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Possible reform of investor-State dispute settlement (ISDS)

Submission from the Government of China

Note by the Secretariat

This note reproduces a submission received on 18 July 2019 from the Government of China 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.

Annex

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Recommendations of China regarding investor-State dispute settlement reform

I. Background

More than 940 international investment disputes are known to have arisen since the first treaty-based international investment dispute took place in 1987. The present investor-State dispute settlement (ISDS) mechanism plays an important role in protecting the rights and interests of foreign investors and promoting transnational investment. It also helps to build the rule of law into international investment governance and to avoid economic disputes between investors and host countries escalating into political conflicts between nations. Therefore, China believes that the ISDS mechanism is one that is generally worth maintaining.

At its fiftieth session in July 2017, the United Nations Commission on International Trade Law (UNCITRAL) decided to authorize its Working Group III to discuss the problems existing in the ISDS mechanism, as well as the need and potential proposals for reforming it. After two years of discussion, Working Group III acknowledged that there are problems requiring reform in the present ISDS mechanism, and it decided to simultaneously study and formulate a variety of potential reform proposals, including those for systemic reform.

China welcomes this reform initiative. The Chinese Government has been steadfast in its pursuit of multilateralism, actively promoting international cooperation via the Belt and Road Initiative, spurring the construction of an open world economy, upholding the concept of a cooperatively built and shared global governance, and promoting the construction of a new international relationship of mutual respect, fairness and justice, and win-win cooperation. As early as the eighth Leaders' Summit of the Group of 20, held in 2013, President Xi Jinping called for "exploring ways to improve global investment norms and guide the rational flow of global development capital". At the Hangzhou Summit in September 2016, the leaders of the Group of 20 agreed on the Guiding Principles for Global Investment Policymaking, which proposed that "dispute settlement procedures should be fair, open and transparent, with appropriate safeguards to prevent abuse". These efforts have clearly shown the direction to be taken in promoting the process of ISDS reform.

II. Main problems of the current investor-State dispute settlement mechanism

As seen in applicable practice, the basic functions of the ISDS mechanism are to interpret and apply treaties and determine the responsibilities of States. It is thus part of a body of remedies that are in the nature of public international law. Investment arbitration is an important means of settling disputes between investors and States. However, although the ISDS mechanism has played a major role in protecting the rights and interests of foreign investors and promoting transnational investment, it has also created many problems in practice. China believes that the issues outlined below deserve the attention of all parties.

1. Arbitral awards lack an appropriate error-correcting mechanism

Current investment arbitration lacks an institutionalized and reasonable mechanism for correcting errors. Under the Washington Convention, the scope of review by ad hoc annulment committees is confined to certain specific matters. In addition, the history of such negotiation shows that the contracting parties do not view

annulment committees as an appeal mechanism. Under the UNCITRAL Arbitration Rules, parties may resort to domestic courts for investment-arbitration awards in accordance with the domestic law of the place of arbitration. However, because the rules applied by the courts in the place of arbitration and those applied by international arbitration tribunals differ with regard to such issues as applicable law, treaty and legal interpretation, and evidence, the judgments of the courts in the place of arbitration often give rise to many disputes.

2. Arbitral awards lack stability and predictability

The current rules for investment arbitration mainly provide arbitration procedures for ad hoc arbitration tribunals. Different cases may be heard by different arbitrators, and it is difficult for arbitration tribunals in different cases to guarantee the stability and predictability of the awards. The awards made by many arbitral tribunals differ from those in previous cases, and some arbitral tribunals have made it clear that it is not the duty of the arbitral tribunal to coordinate consistency among past and future arbitral awards. The numerous inconsistencies in the awards arrived at through the investment arbitration mechanism and the uncertainty of arbitration results have seriously affected the expectations of the parties involved. The mechanism clearly cannot meet the requirements for realizing the rule of law in international investment.

