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UNCITRAL Working Group III: Can Reforming Procedures Rebalance Investor Rights and Obligations?

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I. Introduction

There are lively debates about reforming the international investment regime, and a working group of the United Nations Commission on International Trade Law (UNCITRAL) is considering reform of investor-state dispute settlement (ISDS).[1] UNCITRAL Working Group III on ISDS Reform has a three-pronged mandate: to identify and consider concerns regarding ISDS; to consider whether reform is desirable to address these concerns; and if reform is deemed desirable, to develop proposed solutions.[2]

The asymmetrical nature of the investment regime, and of ISDS, has been a recurring concern in public debates: usually investors alone can initiate arbitrations based on investment treaties that are primarily aimed at protecting their assets.[3] Some recent bilateral and regional investment treaties affirm certain responsibilities or even obligations for investors to uphold standards of responsible business conduct (RBC), for example in the areas of human rights, labour, the environment, corruption and corporate governance; however, the implications of these provisions in a dispute settlement context are not always clear.[4] The UNCITRAL Working Group provides a unique opportunity for multilateral reform, but only if the full gamut of relevant issues are identified.

The Working Group has interpreted its mandate as being limited to the procedural aspects of ISDS,[5] and is presently in the process of identifying concerns meriting reform. To date, the Working Group has identified three categories of concerns for which it deemed reform to be desirable: (1) consistency, coherence, predictability and "correctness" of arbitral decisions; (2) independence, impartiality, diversity and other concerns about arbitrators; and (3) cost and duration of investor-state arbitration.[6] These concerns are important, but they do not represent a comprehensive reform agenda that can align the investment regime with pursuit of the United Nations (UN) Sustainable Development Goals (SDGs), or address systemic imbalances in the investment regime.[7]

While the discourse around RBC requirements has primarily focused on substantive rights and obligations, the integration of these requirements in the international investment regime presents procedural dimensions that fall within the purview of the UNCITRAL Working Group. Merely affirming responsibilities or obligations is unlikely to have meaningful effect without complementary procedural mechanisms for sanctioning non-compliance in an ISDS context. The UNCITRAL process creates the need and the opportunity to explore how procedural innovations could help give effect to RBC requirements imposed by domestic or international law, and help rebalance the asymmetrical nature of ISDS.

This policy brief takes stock of recent developments and explores possible options for ISDS reform. The remainder of the brief is organised as follows: Section II examines the case for reform and reviews recent trends in investment treaty practice. Section III investigates the procedural dimensions of RBC requirements, identifying potential innovations that could provide those requirements with greater weight. Section IV explores possible next steps in connection with the UNCITRAL Working Group.

II. The case for reform and recent trends in treaty practice

Most investment treaties focus on protecting foreign inves-

Abstract

The work of the United Nations Commission on International Trade Law (UNCITRAL) provides an opportunity to rebalance the international investment regime – but only if the full gamut of key issues are identified. Requiring investors to uphold standards of responsible business conduct (RBC) is largely a function of substantive rights and obligations, but it also presents procedural dimensions that fall within the purview of the UNCITRAL process. This policy brief explores the issues and discusses possible options for reform.

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tors and their investments but say little or nothing about the responsibilities of investors. Most also enable foreign investors to bring disputes to investor-state arbitration. The rationale for offering such investment safeguards is that they are expected to "promote economic relations, encourage investment flows, and increase the prosperity of contracting parties".[8] Nevertheless, today – sixty years after the first investment treaty was signed – there is no conclusive evidence that the treaties lead to an increase in foreign investment, or contribute to the economic development of host states.[9] In fact, it is not uncommon for foreign investments to have negative socio-economic and environmental impacts.[10]

Domestic law may be used to promote social, economic and environmental policy goals and address harmful business practices. But while issues of compliance with domestic law have proved decisive in some investor-state arbitrations where tribunals dismissed claims as inadmissible or on jurisdictional grounds,[11] uncertainty remains about how arbitral tribunals should coordinate the application of domestic and international laws alongside each other. Further, the adoption or reform of domestic law measures in wide-ranging policy areas has exposed states to arbitration claims.[12] Issues of coordination also apply to different international norms: arbitrators (including members of the same arbitral tribunal) have reached different conclusions as to whether international instruments other than investment treaties (human rights treaties, for example) can create obligations on investors, and what implications, if any, this should have in ISDS.[13]

In this context, entrenching RBC requirements within the investment regime has emerged as a way to rebalance the rights and obligations of investors and states, and more clearly direct arbitral tribunals on how those requirements should be taken into account when settling investor-state disputes.[14] In more general policy terms, if the treaties aim to promote investment flows in order to advance sustainable development, there is a case for binding the treaties' protections to compliance with parameters of investment quality to ensure the investments do, in fact, advance social, economic and environmental policy goals.

