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Possible reform of Investor-State dispute settlement (ISDS)

Submission from the Republic of Korea

Note by the Secretariat

This note reproduces a submission received on 31 July 2019 from the Government of the Republic of Korea in preparation for the thirty-eighth session of Working Group III. The submission is reproduced as an annex to this Note in the form in which it was received.

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Annex

I. Introduction

The Republic of Korea ("Korea") appreciates the collective efforts of the member States participating in the Working Group III over the past four sessions to identify a wide range of concerns over the Investor-State Dispute Settlement ("ISDS") mechanism contained in international investment agreements ("IIAs"), and to explore possible options for reform. As the discussions of the Working Group will enter the next phase at its 38th session in October 2019, Korea wishes to provide its observations concerning the future focus of the Working Group, in order to contribute to the ongoing discussions.

Given the open-ended nature of the discussions at the Working Group and the evolving nature of the topics, Korea believes that the Working Group will most benefit from taking a flexible stance in evaluating possible options for reform, while keeping its current momentum. In this context, Korea's goal is to provide a practical contribution to facilitate the discussions of the Working Group.

In this submission, which also reflects diverse opinions from academia and civil society,[1] Korea would like to cover three main topics: (i) modalities of future discussions; (ii) additional topics for the Working Group's discussions; and (iii) suggestions relating to a standing mechanism for the settlement of international investment disputes ("standing mechanism") approach.

II. Modalities of Future Discussions at the Working Group

Two distinct approaches emerged during the previous sessions of the Working Group. One approach suggests an "incremental" reform option. It proposes that States canvass further concerns and pursue necessary changes within the existing framework of the ISDS mechanism.[2] The other approach suggests States to seek "structural" reform. This approach implies that the concerns tabled so far indicate a need to explore an overhaul of the current ISDS system.[3] Having recognized the existence of the two distinct approaches and the divisiveness of the views expressed at the Working Group, the States have agreed to adopt a "two-track" system, whereby the Working Group will explore both approaches in its future discussions, and devote an equal amount of time and resources to both.[4]

The remaining task is how to administer this two-track approach in a fair, balanced and efficient manner, so that the States can achieve the objectives set forth in the mandate of the Commission. As already discussed during the 37th Session of the Working Group, a bifurcated scheme of discussions and negotiations under the two-track system would impose a logistical burden on both the States and the Secretariat. From our point of view, the past four sessions have already alerted us to

[1] Several Korean civil society groups, under the name of the People's Solidarity for Participatory Democracy ("PSPD"), published and submitted a joint statement to the Korean Ministry of Justice in June 2019, suggesting several reform options with regard to the UNCITRAL Working Group discussions. The submission includes (i) prohibition of third-party funding; (ii) mandatory exhaustion of local remedies; (iii) broader participation of third-parties (including civil society); (iv) enhancing the use of counterclaims for Respondents; (v) strengthening transparency; (vi) prevention of disputes; and even (vii) abolition of the ISDS system. They pointed out that UNCITRAL's discussions on ISDS reform is a great opportunity to develop a more democratic and human rights-friendly investment policy, based on the United Nations' Sustainable Development Goals and Millennium Development Goals. *Opinion on ISDS Reform submitted by Lawyers for Democratic Society and People's Solidarity for Participatory Democracy on June 27*, 2019.

[2] A/CN.9/970, *Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1–5 April 2019)*, para. 68.

[3] Ibid., para. 71.

[4] Ibid., para. 81.

the significant logistical burden for the States and the Secretariat in organizing, preparing and operating the Working Group. In this regard, the two-track model may add another layer of complexity, unless it is managed properly.

Most importantly, in Korea's view, the two-track model should not mean, in effect, having or permitting two different sub-groups within the Working Group working independently and separately. Not only could this deepen the divisiveness in the group, but it may also make the achievement of the objective more elusive, due to mounting logistical obstacles. Hence, Korea believes it is critical to ensure that the Working Group does not break into two separate sub-groups. Rather, throughout the process, there should be one single group working on two different strands of discussions.

To clarify, the discussion of each track should be a continuation of the discussion of the other track and vice versa. In other words, there should not be a suspension of discussions on one track to start the other track. The member States could simply adjust the way of looking at the issues. Thereby, discussions of one track could enlighten those in the other track in a mutually complementary way. The momentum of the discussions could therefore be preserved, and efficiency ensured, as much as possible.

