2020.

Section 5: Rebalancing investment dispute settlement

Pursuit of the SDGs and the 2030 agenda also implies changes to international investment policymaking, including IIAs. Both substantive rules and rules on dispute settlement need to be oriented towards today's sustainable development imperative, which is the overarching objective of IIA reform.

The following developments outside of the traditional realm of investment policymaking may provide insights for further thinking on the rebalancing of investment dispute settlement:

- SDG 16 (Peaceful and inclusive societies for sustainable development), which calls on States to "promote the rule of law at the national and international levels and ensure equal access to justice for all";
- The UN Guiding Principles on Business and Human Rights;
- The "zero draft" on a legally binding instrument to regulate – in international human rights law – the activities of TNCs (UN Working Group on Business and Human Rights);
- "The Hague Rules on Business and Human Rights Arbitration" project; and
- Other research and policy analysis on access to justice and IIAs conducted by academia and think tanks.

Conclusions and way forward

While it is too early to assess the concrete impact of today's reform efforts, two points that have guided UNCTAD's work on improving investment dispute settlement remain crucial. First, reform of investment dispute settlement must not be viewed in isolation. It needs to be synchronized with reform of the substantive investment protection rules embodied in IIAs. Second, reform of both substantive rules and rules on dispute settlement needs to be oriented towards today's sustainable development imperative. Creating a policy regime that effectively mobilizes investment and channels it towards the SDGs is the goalpost. The investment dispute settlement system must be designed to produce just outcomes that are viewed as reflecting key societal values. Transparent and inclusive decision-making on reform as well as cross-fertilization and coordination between different processes, such as the 2030 agenda for sustainable development, are essential in this regard.

UNCTAD, as the United Nations' focal point for international investment and development, backstops ongoing policymaking processes with a view to ensuring that the IIA regime – including the way in which investment disputes are settled – works for sustainable development. UNCTAD supports sustainable development-oriented IIA reform through its three pillars of work: development of policy tools based on research and policy analysis; technical assistance, and intergovernmental consensus building.

Introduction

ISDS remains a controversial and dynamic aspect of international investment policymaking. The annual number of known treaty-based ISDS cases remains at record level, with most cases invoking old-generation treaties. As evidenced by recent debates, ISDS concerns set out by UNCTAD in 2013 largely persist today. The seven ISDS challenges set out in UNCTAD's 2013 World Investment Report (*WIR13*) include: legitimacy, transparency, nationality planning, consistency of arbitral decisions, erroneous decisions, arbitrators' independence and impartiality, and financial stakes. UNCTAD's options for reforming investment dispute settlement were launched in response to these concerns (*WIR15,* table 1).

During the past few years, ISDS reform has been making its way into mainstream investment policymaking and UNCTAD options have shaped such reform. At the same time, reform depth varies: some countries seek more comprehensive reforms covering a wider array of issues, while others seek rather marginal reforms. Most of the reform activity continues to take place at the treaty level, including bilateral, regional, plurilateral agreements. Moreover, different stakeholders have different understandings of what the term "reform" entails in the context of investment dispute settlement, which also becomes evident in multilateral processes (e.g. at UNCITRAL).

Taking stock of where reform stands today, this IIA Issues Note traces ISDS-related reform developments in recently concluded IIAs (section 1); reform actions by country grouping and geographical region (section 2); recent plurilateral and megaregional treaties (section 3); multilateral processes (section 4); and relevant processes occurring outside the traditional realm of investment policymaking (section 5).

1. Reform options emerging from recent treaty practice

In the IIAs signed in recent years, countries have implemented a large number of ISDS reform elements as part of broader IIA reform. Most of these elements follow the options identified by UNCTAD in the Investment Policy Framework for Sustainable Development (2015) and in the Road Map for IIA Reform (2015) (table 1), subsequently included in the Reform Package for the International Investment Regime (2018).

Alongside ISDS-specific reform elements, many of the IIAs reviewed also include important modifications to other treaty components that have implications for ISDS reform. Among others, these are the treaty scope (refined definitions of investment and investor, exclusions of sectors or policy areas from the treaty scope), key substantive rules (e.g. refined provisions on fair and equitable treatment and indirect expropriation) and exceptions (e.g. general public policy exceptions, security exceptions). While these elements have a pronounced effect on the breadth and "bite" of a treaty's ISDS mechanism, they are not the focus of this IIA Issues Note.