3. Arbitrators' professionalism and independence are questioned

As the existing investment arbitration system borrows from the practical experience of commercial arbitration, the appointment process for arbitrators fails to fully reflect the professional requirements of international public law required for investment arbitration. At present, there is no code of conduct for arbitrators in the investment arbitration field; the procedures of arbitrator-appointing bodies are insufficiently transparent; and the system for arbitrator recusal is insufficiently sound. In the investment arbitration field, there are even instances of arbitrators' identities overlapping with those of lawyers, possibly creating conflicts of interest. The fact that investment arbitration lawyers and arbitrators comprise only a very small pool of experts is a phenomenon deserving of special attention. The ISDS mechanism should be more open and inclusive, and there should be greater participation of experts from developing countries.

4. Third-party funding affects the balance between parties' rights

Third-party funding in investment arbitration is a controversial phenomenon that has appeared in recent years. This practice, which emerged from commercial litigation activities, may lead to a convergence of interests among arbitrators and sponsors, or even conflicts of interest. Third parties and investors often reside outside the host country, meaning that the host Government lacks both information on and jurisdiction over them and, accordingly, needs international cooperation or assistance. Moreover, host Governments, especially those of developing countries, also face the burden of high investment arbitration costs, a situation that needs to be addressed by establishing appropriate mechanisms.

5. Time frames are overly long and costs overly high

The average duration of an investment arbitration case is three to four years, and the average duration of an annulment procedure under the Washington Convention is nearly two years. Such lengthy processes require heavy investment of resources by the parties. With regard to arbitration costs, the latest data show that the average total cost of legal services for parties to arbitration exceeds $11 million, imposing a heavy burden on the parties. Conciliation and other alternative dispute resolution measures are rarely used and fail to perform the role of improving efficiency and reducing costs.

III. Chinese considerations regarding goals and proposals for the present reform

China believes that among the many problems that have come to light, some of the institutional issues tend not to lend themselves to resolution through bilateral investment agreements between Member States. Rather, they need to be resolved by improving the structure of multilateral ISDS rules and mechanisms, along with a review and formulation of balanced rules for dispute resolution. The present reform proposal should remedy the main shortcomings of the current mechanism for settling investment disputes and promote the process of building the rule of law into the field of international investment. The reform proposal should not only safeguard the legal regulatory power of the host country but also protect the rights and interests of investors and enhance confidence in the ISDS mechanism among parties to disputes.

China is open to possible proposals for improving the ISDS mechanism. In our view, proposals that can currently be considered include, but are not limited to, the following areas:

1. A permanent appellate mechanism

China supports the study of a permanent appeal mechanism as a reform proposal for resolving the main problems in the current ISDS regime. Establishing such a mechanism, grounded on international treaties and the clarification of the corresponding procedural, institutional and personnel issues involved, would be an important factor in promoting application of the rule of law to the settlement of disputes between investors and States. It would help improve error-correcting mechanisms, strengthen legal expectations for investment dispute settlement and establish limitations for the conduct of judges. It would also foster further standardization and clarification of procedures, thus reducing the abuse of rights by parties to disputes. Efforts to regulate existing appeal mechanisms, or to draft provisions to effect links with potential appeal mechanisms, have begun under recent international investment agreements (including those signed by China). However, regulating appeal mechanisms by formulating multilateral rules is more efficient than doing so through bilateral investment agreements, and it can minimize institutional costs. The practical experience of the World Trade Organization dispute settlement mechanism reflects the relatively high efficiency of its appeal mechanism as well as its moderate operating costs.