Korea submits that this formula is feasible because we believe that the substantive elements (i.e., concerns identified so far) to be discussed regarding the two approaches remain the same (or at least largely overlap). The targets and subjects of the discussions are either identical or quite similar. The only difference seems to lie in how to address the identified concerns. If that is the case, the Working Group might consider the following format. In each week of the future sessions, the Working Group may start the discussion in an incremental approach, and the results of the discussion may then be transferred to the structural reform approach; perhaps the only difference in the structural reform discussion would be to view the same issues from the perspective of the introduction of a new standing mechanism. Likewise, the content of the discussions in the structural reform track may then be transferred to the incremental track when the next session resumes. In other words, the issues discussed in one track may be moved onto the other on a continual basis. With proper advance planning, Korea believes that this suggestion could be implemented in an efficient manner. The Secretariat could be entrusted to come up with a specific plan in this regard.

During this process, Korea is of the view that it is critical to respect and preserve the discretion of the Chair. The Chair could exercise such discretion in a flexible manner, while maintaining overall balance and fairness. Each track should be given equal time for discussions, in principle, provided that the Chair may redistribute the time, depending on the developments of the discussions.

With respect to the final outcome of the Working Group discussions, it has been repeatedly underscored that, at this time, there should be no pre-determined conclusion. The Working Group should make sure that the outcome remains open-ended. In our view, this is the best possible way to encourage meaningful and candid contributions of the States in the Working Group.

At the end of the discussions, the results of the discussions on the two tracks could be put on the table for final consolidation, organization or adjustment. Preferably, there would be one final "package". In such single, final package, a multilateral instrument could be offered to the States wanting such an option. The package could also provide guidance and alternatives that the States could select from and apply in their future IIAs. A State could choose none, one of the two, or both, depending upon its circumstances and the content of the final package.

III. Additional Topics for the Working Group's Discussions

Korea wishes to bring the following topics to the Working Group's attention to enrich the ongoing discussions: (1) regulation of third-party funding; (2) international cooperation on investment dispute prevention; and (3) regulation of claims by multinational hedge funds.

1. Regulation of Third-Party Funding

Through the comments and information from previous sessions, it has been widely recognized that the practice of third-party funding ("TPF") has seen a substantial growth in terms of the number of operating funders, as well as the amount of capital available.[5] In Korea, a variety of opinions exist on how to deal with TPF. Civil society organizations assert that TPF should be prohibited in principle, but allowed in exceptional circumstances in order to ensure access to justice.[6] However, on the assumption that the Working Group discussions are going in the direction of the regulation of TPF, not its entire prohibition, we would like to offer some points for consideration.

The previous discussions in the Working Group have shown that States share an understanding of the core rationales behind the necessity of regulating TPF, e.g., dealing with issues of hidden conflicts of interest between arbitrators and funders, undue third-party control and influence over case management or dispute settlement, problems of confidentiality, security for costs, and an increase in frivolous claims.[7] Korea shares the same concerns, and would like to reiterate its interest in initiating a comprehensive discussion on this subject. Such discussion would be best addressed in three stages: scope of regulation; duty of disclosure and related requirements; and measures of enforcement.

In terms of the scope of regulation, an emphasis could be placed on the necessity of including legal counsel and representatives within the scope of the possible regulation of TPF. The inability of a party to comply with adverse awards (including adverse awards on costs) has been identified as one of the core concerns behind the regulation of TPF.[8] This is especially the case for the responding States, as there have been instances where States have been awarded costs but ultimately failed to collect.[9] Alternate fee arrangements, such as contingency fee arrangements, are classic examples of funding provided by party representatives and, in many cases, could imply the potential risk of the impecuniosity of a party. Ensuring the prospective regulation of TPF to cover the costs of counsel and representatives could help enhance the effectiveness of such new regulation.

