European Economic and Social Committee

OPINION

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Multilateral investor-State arbitration court

Multilateral investor-State arbitration court: assessment of the UNCITRAL process and its achievements in light of civil society recommendations
(Own-initiative opinion)

REX/551

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Outcome of vote (for/against/abstentions)	176/0/0

1. Conclusions and recommendations

1.1 Effective and functioning international investment protection system with dispute resolution is in the interest of the EESC. However, the EESC has backed the criticism of the investor-State dispute settlement (ISDS) provided for in trade and investment agreements. This criticism, raised by civil society, mainly concerns questions about the legitimacy, consistency and transparency of this arbitration system.

1.2 The EESC takes note of the European Commission's mandate to negotiate, under the auspices of the United Nations Commission on International Trade Law (UNCITRAL), the possible establishment of a multilateral investment court (MIC). However, it regrets that the ongoing negotiations are focusing more on procedural issues rather than substantive ones.

1.3 Five years into this first multilateral process of reforming ISDS, material progress has been limited, except with regard to the drafting of a code of conduct for arbitrators, the details of which still need to be determined. The strand of discussions on the structural reform of the ISDS system, of which the creation of a permanent court is proposed as a key element, is struggling to find a solution shared by all UNCITRAL Member States.

1.4 Since no consensus has been reached amongst Member States in the relevant international organisations, no revision of the substantive law is currently envisaged. The EESC therefore urges the European Commission to continue pursuing the reform of substantive law issues along with the procedural rules. Among the substantive issues, vague or too far-reaching provisions of fair and equitable treatment (FET) should be limited to non-discrimination and direct expropriation as essential elements of investment protection.

1.5 Furthermore, it calls to ensure that some of the more crosscutting issues are kept on the negotiating table, including the chilling effect of ISDS, the exhaustion of local remedies, and access of third parties, such as local communities impacted by investments. Outcomes of this process have to be real and make a difference. The process must not stop at tweaks with the current ISDS arbitration system, being hailed as a success.

1.6 The EESC notes that the reform of the rules of procedure (particularly those on transparency, ethical rules, access to and the cost of arbitration) nevertheless paves the way for a debate on the reform of substantive rules.

1.7 The EESC would like for the *amicus curiae* model[1] to include third party interventions by all stakeholders (such as local residents, workers, unions, environmental groups or consumers) and to ensure their due consideration by judges.

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[1] The *amicus curiae* (friend of the court) procedure refers to an entity or person who is not party to a dispute but who wishes to submit legal arguments to the court. The admission of any *amicus curiae* is carried out on the basis of strict conditions in order to ensure that the balance of rights between the parties is respected during the trial. However, it also contains the promise of legitimacy, brought by the *amicus curiae* to the investment arbitration process. https://www.iisd.org/itn/fr/2019/04/23/protecting-social-rights-using-the-amicus-curiae-procedure-in-investment-arbitration-a-smokescreen-against-third-parties-maxime-somda/.

1.8 The EESC welcomes the OECD's work aimed at taking into account the challenges of sustainable development in investment agreements, but urges that it will complete its work by taking social issues into consideration, particularly making due diligence an eligibility criteria for foreign investors.

1.9 The EESC has always stressed (particularly in opinion REX/501 on a Multilateral Investment Court), that the MIC must in no way affect the ability of the EU and its Member States to fulfil their obligations under international agreements on the environment, human rights, labour rights and, of course, consumer protection. Procedural safeguards against claims that target domestic public interest legislation must also be provided for; the EESC considers that this objective could be achieved by introducing a hierarchy clause[2] and a public interest carve-out.

1.10 The EESC notes that while UNCITRAL WG-III is centred on procedural elements, this may lead to benefits in the future towards a clearer and more stable case law, which would also facilitate reforming applicable substantive law in investment treaties.