Table 1. Sets of options for reforming investment dispute settlement

Reforming existing investor-State arbitration		Replacing existing investor-State arbitration
Fixing existing ISDS mechanisms	Adding new elements to existing ISDS mechanisms	
1. **Improving the arbitral process**, e.g. by making it more transparent and streamlined, discouraging submission of unfounded claims, addressing ongoing concerns about arbitrator appointments and potential conflicts	1. **Building in effective alternative dispute resolution** (ADR)	1. **Creating a standing international investment court**
2. **Limiting investors' access**, e.g. by reducing the subject-matter scope, circumscribing the range of arbitrable claims, setting time limits, and preventing abuse by "mailbox" companies	2. **Introducing an appeals facility** (whether bilateral, regional or multilateral)	2. **Replacing ISDS by State-State dispute settlement**
3. **Using filters for channelling sensitive cases** to State-State dispute settlement		3. **Replacing ISDS by domestic dispute resolution**
4. **Introducing local litigation requirements** as a precondition for ISDS		

Source: UNCTAD, *WIR15* and Reform Package for the International Investment Regime (2018).

a. IIAs signed in 2018

This section examines the take-up of ISDS reform in IIAs concluded in 2018.[1] Annex table 1 contains a detailed mapping of the 2018 IIAs.

- **Overall prevalence of reform elements:** Nearly all IIAs concluded in 2018 contain at least one, and most contain several, mapped ISDS reform elements. Five treaties contain 15 or more (table 2). Looking at reform elements that relate to procedural issues, some procedural reform elements are used particularly often, while others appear in a very small number of IIAs (box 1).

Table 2. Prevalence of mapped ISDS reform elements in IIAs concluded in 2018

2–4 reform elements	5–8 reform elements	9–12 reform elements	13–24 reform elements
• Japan–United Arab Emirates BIT (4) • Kazakhstan–Singapore BIT (2)	• Armenia–Japan BIT (5) • Singapore–Sri Lanka FTA (7)	• Argentina–Japan BIT (11) • Argentina–United Arab Emirates BIT (11)	• Belarus–India BIT (13) • Australia–Peru FTA (15) • Central America–Republic of Korea FTA (15) • CPTPP (15) • EU–Singapore IPA (15) • USMCA (16)

Source: UNCTAD, based on annex table 1.

Note: This table does not include treaty examples that omit ISDS (Brazil–Ethiopia BIT, Brazil–Guyana BIT, Brazil–Suriname BIT) or contain an unreformed ISDS mechanism (Kazakhstan–United Arab Emirates BIT, Mali–Turkey BIT, Mali–United Arab Emirates BIT), which are shown in table 3.

Five principal approaches

Overall, five principal approaches emerge from IIAs signed in 2018 (table 3):

I. **No ISDS**: The treaty does not entitle investors to refer their disputes with the host State to international arbitration (either ISDS is not covered at all, or it is subject to the State's right to give or withhold arbitration consent for each specific dispute, in the form of a so-called "case-by-case consent").

II. **Standing ISDS tribunal:** The system of ad hoc investor-State arbitration and party appointments is replaced with a standing court-like tribunal (including appellate level), with members appointed by contracting parties for a fixed term.

III. **Limited ISDS:** This may involve a requirement to exhaust local judicial remedies (or to litigate in local courts for a prolonged time-period) before turning to arbitration, the narrowing of the ISDS subject-matter scope (e.g. limiting treaty provisions subject to ISDS, excluding policy areas from the ISDS scope) and/or the setting of a time limit for submitting ISDS claims.

IV. **Improved ISDS procedure:** The treaty preserves the existing system of investor-State arbitration but with certain important modifications (box 1). Such modifications may aim, amongst others, at increasing States' control over the proceedings, opening them up to the public and third parties, enhancing suitability and impartiality of arbitrators, increasing efficiency of proceedings, and limiting remedial powers of ISDS tribunals.

V. **Unreformed ISDS mechanism:** The treaty preserves the basic ISDS design typically used in the old-generation IIAs, characterized by broad scope and lack of procedural refinements.

A number of observations can be made with respect to these five principal approaches to ISDS-related reform.

- **Depth of individual reform approaches:** Some of the approaches are more far-reaching than others. "No ISDS" and "Unreformed ISDS mechanism" are at the outer ends of the spectrum, each coming with its own set of significant implications. The extent of reform engagement within each approach can also vary (significantly) from treaty to treaty. "Limited ISDS" may range from a treaty that requires exhaustion of local remedies to a treaty that sets a three-year time limit for submitting claims. "Improved ISDS procedure" is the approach with the largest number of mapped reform elements, covering different aspects of reform (box 1).

[1] Eighteen IIAs concluded in 2018 with texts available were reviewed for this section.

- **Combination of reform approaches:** Three of the five principal approaches are not mutually exclusive and can be combined. For example, procedural improvements (approach IV) can be used as a standalone approach or in combination with approaches II or III. "I. No ISDS" and "V. Unreformed ISDS mechanism" are self-standing approaches.
- **Frequency of reform approaches:** It varies how often each approach is used (table 3). For 2018, the most frequently used approaches have been "Limited ISDS" and "Improved ISDS procedure", often used in combination.