As for the requirements of disclosure, an explicit provision could be introduced to stipulate that parties are subject to a duty of disclosure regarding the existence of TPF, the identity of the funder and, possibly, the general nature and terms of the TPF agreement at issue. Relevant requirements could be supplemented by IIAs or through a tribunal's authority to order more extensive disclosure if deemed necessary. Furthermore, the tribunal, having taken into account the relevant circumstances of the

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[5] *Possible reform of investor-State dispute settlement (ISDS): Third-party funding*, *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.157, para. 7; *Report of the Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fifth session (New Work, 23–27 April 2018)*, UN Doc. A/CN.9/935, para. 89.

[6] *Opinion on ISDS Reform submitted by Lawyers for Democratic Society and People's Solidarity for Participatory Democracy on June 27, 2019.*

[7] *Possible reform of investor-State dispute settlement (ISDS): Third-party funding*, *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.157, paras. 16–34.

[8] *Possible reform of investor-State dispute settlement (ISDS): Third-party funding*, *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.157, para. 31.

[9] ICSID Secretariat, *Survey for ICSID Member States on Compliance with ICSID Awards (2017)*, at 4; Christine Sim, *Security for Costs in Investor-State Arbitration*, 33(3) ARBITRATION INTERNATIONAL 427, at 461–462.

dispute, such as the existence of TPF and the nature of its arrangements, may order security for costs in order to deal with the possibility of a party's impecuniosity.

In the case of any breach of or non-compliance with these requirements, a proper means of enforcement would be essential. In this regard, a suspension of proceedings – which may potentially lead to the termination of proceedings – or the possibility of an adverse cost allocation may be viable options. Failure to disclose may also be stipulated as grounds for a tribunal to apply adverse inference against the party concerned.

Korea has submitted comments on this issue in the context of the ICSID Rule Amendments.[10] Current ICSID Rule Amendment discussions on TPF, with input from both the ICSID Secretariat and participating States, offer an important contribution to future discussions of this issue in the Working Group.

2. International Cooperation on Investment Dispute Prevention and Response

As numerous studies have confirmed, responding to ISDS proceedings requires a significant amount of time and expense. Korea has maintained that focusing on the "prevention" of disputes, rather than "post-dispute" regulation, is more cost-effective. In fact, Korea has made ongoing efforts to devise and implement measures for ISDS prevention including, as noted by some member States during our discussions, the ombudsman system and the publication of handbooks.

Korea's experience indicates that a foreign investment ombudsman system can be a valuable asset for investment retention and dispute prevention by providing comprehensive "after-care" of foreign investors. Through this system, complaints can be addressed and discrepancy of related agencies can be harmonized. The ombudsman system can help prevent a complaint from being escalated into an investment dispute. ISDS handbooks and booklets are being published and circulated by the Korean Government in order to provide general information on dispute prevention and the meaning of key provisions of IIAs. Upon request from government agencies, local municipalities or public entities, the ministry in charge provides lectures and seminars on ISDS prevention based on the information in these handbooks.

Notably, Korea has learned from its experience with a series of recent ISDS cases that the accumulation of expertise, experience, knowledge and institutional capacity plays a crucial role in an effective response to investment disputes, particularly in the early stages of investment arbitration. In this context, Korea believes that member States could greatly benefit from the development of a systematic method of sharing knowledge and successful practices on dispute prevention and response. A similar point has already been raised in the Working Group by[11]the Government of Thailand, which proposed that the Working Group explore the creation of a "Guideline on Dispute Prevention" and the establishment of an "Advisory Centre on International Investment Law".[12] Korea recognizes the merits of and supports these proposals.

The Advisory Centre could become a hub for collecting and disseminating best practices and institutional information. The Centre could assist developing States by publishing policy guidelines, providing education on dispute prevention, creating a database for arbitral awards and decisions, and providing legal advice on how to manage potential disputes. On this note, Korea would like to add that a network of regional advisory centres may be more effective in pursuing such an objective. Korea would like to take this opportunity to suggest to the member States that the existing UNCITRAL Regional Centre for Asia-Pacific (RCAP) could be a viable option to assume such responsibilities.

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[10] *The Republic of Korea's Further Comments to ICSID Rule Amendments*, at 3–5, 9–11. (Available at: https://icsid.worldbank.org/en/Documents/Korea_CommentsWP2_06.28.2019.pdf).

[11] *Possible reform of investor-State dispute settlement (ISDS): Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.149, para. 59.