Several recent investment treaties feature RBC provisions oriented towards states and/or investors. For example, "non-lowering of standards" clauses discourage states from deviating from national labour or environmental laws in order to attract investment, and other provisions reaffirm the obligations of states under international treaties. In terms of investor responsibilities, approaches vary.[15] Some treaties require investors to comply with domestic laws.[16] In some countries, however, weak legal frameworks mean that compliance with national law may not be enough to ensure responsible business conduct.

Moreover, some recent investment treaties encourage investors to apply international voluntary standards of corporate social responsibility. While these standards can go beyond national law requirements and while such "best efforts" clauses can convey the states' expectations to the investors, the limitation is that the clauses are not typically formulated in mandatory language nor backed by effective enforcement mechanisms. However, a few recent treaties use mandatory language when requiring investors to respect human rights, act in accordance with international instruments on labour rights, and comply with certain environmental impact assessment requirements.[17] Box 1 provides a few illustrative examples of these diverse approaches.

III. Giving effect to RBC requirements via procedural reforms

Ensuring that any RBC provisions are effective would require clarifying the consequences of non-compliance in the context of dispute settlement. In other words, ISDS procedure is largely determinative of the enforceability of RBC requirements. In this regard, there are several questions for the UNCITRAL Working Group to consider:

- **Should investor non-compliance be a jurisdictional (or admissibility) issue in investor-state arbitration, so investments that breach RBC standards are, in effect, excluded from legal protection?** Some investment treaties already limit their protections to investments made in accordance with national law, and as discussed some arbi-

Box 1. Examples of RBC clauses in recent investment treaties

- *Brazil – Guyana Bilateral Investment Treaty (BIT), Article 14(1)(b)* (2018) : Investors and their investment shall not, either prior to or after the establishment of an investment, offer, promise, or give any undue pecuniary advantage, gratification or gift whatsoever, whether directly or indirectly, to a public servant or official of a Party as an inducement or reward for doing or forbearing to do any official act or obtain or maintain other improper advantage.
- *Morocco – Nigeria BIT, Article 14* (2016): Investors or the investment shall comply with environmental assessment screening and assessment processes applicable to their proposed investments prior to their establishment, as required by the laws of the host state for such an investment or the laws of the home state for such an investment, whichever is more rigorous in relation to the investment in question.
- *Netherlands Model BIT, Article 7(1)* (2018): Investors and their investments shall comply with domestic laws and regulations of the host state, including laws and regulations on human rights, environmental protection and labor laws.
- *Argentina – Qatar BIT, Article 12* (2016): Investors operating in the territory of the host Contracting Party should make efforts to voluntarily incorporate internationally recognized standards of corporate social responsibility into their business policies and practices.

tral tribunals confronted with alleged violations of national law have dismissed claims as inadmissible or found they lacked jurisdiction to adjudicate the dispute.[18] But uncertainty remains, particularly if non-compliance occurs *after* an investment has been made, for example in the operation, management or disposition of the investment. A new international instrument on ISDS could condition access to ISDS on investors' compliance with national law and other relevant RBC requirements both in the making and the operation and disposal of an investment.

• **Should tribunals consider RBC requirements when deciding the merits of the dispute, and/or when assessing any damages the state may owe to the investor?** Some arbitral tribunals have reduced the amount of damages they awarded after they considered the investor's own conduct,[19] and this approach has found its way in some recent investment treaty practice.[20] While the merits are likely to hinge on substantive rights and obligations, damages issues present procedural dimensions, because they relate to the remedies that ISDS tribunals can provide. Many investment treaties govern compensation standards for lawful expropriations but are silent on how to calculate damages for unlawful treaty breaches. Procedural reforms could clarify methods for calculating damages, and they could elaborate on how tribunals should consider non-compliance with RBC requirements in awarding damages. However, there are questions as to whether it would be appropriate for fundamental issues such as human rights violations to only translate into a reduction of the damages owed to an investor. In any case, clarifying how RBC non-compliance affects the calculation of damages in an ISDS context should not prejudice other liabilities the investor may face under other domestic or international instruments.