1.11 The EESC stresses that under both customary international law and international human rights law, individuals are required to seek redress before domestic courts before being able to bring international proceedings against a State, and regrets, however, that international investment law does not generally require the exhaustion of domestic remedies. The EESC notes that this system discriminates against SMEs, given their limited financial resources. The EESC therefore encourages the Commission to pursue in the UNCITRAL process the issue of exhaustion of local remedies before any international referral. ISDS should be recognized as an extraordinary remedy.

1.12 The EESC reminds the Commission of its request to be more closely involved in its UNCITRAL's work.

1.13 The EESC reiterates the need to achieve consistency between the EU's ambitious sustainable development goals, and the framework for reforming the ISDS model. Poorly designed investment treaties can hinder progress, whereas well designed ones can help societies front current challenges. We need to develop a new model for international investment governance that fills the significant gap between the investment system on the one hand and human and labour rights and the environment on the other.

2. **Introduction**

2.1 Investor-State dispute settlement (ISDS) is a mechanism in numerous free trade agreements and international investment agreements (IIA) for settling disputes concerning the implementation of investment protection agreements.

2.2 It is a means for redress before a private arbitration tribunal initiated by a foreign investor from a contracting State against a State that has infringed the provisions of the treaty in question.

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[2] When States that have participated in negotiations wish to determine the ranking of subsequent treaties on the same subject, the final clauses contain provisions governing the relationship between the new treaty and existing treaties, or future treaties, on the same subject.

2.3 One arbitrator is nominated by the company, a second by the State, and a third by the Secretary-General of the Permanent Court of Arbitration.

2.4 The EESC has already addressed ISDS issues on several occasions[3]. The purpose of this opinion is therefore not to analyse all the flaws and challenges of ISDS arbitration, but to explore and take a position on the reform and modernisation processes of this dispute settlement method – in which the European Commission plays a central role – currently under discussion at UNCITRAL.

3. General comments

3.1 The ISDS model has been frequently criticised in recent years, with interest in reforming investment treaties steadily increasing, in terms of undermining States' right to regulate and challenging democratic legitimacy, the breach of European regulatory standards (whether they be health, phytosanitary, social or environmental standards), or the neutrality and independence of the arbitrators.

3.2 The most frequently identified problems concern the lack of **transparency** in investment disputes, the lack of consistency and **predictability of arbitration outcomes**, the role and independence of arbitrators, doubts about their legitimacy, and the deterrent effect of rulings on the State's regulatory powers. The **deterrent effect** refers in particular to the fact that States could be deterred from adopting legislation that is by definition in the public interest, for fear of being exposed, to the detriment of their citizens and taxpayers, to liability under an investment treaty, and to the possibility of having to pay large sums to foreign investors in the event of litigation.

3.3 Criticism often also concerns ISDS clauses that contain vague and too far-reaching concepts such as "fair and equitable treatment" and "indirect expropriation", which can create legal uncertainty and potential misuse.

3.4 Similarly, the **principle of no appeal or recourse for annulment or review**, unless otherwise agreed, affects the right to effective judicial remedy. Investors have been exploiting flaws in these traditional ISDS systems in recent years, leading to an unprecedented increase in investor-State disputes, as well as a significant increase in investor claims and higher litigation costs.

3.5 It is imperative that investor-State dispute settlement mechanisms be fundamentally reformed, as current challenges, such as climate change (for which a just transition for workers towards a low-carbon economy will need to be implemented), COVID-19 responses, the digital transition and achieving sustainable development goals (including the concept of decent work), can only be addressed through national and international investments.

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3 REX/501 Multilateral Investment Court.
REX/464 – The position of the EESC on specific key issues of the TTIP.
REX/411 – Investor protection and investor to state dispute settlement in EU trade and investment agreements with third countries.

3.6 The EESC reiterates the need to have a modern, effective and functioning international investment protection system with dispute resolution but also to achieve consistency between the EU's ambitious sustainable development goals, and the framework for reforming the ISDS model. Poorly designed investment treaties can hinder progress, whereas well designed ones can help societies front current challenges.