2. The right of the parties to appoint arbitrators

The right of the parties to appoint arbitrators is a basic feature of international arbitration as traditionally practised, and it also reflects the will of the parties. Participants in investment arbitration (investors, host-country Government officials, lawyers or arbitrators) generally believe that this feature is the core and most attractive feature of international arbitration. Because investment disputes often involve complex factual and legal issues at the first-instance stage of legal proceedings, many factors need to be considered by the parties in determining the composition of the arbitral tribunal and the suitability of the arbitrators selected for it, such as legal background, experience and nationality, as well as the level of energy input and special expertise that may be required for a particular case. It is noteworthy that most other dispute settlement mechanisms in the fields of international public law or international economics and trade retain similar practices, allowing parties to disputes to choose trusted experts to hear cases. The protection of investments was the original motivation for setting up international investment arbitration mechanisms, and as such this aspect cannot be ignored. The right of parties to appoint arbitrators at the first-instance stage of investment arbitration is a widely accepted institutional arrangement that is an important aid to enhancing the confidence of parties to disputes, especially investors, and should be retained in any reform process.

3. Rules relating to arbitrators

While retaining the right of parties to appoint arbitrators, it is necessary to improve the processes for dealing with arbitrator qualifications, conflicts of interest, selection and disqualification. China notes that Working Group III and the International Centre for the Settlement of Investment Disputes are jointly studying relevant codes of conduct. Considering the public-law nature of the ISDS mechanism, arbitrators should have professional knowledge in the fields of international public law and international economic law, avoid potential conflicts of interest and prevent inequities that may be caused by their improperly practising concurrently as lawyers. Countries with differing cultural backgrounds often have different understandings of arbitrators' conflicts of interest or issues, so it is necessary to further clarify the specific connotation of such conflicts. The proposed reform should also improve the rules for selection and disqualification of arbitrators to increase transparency and reasonableness.

4. Alternative dispute resolution measures

In contrast with investment arbitration, investment conciliation emphasizes the value of harmony and can offer the host country and investors a high degree of flexibility and autonomy. Conciliators also have more opportunities to adopt creative and forward-looking methods to promote the settlement of investment disputes, thereby helping the parties to achieve mutually beneficial results as well as avoiding lengthy arbitration processes and high litigation costs. From the broader perspective of practical dispute resolution experience, adopting alternative dispute resolution measures is more advantageous for maintaining long-term cooperative relationships between investors and host Governments. In addition, it helps host countries to protect foreign investment through appropriate measures, thus serving the purpose of averting disputes and avoiding intensification of conflicts. China believes that the establishment of a more effective investment conciliation mechanism should be actively explored.

5. Pre-arbitration consultation procedures

China supports the inclusion of pre-arbitration consultation procedures, specifying that the investor and the central Government of the host country are the consultation principals, and stipulating consultation as a compulsory obligation of both parties. Similar rules have been incorporated in many international investment agreements and have played a very positive role in resolving investment disputes. Three to six months of consultation prior to the commencement of arbitration proceedings will be helpful for settling investment disputes. Investors and host countries can use this procedure to gain a clearer understanding of each other's claims, the measures involved and the legal provisions of the host country, as well as to explore possible solutions in order to avoid having disputes escalate to arbitration proceedings.

6. Transparency discipline for third-party funding

China supports the stipulation of transparency discipline for third-party funding. The parties involved should disclose related funding on a continuous basis and avoid direct or indirect conflicts of interest between arbitrators and third-party funders. The legal consequences to be borne by the parties involved for failure to fulfil their disclosure obligations should be made clear.

IV. Recommendations for advancing the working process of Working Group III

China notes that, as mandated, the present reform process is led by Governments and encourages the participation of other international institutions and the public. China believes that the formulation of multilateral rules requires the joint efforts of

Member States; and the vitality of multilateral mechanisms also depends on the joint participation of Member States. China supports Member States in promoting the reform process by various means under UNCITRAL and also supports cooperation between UNCITRAL and other international organizations on this issue. China believes that the simultaneous consideration of all issues and the proposals for their resolution by Working Group III of UNCITRAL is a pragmatic arrangement that can take into account the needs of all parties, but a certain degree of procedural flexibility needs to be retained in order to avoid overlooking some important reform proposals.