• **Should states be able to bring counterclaims against investors over alleged violations of responsible investment standards?** Such counterclaims could enable a government to address social or environmental issues through investor-state arbitration, and in recent years several respondent states filed counterclaims alleging RBC violations. However, counterclaims have rarely succeeded, and procedural reforms could clarify the conditions and the arrangements for states to bring counterclaims. This may involve, for example, clarifying the nature of the "connectedness" the counterclaim must have with the investor's claim if it is to be admissible – an issue that proved a sticking point in several arbitrations.[21] There are also questions about the safeguards that would be needed to ensure that any payments are used to provide redress to those most directly affected.[22]

• **What scope should there be for third parties to invoke RBC provisions?** Many contemporary investor-state disputes are rooted, at least in part, in conflicts that involve third parties — which could be the people affected by the investment. Further, third parties such as workers or indigenous peoples may be most directly impacted by investor non-compliance with RBC provisions, and they could play an important role in holding investors to account for RBC violations. Yet existing ISDS rules do not provide effective means for actors whose rights or interests are at stake to meaningfully participate in investor-state arbitration.[23] Addressing this issue raises questions about the substantive rights and obligations established in the treaties, but it also requires rethinking procedural aspects – for example, by creating a right for third parties to intervene in the proceedings.[24]

• **Should non-compliance with RBC requirements have a bearing on the tribunal's decision on costs?** This may involve, for example, shifting the respondent's costs to the claimant, in part or in full.

IV. Next steps

With regards to the three categories of concerns the UNCITRAL Working Group III has already identified, discussions are now ripe to move to the next stage, which involves exploring concrete options for reform. However, the Working Group has yet to properly discuss other recurring concerns about ISDS. Rebalancing investor rights and obligations has been at the centre of public concerns about the asymmetric nature of ISDS and the international investment regime. This issue presents substantive dimensions, but also procedural aspects that fall within the Working Group's remit. If the Working Group is to enable meaningful reform, it should give serious consideration to this issue.

Endnotes:

[1] See https://uncitral.un.org/en/working_groups/3/investor-state.

[2] Report of the United Nations Commission on International Trade Law, Fiftieth Session (3-21 July 2017), A/72/17, para. 264. Available from http://www.uncitral.org/pdf/english/commissionsessions/unc-50/A-72-17-E.pdf.

[3] Alessandra Arcuri, "The Great Asymmetry and the Rule of Law in International Investment Arbitration", in *Yearbook on International Investment Law and Policy 2018*, Lisa Sachs, Lise Johnson and Jesse Coleman, eds. (Oxford University Press, 2019); Anil Yilmaz Vastardis, "Justice Bubbles for the Privileged: A Critique of the Investor-State Dispute Settlement Proposals for the EU's Investment Agreements", *London Review of International Law* 6(2) (2018): 279–297.

[4] Lorenzo Cotula, "Raising the Bar on Responsible Investment: What Role for Investment Treaties?" (IIED, March 2018). Available from http://pubs.iied.org/pdfs/17454IIED.pdf.

[5] UNCITRAL, Report of Working Group III (ISDS Reform) on the Work of its Thirty-Fourth Session – Part I, 19 Dec. 2017, A/CN.9/930/Rev.1, p. 5. Available from https://documents-dds-ny.un.org/doc/UNDOC/GEN/V18/029/83/PDF/V1802983.pdf?OpenElement.

[6] UNCITRAL, Draft report of Working Group III (Investor-State Dispute Settlement Reform) on the Work of its Thirty-Sixth Session, 6 Nov. 2018, A/CN.9/964. Available from https://uncitral.un.org/sites/uncitral.un.org/files/draft_report

_of_wg_iii_for_the_website.pdf.

[7] Lorenzo Cotula and Brooke Güven, "Investor-State Arbitration: An Opportunity for Real Reform?", IIED Blog, 7 December 2018. Available from https://www.iied.org/investor-state-arbitration-opportunity-for-real-reform. See also Martin Dietrich Brauch, "Multilateral ISDS Reform is Desirable: What Happened at the UNCITRAL Meeting in Vienna and How to Prepare for April 2019 in New York", IISD Blog, 21 December 2018. Available from https://www.iisd.org/itn/2018/12/21/multilateral-isds-reform-is-desirable-what-happened-at-the-uncitral-meeting-in-vienna-and-how-to-prepare-for-april-2019-in-new-york-martin-dietrich-brauch/.

[8] Federico Ortino, *Substantive Provisions in IIAs and Future Treaty-Making: Addressing Three Challenges* (E15 Task Force on Investment Policy, June 2015), p. 1. Available from http://e15initiative.org/wp-content/uploads/2015/09/E15-Investment-Policy-Ortino-FINAL.pdf.

[9] Joachim Pohl, "Societal Benefits and Costs of International Investment Agreements: A Critical Review of Aspects and Available Empirical Evidence", OECD Working Papers on International Investment 2018/01. Available from www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements_e5f85c3d-en.

[10] See e.g. Nadia Doytch and Merih Uctum, "Globalization and the Environmental Impact of FDI", City University of New York Economic Working Papers (2016). Available from https://academicworks.cuny.edu/cgi/viewcontent.cgi?article=1011&context=gc_econ_wp.