4. Issues at stake in the EU

4.1 Criticism of the ISDS model prompted the European Commission to replace it through the creation in 2015 of a permanent investment dispute settlement body, specifically designed to address the above-mentioned concerns.

4.2 It should be clarified that through the creation of a MIC, the Commission only aims to address procedural issues related to **dispute settlements, and does not fully respond to the substantive criticism of the ISDS**.

4.3 Under this current reform approach, substantive issues such as applicable law or rules of interpretation, including ensuring consistency with other international obligations (for example from the International Labour Organization and the United Nations Conventions) can only be addressed in the underlying investment agreements to be applied to the MIC.

4.4 The EESC is therefore concerned that even if a new dispute settlement system were agreed at multilateral level, it would not resolve the substantive issue of the bilateral investment protection agreements, which contain vague or too far reaching provisions that leave room for abuse (such as those on fair and equitable treatment, including indirect expropriation outlined above). The EESC therefore advocates to limit FET provisions exclusively to non-discrimination and direct expropriation and urges the European Commission to not only take into account procedural elements but to also address these applicable substantive law issues.

4.5 The exact features of the MIC (such as its composition, its budget, the possibility of receiving support from a secretariat, etc.) will depend on the outcome of the upcoming negotiations between the countries joining the new system.

5. The need for an approach that is consistent with sustainable development and social justice goals

5.1 The current public and even expert perception is that there is a significant gap between the protection of investments, which is legally binding with binding legal instruments for its enforcement, and the protection of human, social, environmental and health rights, whose international schemes are either partially binding or not binding at all, or if binding, lack instruments for their proper enforcement.

5.2 The debate on ISDS system reform must also take into account the European Commission's new approach on the implementation and enforcement of trade and sustainable development chapters in the EU free trade agreements that reviews the 2018 **15-point action plan**[4].

5.3 The EESC welcomes the launch of the Organisation for Economic Co-operation and Development's (OECD) initiative[5] on the future of investment treaties, which explores how the treaties of tomorrow could help address the challenges identified above, as well as any ideas for reform. The urgent need to tackle the climate crisis is at the heart of this initiative. However, it urges to complement its work by taking social issues into consideration, particularly making due diligence an eligibility criteria for foreign investors.

5.4 The OECD's work includes important milestones of a Council Recommendation on FDI Qualities for Sustainable Development that was adopted by OECD ministers in June 2022. It is the first multilateral instrument to help policy makers enhance the positive contribution of international investment to the SDGs. It is supplemented by the FDI Qualities Policy Toolkit and the FDI Qualities Indicators 2022.

5.5 Like the European Parliament's Committee on International Trade (INTA)[6], the EESC believes that EU investment policy should not only meet investor and recipient State expectations, but **also the EU's wider economic interests, its external policy objectives, as well as its priorities**, particularly those on environmental protection and the protection of human and fundamental rights.

5.6 The EESC stresses that under both customary international law and international human rights law, individuals are required to seek redress before domestic courts before being able to bring international proceedings against a State, and regrets that by contrast, international investment law does not generally require the exhaustion of domestic remedies before any international referral.

5.7 The EESC therefore encourages the Commission to further investigate the issue of the exhaustion of local remedies.

6. The role of Working Group III (WG-III) of the UN Commission on International Trade Law (UNCITRAL)

6.1 On the basis of the mandate provided by the Council, the Commission started negotiations with UN Member States under the auspices of UNCITRAL, in WG-III.

6.2 The EESC reminds the Commission of its request to be more involved in UNCITRAL's work.

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4 The EESC addressed this issue with its opinion REX/535 Next Generation Trade and Sustainable Development – Reviewing the 15-point action plan: https://www.eesc.europa.eu/en/our-work/opinions-information-reports/opinions/next-generation-trade-and-sustainable-development-reviewing-15-point-action-plan-own-initiative-opinion-priority-2/timeline.

