



A SHAKE-UP OF THE SYSTEM OF INVESTMENT TREATY ARBITRATION: WHAT DOES THE FUTURE HOLD?

21 February 2018 | Global

Legal Briefings - By **Christian Leathley, Andrew Cannon and Iain Maxwell**

Over the past few years, investment arbitration (also known as "Investor State Dispute Settlement", or "ISDS"), has captured the public's attention like never before.

[First published in Inside Arbitration, Issue 5](#)

The ongoing debate came to greater prominence during the negotiation of the proposed Transatlantic Trade and Investment Partnership (TTIP) between the EU and US, through a public consultation launched by the EU Commission in 2014. Although the consultation focused on the EU's proposed new approach to investment protection and investor-state dispute resolution in the TTIP, it shed a light on investment arbitration more generally, encouraging public engagement with the topic and a far greater scrutiny of its key components than had previously been seen. Moreover, it provided an opportunity for critics of the system to organise and air their concerns publicly and in a forum where they would resonate. The impact of the consultation was considerable and led to global discourse as to the future of ISDS. There is a widely reported view that some degree of reform is needed to rehabilitate, or reframe, the investment arbitration system and to restore faith in its legitimacy. In this brief article we highlight the key ongoing developments in the shake-up of the system of investment treaty arbitration and pose the question as to what the future holds.

THE EU'S RESPONSE: A MULTILATERAL INVESTMENT COURT

Since the EU first launched its consultation on the TTIP in 2014, the EU's plans for the resolution of investor-state disputes in its own future investment agreements with third countries have developed. The EU now appears determined to pursue wholesale change to the previous system of "ad hoc" arbitration, where tribunals are appointed in a manner similar to that used in commercial arbitration. Instead, the EU is seeking to build consensus with other states to develop a permanent Multilateral Investment Court (**MIC**), aiming to create what it describes as a "**coherent, unified and effective**" approach to investment dispute resolution for all investment treaties.

What is this Multilateral Investment Court and what is it intended to achieve?

Many of the criticisms raised against the existing system of investment arbitration focus on the "ad hoc" nature of the tribunals chosen to decide disputes, and the perceived potential for arbitrators to have conflicts of interest. Concerns have also been raised about the absence of a system of binding precedent, inconsistencies in decision-making, the cost and time involved in investment arbitration, lack of transparency and the very narrow grounds on which arbitral awards can be challenged.

The MIC proposed by the EU would be a permanent international court empowered to hear disputes about investments between investors and states that have accepted its jurisdiction to decide whether there has been a breach of the obligations guaranteed in investment treaties. By seeking procedural consistency through introducing both a standing court, with an appointed body of decision-makers overseeing the investor-state dispute process, as well as an appeal mechanism, the Commission aims to establish a system which is predictable in delivering consistent case-law. The EU's intention is that states would agree to replace the method of dispute settlement in their existing investment treaties with the MIC in future.

Is it going to happen?

As a first step to the envisaged establishment of the MIC, the EU has been seeking the establishment of an individual standing investment court under each of its recent investment agreements with third countries, to replace the previous "ad hoc" arbitration model. This court would only be appointed to adjudicate, however, on disputes arising under that specific agreement. Two agreements have been concluded to date containing such provisions: with Vietnam and Canada, although none has yet entered into force. While the Canada agreement (known as the Comprehensive Economic and Trade Agreement, or **CETA**) has been provisionally applied, that provisional application has excluded the investment chapter and investment dispute resolution provisions. In a July 2017 factsheet concerning the negotiation of the EU-Japan FTA, the Commission noted that "[f]or the EU ISDS is dead", and that such an investment court system is now being pursued in all of its trade agreements.

In the longer term, the obvious problem of a proliferation of individual, treaty-specific investment courts is sought to be overcome by the establishment of the MIC referred to above, which would have jurisdiction over disputes arising under any number of investment treaties. This intention is clear, for example, from the commitment which the EU and Canada made in the CETA to "pursue with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes". Moreover, the EU has asked the UN Commission on International Trade Law (**UNCITRAL**) to consider its suggestion of an MIC in UNCITRAL's work on wider ISDS reform (see further below).