[12] *Submission from the Government of Thailand*, UN Doc. A/CN.9/WG.III/WP.162, paras. 25–27.

3. Claims by Multinational Hedge Funds

As a final point for further discussions in the Working Group, Korea would like to bring the attention of member States to the necessity of regulating abusive claims by multinational hedge funds.[13] As some delegations aptly pointed out during previous sessions, the number, as well as the size, of claims brought by multinational funds has increased. Despite the increasing challenges over their compatibility with the object and purpose of IIAs, some of these funds are allegedly abusing their multi-layer, ambiguous corporate structures (usually tailored for tax purposes) to "shop around" for the ISDS cases in different jurisdictions.

Almost all IIAs signed and ratified to date aim to achieve the objective of promoting the economic development of the State parties by establishing conditions under which foreign investors are likely to enter, while at the same time protecting the rights of the foreign investors.[14] The IIAs generally impose limitations on the scope of substantive protection and jurisdiction by stipulating "covered" or "protected" investments and investors. In this regard, previous awards have confirmed that investments worthy of protection must possess certain qualities, such as sufficient duration and contributions to the host State's economic development.[15] Yet, the current IIA regime has not had the opportunity to scrutinize the unique nature of the claims of short-term hedge funds from this perspective. Nor have arbitral tribunals looked into this phenomenon or generated appropriate jurisprudence. Questions can be raised about whether and how these funds may or may not satisfy the basic requirements of being an "investment" and/or "investor".

IV. Standing Mechanism Discussion

While Korea believes that structural reform is one viable option to address the previously identified concerns of States regarding the current ISDS regime, it holds the view that, before the Working Group comes to any premature conclusion, it is necessary to first carefully and thoroughly explore and examine the legal issues and logistical challenges pertaining to such structural overhaul. We would like to note that structural reform might entail unintended or unexpected consequences in many respects, as the Working Group is reviewing a 53-year old system which has produced 3,300-plus IIAs. In particular, having a clearer picture of a multilateral arrangement, such as a standing mechanism, that not only encompasses its strengths but also its weaknesses, will help States to minimize and prepare for any such unintended consequences.

Compatibility with the current ISDS system may be one of the issues that deserve most attention. More attention should be given to a prospective multilateral arrangement's compatibility with the existing ICSID Convention, the New York Convention and the States' IIAs. More specifically, the States may seek clarification as to whether these existing instruments would have to be amended to accommodate a prospective standing mechanism. Some member States may also have to amend their domestic legislation.

Another critical issue is how long a transition period might take. It seems possible that some States may encounter a situation where they will be dealing with two different systems in the transition period. The States would have to deal with ISDS proceedings under their existing IIAs while, at the same time, handling proceedings on a newly created standing mechanism. To some States, this could mean

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[13] In A/CN.9/WG.III/WP.149, *Possible reform of investor-State dispute settlement (ISDS): Note by the Secretariat*, Annex A.2., abuse of process has been indicated as one of problems of the current ISDS mechanism.

[14] KENNETH VANDEVELDE, BILATERAL INVESTMENT TREATIES: HISTORY, POLICY, AND INTERPRETATION, Oxford University Press (2009), at 1–2.

[15] These two requirements have long been recognized as forming an integral part of the so-called "*Salini* test". See CHRISTOPH SCHREUER ET AL., THE ICSID CONVENTION: A COMMENTARY (2ND EDITION), Cambridge University Press (2009), at 130–134.

another layer of fragmentation in terms of settling investment disputes. Therefore, how to cope with such a situation during the transition period appears to be an important discussion topic for the Working Group.

In addition, selection of adjudicators would be another practical challenge. With respect to selection criteria, various factors, such as regional representation, diversity in backgrounds, and proven expertise, would have to be taken into account. Devising an agreeable selection process would be equally important. Selecting and retaining adjudicators who can address the identified concerns will be essential for the success of the reform. Likewise, a formula to secure the financial resources to fund a new multilateral arrangement and to allocate the costs between the States deserves the careful attention of the Working Group. Whether a structural reform option will be indeed viable and feasible ultimately depends upon how these specific issues are addressed and sufficiently contemplated by the Working Group.

In this context, Korea believes that the Working Group's discussions of structural reforms may be most productive if they can be conducted with these systemic implications and practical challenges in mind.