5 https://www.oecd.org/investment/investment-policy/investment-treaties.htm.

6 Draft report on the future of the EU's international investment policy. Rapporteur: Anna Cavazzini. 2021/2176 (INI) of 7 February 2022.

6.3 In November 2017, UNCITRAL has entrusted Working Group III with 'a broad mandate to work on the possible reform of investor-State dispute settlement (ISDS)'. During the first phase of its deliberations, WG-III identified a number of concerns.

Related to the global costs and duration of ISDS[7]:

- The Working Group took note of analyses based on limited available information suggesting that 80 to 90% of costs in ISDS were associated with fees for legal representation and for experts, and that the costs per proceeding averaged USD 8 million.
- Particular attention was drawn to the fact that the high costs of ISDS paid with public funds were difficult to justify for developing States, whose financial resources were scarce.
- It was pointed out that the implications of the duration and cost of the procedures were also derived from the fact that the ISDS regime did not follow the rule of binding precedent, resulting in a lack of predictability.
- It was further stated that the high costs of ISDS under some approaches could limit the access of small and medium-sized enterprises to the ISDS mechanism, thus depriving them of the protection provided to them under investment treaties.
- It was also stated, however, that excess costs could be attributed under some approaches in part to abusive practices, parallel proceedings, the absence of clear procedural rules, and the absence of a mechanism to dismiss frivolous claims at an early stage.
- In addition, it was pointed out that the increase in costs was related to systemic issues and the structure of the ISDS regime, or even the lack of a system. These issues, it was added, had led to a lack of consistency and, importantly for States as respondents in particular, a lack of predictability of outcome.

Related to existing substantive concerns taking due note of the interaction with underlying substantive standards[8]:

- Means other than arbitration to resolve investment disputes as well as dispute prevention methods
- Exhaustion of local remedies
- Third-party participation
- Counterclaims
- Regulatory chill
- Calculation of damages

6.4 From the outset of its work, WG-III has worked on two main ways forward; the first being a possible structural reform, covering the creation of a permanent court and an appeals system, the appointment of judges and the scope of appeals. The second parallel track concerns non-structural and incremental reform elements, such as the creation of a code of conduct for arbitrators and judges (to increase transparency and avoid conflicts of interest), a methodology

7 Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November-1 December 2017).

8 Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1 – 5 April 2019).

for assessing damages and interest, and ways to foster mediation between the parties. No major progress has been made, however, on structural reform and cross-cutting issues. For example, the permanent court's jurisdiction, composition and members' appointments procedure are still under discussion in the delegations.

6.5 In turn, the European Commission introduces to the debate clear requirements on ethics and impartiality, non-renewable appointments, the full-time employment of arbitrators and mechanisms for the appointment of independent judges. The EESC supports this approach, as strict rules are needed to avoid conflicts of interest.

6.6 Initially raised more crosscutting issues such as the chilling effect of ISDS, the exhaustion of local remedies, and access of third parties, such as local communities impacted by investments received less attention to the frustration of many observing civil society groups. Fully in line with its own recommendations of REX/501, the EESC encourages the Commission to ensure these fundamental questions are kept on the table and satisfactorily addressed.

6.7 The EESC regrets the lack of clarity on the WG-III website and in its meeting minutes, which prevents interested parties from properly informing themselves on the progress of work.

6.8 The EESC notes that while WG-III's work is centred on procedural elements, this may lead to benefits in the future, such as clearer and more stable case law, which would also facilitate reforming applicable substantive law in investment treaties. However, for a multilateral ISDS reform process to make a real difference, the EESC considers it essential for an institutional reform to move away from ad-hoc arbitration, to take a more holistic approach to international investment governance, and not to just replace ISDS arbitration with an investor-state court.

Brussels, 26 October 2022

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The president of the European Economic and Social Committee