It remains to be seen for how long the EU continues to introduce the individual investment courts under each agreement whilst pursuing the ambition of the overarching MIC, or whether it will seek to set up a plurilateral court under one EU agreement, but then use this same court for the resolution of disputes under other agreements. The main obstacle of course will be securing the agreement of the third states involved, even if all of the EU's own member states are fully supportive.

There is also a legal question mark which remains over the EU's plans. On 6 September 2017, Belgium submitted a request to the Court of Justice of the European Union for an opinion on the compatibility of the investment court system set up under the CETA with the European Treaties. Depending on the court's opinion, even the two investment courts already negotiated and agreed may be called into question.

WHAT IS AN INVESTMENT TREATY OR INTERNATIONAL INVESTMENT AGREEMENT (IIA)?

An investment treaty is an agreement reached between two or more countries containing reciprocal undertakings for the promotion and protection of private investments made by nationals of the state parties in each other's jurisdictions. These undertakings can form part of a standalone treaty or part of a wider agreement, for example, a free trade agreement or an agreement focused on sectoral co-operation (such as the Energy Charter Treaty).

WHAT IS INVESTMENT TREATY ARBITRATION?

Investment treaties are unique in international law. If a host state fails to deliver on its undertakings to protect or promote investment, an investor of the other state party may bring an arbitration against the host state for breach of its obligations. These arbitrations will take place as set out in the treaty, often under the rules of the International Centre for the Settlement of Investment Disputes (ICSID) or through "ad hoc" arbitration under the UNCITRAL Rules.

UNCITRAL: REFORM OF ISDS?

In July 2017, UNCITRAL gave one of its working groups, Working Group III, a broad mandate to work on the possible reform of ISDS. The working group was asked to identify concerns regarding ISDS, consider whether reform was desirable and, if so, to develop recommendations.

The first session of Working Group III was held in late November 2017 and was attended by more than 300 participants representing 80 States and 35 observers, including the EU and various interested parties. Working Group III discussed certain procedural aspects of ISDS, including duration and cost of proceedings, allocation of costs, security for costs, third party funding, transparency, and early dismissal mechanisms. Working Group III also exchanged views on the overall consistency and coherence of the ISDS system and its outcomes. The working group is scheduled to continue its discussion at its next session in New York from 23 to 27 April 2018.

If UNCITRAL Working Group III recommends solutions, what impact will these have?

It is likely to be at least 2019 before the working group makes any recommendations. It is important to be aware that UNCITRAL itself is not a signatory to any investment agreements. However, steps taken by UNCITRAL can have significant practical consequences. In late 2014 UNCITRAL was responsible for developing a Convention on Transparency in Treaty-based Investor-State arbitration (known as the Mauritius Convention). This Convention supplements existing investment treaties by applying detailed transparency-related obligations in the context of resolution of investor-state disputes under existing BITs where both parties to the BIT are also parties to the Mauritius Convention.

Whilst it has only been ratified by three states to date, the Convention has received 22 signatures, and has attracted significant international attention. If it continues to grow and more states accede, some are suggesting that the Convention could serve as a template for a further treaty introducing a multilateral investment court system for resolution of investor-state disputes under existing investment treaties.

CHANGES AT ICSID: A REVISION TO THE ICSID ARBITRATION RULES?

The International Centre for the Settlement of Investment Disputes (**ICSID**) was established in 1966 by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. It is an independent dispute-settlement institution which can be chosen by member States as a forum for resolution of investor-State disputes in their investment treaties, investment laws and investment contracts, with disputes resolved under the Convention and the ICSID Arbitration Rules. Investor-State disputes involving a non-member State can be resolved using ICSID's additional facility rules.

"Whilst it has only been ratified by three states to date, the Convention has received 22 signatures, and has attracted significant international attention"

In October 2016, ICSID launched a consultation on the amendment of the ICSID Arbitration Rules and invited Member States to make proposals. A similar invitation was issued to the general public in January 2017. The ICSID Secretariat has collected these comments and is preparing background papers on 16 topics that have been identified for potential rule amendment. The papers are expected to be published in early 2018.