Table 3. Principal approaches to ISDS reform: distribution of IIAs concluded in 2018

No ISDS	Standing ISDS tribunal[a]	Limited ISDS[b]	Improved ISDS procedure[c]	Unreformed ISDS mechanism[d]
• Brazil–Ethiopia BIT • Brazil–Guyana BIT • Brazil–Suriname BIT • CPTPP (five bilateral opt-outs) • USMCA (Canada–Mexico, Canada–United States)	• EU–Singapore IPA	• Argentina–Japan BIT • Argentina–United Arab Emirates BIT • Armenia–Japan BIT • Australia–Peru FTA • Belarus–India BIT • Central America–Republic of Korea FTA • CPTPP (except for five bilateral opt-outs) • EU–Singapore IPA • Japan–United Arab Emirates BIT • Kazakhstan–Singapore BIT • Singapore–Sri Lanka FTA • USMCA (Mexico–United States)	• Argentina–Japan BIT • Argentina–United Arab Emirates BIT • Armenia–Japan BIT • Australia–Peru FTA • Belarus–India BIT • Central America–Republic of Korea FTA • CPTPP (except for five bilateral opt-outs) • EU–Singapore IPA • Japan–United Arab Emirates BIT • Singapore–Sri Lanka FTA • USMCA (Mexico–United States)	• Kazakhstan–United Arab Emirates BIT • Mali–Turkey BIT • Mali–United Arab Emirates BIT

Source: UNCTAD, based on annex table 1.

Note: [a] Excluding treaties envisaging a possible future appellate mechanism (bilateral or multilateral) to review ISDS awards. [b] The extent of reform engagement within this approach can (significantly) vary from treaty to treaty. [c] Treaties that include at least two mapped procedural innovations (box 1) are included in the "Improved ISDS procedure" category. [d] Treaties that include no more than one mapped procedural innovation (box 1) and none of the characteristics present in other categories are placed in the "Unreformed ISDS mechanism" category.

Box 1. Improved ISDS procedure: reform elements

Mapped reform elements grouped under the "Improved ISDS procedure" approach:

Enhancing States' role in ISDS

1. Enabling State Parties to issue joint treaty interpretations binding on tribunals
2. Requiring certain questions to be submitted to State Parties for joint determination
3. Enabling non-disputing State Parties to participate in the proceedings
4. Enabling disputing parties to review and comment on the draft arbitral award
5. Enabling the respondent State to submit counterclaims

Enhancing the suitability and impartiality of arbitrators/adjudicators

6. Including rules on qualifications of arbitrators/adjudicators, a code of conduct and/or rules on conflicts of interest
7. Prohibiting "double-hatting" of arbitrators/adjudicators (simultaneously acting as counsels or experts in other ISDS proceedings)

Enhancing the efficiency of dispute settlement

8. Enabling early dismissal of manifestly unmeritorious (frivolous) claims
9. Enabling consolidation of related claims
10. Establishing a time limit on the maximum duration of ISDS proceedings
11. Allowing for voluntary non-binding ADR procedures to resolve investor-State disputes

Box 1. Improved ISDS procedure: reform elements

Opening up ISDS proceedings to the public and third parties

12. Including rules on transparency of ISDS proceedings (requiring publication of ISDS documents and/or holding public hearings)
13. Enabling participation in proceedings of interested third parties (amici curiae)

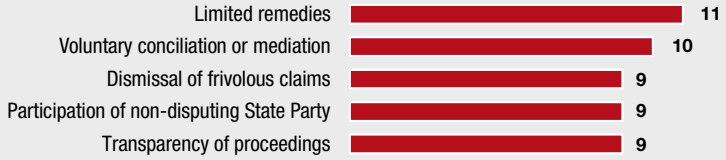
Limiting remedial powers of tribunals

14. Limiting legal remedies that tribunals may grant to investors
15. Limiting the types of damages that may be awarded as compensation for a treaty breach

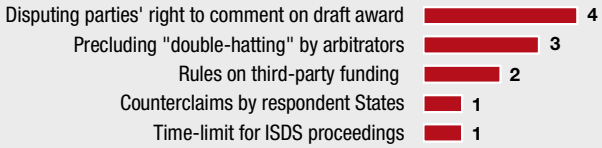
Other improvements

16. Including rules on third-party funding (prohibiting it, or requiring disclosure)

Box figure 1. Most frequent procedural reform elements in 2018 IIA (Number of IIAs)



Box figure 2. Least frequent procedural reform elements in 2018 IIAs (Number of IIAs)



Source: UNCTAD, based on annex table 1.

Country and treaty practice

- **Adoption of reform approaches across country groupings:** ISDS reform (approaches I to IV) is pursued by countries at different levels of development and across geographical regions.
- **Driving forces:** At the same time, individual countries and regions have been the driving forces behind certain approaches, based on their new models and negotiating approaches. For example, Brazil's CIFA model has been operationalized, with some variations, in treaties that exclude ISDS and focus instead on dispute prevention and State-State dispute settlement. The EU's approach is reflected in treaties that dispose of the ad hoc arbitration procedure and party-appointed arbitrators in favour of standing tribunals (including appellate level) staffed with fixed-term adjudicators. India's new model BIT, reflected in one signed treaty so far, has started to shape the country's new treaty practice. The Belarus–India BIT requires exhaustion of