[11] E.g. *Hesham Talaat M. Al-Warraq v. The Republic of Indonesia*, UNCITRAL, Final Award (15 December 2014); *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v. Republic of Kenya*, ICSID Case No. ARB/15/29, Award (22 October 2018).

[12] E.g. *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016). See also United Nations Conference on Trade and Development (UNCTAD), *Investment Policy Framework for Sustainable Development* (2015), pp.73-75. Available from https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1437.

[13] For example, *Bear Creek Mining Corporation v. Republic of Peru*, ICSID ARB/14/2, Award (30 November 2017), paras. 663–668, and Partial Dissenting Opinion of Professor Philippe Sands QC (12 September 2017).

[14] Cotula, *Raising the Bar on Responsible Investment*, supra. See also James Gathii and Sergio Puig, eds., "Symposium on Investor Responsibility: The Next Frontier in International Investment Law", *AJIL Unbound* Vol 113. Available from https://www.cambridge.org/core/journals/american-journal-of-international-law/volume/AED2077F3422BB3F291F651F695CD4FA; Laurence Dubin, "Corporate Social Responsibility Clauses in Investment Treaties", Investment Treaty News, 21 December 2018. Available from https://iisd.org/itn/2018/12/21/corporate-social-responsibility-clauses-in-investment-treaties-laurence-dubin/.

[15] Jesse Coleman, Lise Johnson, Lisa Sachs and Kanika Gupta "International Investment Agreements, 2015-2016: A Review of Trends and New Approaches", in *Yearbook on International Investment Law and Policy 2015-2016,* Lisa Sachs and Lise Johnson, eds. (OUP, 2017), paras. 2.81–2.88. Available from http://ccsi.columbia.edu/files/2014/03/YB-2015-16-Chapter-2-Sachs-et-al.pdf.

[16] Examples include the Belarus-India Bilateral Investment Treats (BIT) 2018 (Article 11(i)) and the Intra-MERCOSUR (Southern Common Market) Investment Facilitation Protocol 2017 (Article 13(1)). Neither treaty has entered into force. See also the Netherlands Model Investment Treaty 2018 (Article 7(1)).

[17] Morocco-Nigeria BIT 2016 (not yet in force), Articles 14 and 18.

[18] E.g. *Hesham Talaat M. Al-Warraq v. The Republic of Indonesia*, and *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v. Republic of Kenya*, supra note 11.

[19] For example, *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA 2012–2, Award (15 March 2016), paras. 6.97–6.99, 6.133. See also *Bear Creek Mining Corporation v. Republic of Peru*, Partial Dissenting Opinion of Professor Philippe Sands QC, supra note 13, para. 39.

[20] Netherlands Model Investment Treaty 2018 (Article 23).

[21] For example, *Saluka Investments BV v. The Czech Republic*, UNCITRAL, Decision on Jurisdiction over the Czech Republic's Counterclaim (7 May 2004), para. 61; *Metal-Tech Ltd v. The Republic of Uzbekistan*, ICSID ARB/10/3, Award (4 October 2013), para. 407; *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic*, ICSID Case No. ARB/07/26, Award (8 December 2016), paras. 1151-1153.

[22] Lise Johnson and Brooke Skartvedt Guven, "The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest", Investment Treaty News, 13 March 2017. Available from https://www.iisd.org/itn/2017/03/13/the-settlement-of-investment-disputes-a-discussion-of-democratic-accountability-and-the-public-interest-lise-johnson-and-brooke-skartvedt-guven/?utm_source=newsletter&utm_medium=email&utm_campaign=itn-march-17&utm_source=newsletter&utm_medium=email&utm_campaign=itn-march-17.

[23] Nicolás M. Perrone, "The international investment regime and local populations: are the weakest voices unheard?", *Transnational Legal Theory* 7:383 (2016); Lorenzo Cotula and Mika Schröder, *Community Perspectives in Investor-State Arbitration* (IIED, 2017). Available from http://pubs.iied.org/12603IIED/.

[24] For more detail on what this might involve, see Lorenzo Cotula and Nicolás M. Perrone, "Reforming Investor-State Dispute Settlement: What about Third Party Rights?" (IIED, February 2019). Available from http://pubs.iied.org/17638IIED/.

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While the reform process of international investment protection treaties is evolving, it is still at a nascent stage. Systemic reforms that would safeguard the sovereign right to regulate and balance the rights and responsibilities of investors would require more concerted efforts on behalf of home and host states of investment in terms of reforming treaties and rethinking the system of dispute settlement.

Experiences of developing countries reveal that without such systemic reforms, developing countries' ability to use foreign direct investment for industrialization and development will be impaired.

The policy brief series is intended as a tool to assist in further dialogue on needed reforms.

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