Are these amendments being considered in response to criticisms of ISDS?

ICSID has carried out four amendments to its rules in the past, some of which have been more detailed than others. ICSID has not indicated that the current amendment process is a response to particular criticisms, stressing more generally that the changes are intended to modernize the rules based on case experience. However, given that over 60% of all known investor-State disputes have been filed at ICSID, such "case experience" will no doubt encompass many of the issues that have been raised elsewhere.

What are the expected areas of change?

The Secretariat has **highlighted 16 areas** where amendments could be considered. These include: appointment of arbitrators, including the possible introduction of a code of conduct; challenges to arbitrators; third party funding; consolidation; preliminary objections and first session; witnesses; experts and other evidence; discontinuance of a case; awards and dissenting opinions; security for costs and security for stay of enforcement of awards ordered by the ad hoc committee; allocation of costs; annulment; publication of decisions and orders (compared to the current provisions referring to awards); as well as the modernization of the means of communication (apparently with a view to making the procedure 'less paper-intensive and more environmentally friendly').

However, it is important to remember that consideration of an amendment may not necessarily result in a specific rule change.

Why the ICSID Rules and not the Convention itself?

Amendments to the ICSID Rules require approval of two-thirds of the member States (ICSID Convention Article 6). Amendment of the ICSID Convention requires unanimous ratification of the member States. It is therefore easier to bring about changes in the system through the Rules rather than the Convention. However, ICSID has noted that it will highlight areas where change would have to be effected through a Convention amendment and see if consensus exists for such a change.

What is the relevance of ICSID Arbitration in an investment court system?

The EU Commission, presently at least, sees a continuing role for arbitration under (i) the ICSID Convention and ICSID Arbitration Rules, and (ii) the ICSID Additional Facility Rules, albeit within an investment court system. A claim under the investment chapters of the CETA and the EU-Vietnam FTA may be submitted to ICSID arbitration or, where not applicable, arbitration under ICSID's additional facility. However, the compatibility of the ICSID system and the new investment courts (whether they operate at a bilateral or multilateral level) is yet to be fully explored.

ALTERNATIVE NATIONAL AND REGIONAL APPROACHES: THE US AND AFRICA

While there are steps being taken at international and EU level to bring about reform to investment arbitration, it is important to remember that other states and blocs are also forging their own paths for reform. Some countries, such as South Africa, India, Indonesia, Venezuela, Bolivia and Ecuador, have sought to terminate or not renew their BITs. Others are seeking to renegotiate or reframe their BITs and regional agreements. This may occur whilst those existing agreements remain in force or following termination. Indeed, there are some indications that Ecuador may be considering entering into some new bilateral arrangements following its programme of terminations.

In the US the debate about ISDS continues. In October 2017, a group of US academics in the fields of law, economics and public policy wrote a letter to President Trump urging the abandonment of ISDS in the renegotiated North American Free Trade Agreement (NAFTA). This letter repeated many of the criticisms raised by stakeholders in the EU's earlier consultation on inclusion of ISDS in the TTIP. However, there remains considerable support for ISDS among other US stakeholders. The NAFTA negotiating objectives released by the US Government in November 2017 are ambiguous on the issue, recording US support for "meaningful procedures for resolving investment disputes," which will "ensur[e] the protection of US sovereignty and the maintenance of strong US domestic industries."

Meanwhile, the South African Development Community has recently introduced amendments to Annex 1 (Cooperation on Investment) of the SADC Finance and Investment Protocol. The preamble to the amendment agreement notes that some of the existing provisions "fail to adequately balance investor protection and development policy space for host States". Not only do the amendments limit the scope of protection to investors from SADC states and remove the guarantee of fair and equitable treatment, the international arbitration provisions were replaced with an obligation to resolve disputes through the domestic courts of the host state. This is undoubtedly a significant statement by a bloc of 15 African states. However, it should not be understood as being indicative of a general rejection of ISDS on the continent. African states have signed 25 bilateral investment treaties with countries from Europe, Eurasia, the Middle East, Asia, North America and South America since the beginning of 2015. Many of these recent agreements include dispute resolution provisions which continue to provide for "ad hoc" arbitration, albeit with clauses which are more sophisticated than the standard short form articles found in the bulk of the BITs negotiated in the global surge in the mid-1990s.

WHAT DOES THE FUTURE HOLD?

The future quite clearly holds reform. It is the extent and speed of that reform that is, as yet, unknown. We can expect that some substantial changes will be proposed to the ICSID Rules and that the necessary two-thirds majority will vote in favour of at least some of those changes. The eventual outcome of the EU's efforts to establish an MIC is more uncertain. Whilst the deliberation of reform at multilateral level has been passed to UNCITRAL, it is one of a number of considerations being reviewed by the working group, concerning both the substantive protections afforded to investors and the mechanism by which disputes are resolved. It is possible that the idea of a standing multilateral investment court may become subsumed in other more or less wide-ranging suggestions for reform. Even were the Working Group to propose a significant shift in approach, it would then require at least some international consensus for those recommendations to translate into action. Similar uncertainty rests over NAFTA, with ISDS forming only one aspect of any potential renegotiation.

A limited number of countries have already decided to move away from investment arbitration, requiring investor-state disputes to be resolved before domestic courts. Nevertheless, the movement towards reform, however fragmented and piecemeal, is likely to uphold the retention of a form of non-national, treaty-based investor-state dispute resolution. Whether a common global system is adopted, or a number of different reformed dispute resolution systems develop, remains to be seen.

WHAT DOES THIS MEAN FOR INVESTORS?

For investors who have structured their investments to benefit from the protections of specific existing investment treaties, it is important to be aware that the focus is largely on the dispute resolution procedures in these treaties, rather than the substantive protections available under them. While we are witnessing a shift in the way certain protections are worded in the newer generation of model BITs, many of which also expressly protect a state's right to regulate, these changes do not impact on existing treaties under which investments have already been made.

A practical impact will likely be felt most quickly in relation to the changes to the ICSID Arbitration Rules. If changes to the Arbitration Rules are proposed and accepted, they could come into force within a year or two, affecting any arbitrations for which the parties have given consent after that date.

As for the EU's proposals, the EU is currently only introducing its investment court proposal into the investment chapters of its new free trade agreements with States with whom the EU previously had no agreement. However, these new EU agreements are designed to replace existing bilateral arrangements between EU Member States and these third party states. For example, if the investment protection and investment court provisions of the CETA enter into force, these will replace the bilateral investment treaties between Canada and individual EU member states, including any dispute resolution provisions that they may contain. In such circumstances, the introduction of the investment court will be a significant change in the way an existing EU investor in Canada, or vice versa, can enforce its rights against a state. Indeed, the nature of the substantive investment protections will also change in most cases, with the CETA including more modern and sophisticated drafting than will have existed under many of the BITs. Conversely, where no bilateral arrangements already exist, treaties entered into by the EU under which an investment court is established will introduce new substantive investment protections and offer a new and additional method of dispute resolution for European investors into jurisdictions where no prior international law system existed. In either case, the practical ramifications of the new court remain as yet unclear, since none has yet been established.

The debate will continue to evolve over the coming months and years. In particular, it is the wider, wholesale changes to the system being considered by UNCITRAL that are worth investors keeping a watchful eye on over the next few years. An international consensus on broad changes to ISDS implemented by an international convention could result in changes to the dispute resolution system for many existing investment treaties. Ultimately, however, it is likely that investors will still be able to protect their investments under international law and before an independent and impartial international body.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.



CHRISTIAN LEATHLEY
PARTNER, NEW YORK

+1 917 542 7812
Christian.Leathley@hsf.com



ANDREW CANNON
PARTNER, CO-HEAD,
PUBLIC
INTERNATIONAL LAW
PRACTICE, DEPUTY
HEAD, GLOBAL
ARBITRATION
PRACTICE , LONDON

+44 20 7466 2852
Andrew.Cannon@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.

© Herbert Smith Freehills 2022

SUBSCRIBE TO STAY UP-TO-DATE WITH INSIGHTS, LEGAL UPDATES, EVENTS, AND MORE

Close