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# Government perspectives on investor-state dispute settlement: a progress report

Freedom of Investment Roundtable  
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## TABLE OF CONTENTS

A.	Introduction.....	4
B.	Diversity of government policies, treaty writing practices and experiences with arbitration.....	4
C.	Key issues .....	7
1.	Access to justice for different types of foreign investor .....	7
2.	Access to justice for other victims of State misconduct.....	8
3.	Costs and the development of third party financing of investment arbitration.....	8
4.	The question of a level playing field between foreign and domestic investors: remedies and treaty shopping .....	9
5.	Enforcement of ISDS awards.....	11
6.	Impact of ISDS on host countries' economies and institutions .....	12
7.	Light but growing regulation of ISDS in bilateral investment treaties .....	13
8.	Characteristics, selection and regulation of arbitrators .....	14
9.	Consistency of ISDS decisions .....	17
D.	Next steps.....	18

## **GOVERNMENT PERSPECTIVES ON INVESTOR-STATE DISPUTE SETTLEMENT: A PROGRESS REPORT**

### **A. Introduction**

Dispute resolution between investors and states has emerged as a high profile policy issue. Growing recourse by investors to investor-state dispute settlement (ISDS) has meant that many countries – both developed and emerging – are facing investment arbitration claims for the first time or with increasing frequency. This increased exposure to investor claims arises partly from changes in investment flows, but also reflects the evolution of international arbitration and growing investor awareness of its possibilities. Noteworthy developments include the emergence of an international arbitration industry: more lawyers and firms becoming involved ISDS in recent years coupled with higher visibility of ISDS claims have contributed to greater knowledge by international investors of an option that might not have been given serious consideration even a few years ago. A more recent and related development likely to lead to additional investor claims is the emergence of third party financing of claims; this typically involves financial institutions with legal expertise that seek to invest in investor claims against states in exchange for a share of any proceeds from the case. Investor claims in ISDS can create high fiscal exposures – claimed compensation frequently amounts to hundreds of millions or billions of dollars, enough to seriously affect public budgets in respondent countries.

Since December 2011, the OECD-hosted Freedom of Investment (FOI) Roundtable has held inter-governmental discussions on a broad range of issues related to ISDS.<sup>1</sup> The focus has been on how investor-state disputes are resolved rather than on the substantive provisions at issue. The initial goals have been (i) to develop a broad picture of the ISDS system including recent developments and emerging issues; (ii) to build up the stock of comparative international institutional information about dispute resolution under the system; and (iii) to invite a broad range of governments to engage over time in a wide ranging, strategic and intergovernmental discussion of the system. The inter-governmental dialogue to date has been active and has benefited from input provided by invited experts and a broad range of comments contributed by the legal community, business and NGOs in a public consultation.

The present report summarises these FOI discussions, presents preliminary findings and outlines future Roundtable work relating to ISDS. The aim of the report is to provide a perspective on ISDS developed by governments, who are, along with international investors, the key actors in ISDS.<sup>2</sup>

### **B. Diversity of government policies, treaty writing practices and experiences with arbitration**

Discussions of ISDS have permitted FOI participants to begin to map and exchange views about the diverse policies and practices encountered in this complex field of international law. The fact finding and

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<sup>1</sup> The Roundtable brings together OECD member and non-member governments from around the globe at regular meetings. It helps governments design better policies to reconcile openness to international investment with legitimate regulation in the public interest.

<sup>2</sup> This progress report reflects discussions, comments and other contributions of government participants in three FOI Roundtables (December 2011; March and October 2012). An OECD-hosted intergovernmental forum, the Roundtable brings together some 50 governments to exchange information, ideas and experiences on investment law and policy. The ICSID Secretariat (providing factual information only) and the UNCTAD Secretariat have also contributed to Roundtable discussions of ISDS. The Roundtable's on-going work on ISDS has also benefitted from comments submitted in a public electronic consultation on ISDS and from the views of experts invited to the Roundtable. The Roundtable expresses its appreciation to those who provided comments and to the invited experts.

information-sharing function of recent dialogue has helped fill information gaps that are particularly problematic in international investment law. Findings to date include:

- ***Diverse legal sources.*** Investment law differs from other major bodies of international economic law in that it is spread across an extraordinary range of international and domestic legal sources of law. Rather than being primarily anchored in a compact and broadly-applicable body of instruments (as is, for example, trade law, with the pre-eminent role of the WTO Agreement and Dispute Settlement Understanding applicable to all 157 WTO members), investment law is contained in (i) some 3000 bilateral or multilateral investment treaties with generally similar but by no means identical provisions; (ii) other international treaties (notably the ICSID Convention and the New York Convention on the Recognition and Enforcement of Arbitral Awards); (iii) various arbitration rules including those developed by governments (ICSID, UNCITRAL) as well as rules developed by business organisations (e.g., ICC, SCC); (iv) customary international law; and (v) the domestic law of various states. The diversity of the applicable procedural rules and substantive law make it difficult to grasp the full scope of issues presented by the system. Indeed, it raises questions whether it is best addressed as a system at all.
- ***Wide recognition that comparative analysis between ISDS and other international dispute resolution systems is informative.*** Governments in the Roundtable have been considering how ISDS compares with dispute resolution at the WTO and under the European Court of Human Rights (ECHR) system, as well as with regard to less directly comparable systems. They noted that although the systems address similar and at times overlapping issues, they vary in many respects (such as the types of parties with access to the system, remedies, selection and status of adjudicators, availability of appeal and timing). There was general support for continuing with such comparisons both for understanding how ISDS compares with other systems – in terms of what it seeks to achieve and how it goes about achieving its objectives – and as a source of ideas for improving ISDS. Some delegates, however, cautioned that the comparisons could in their view be akin to comparing “apples and oranges” because of the differences between the systems. It was suggested that international dispute settlement systems should be evaluated using established principles for good practice in public policy making and adjudication.
- ***A broadly-recognised need for empirical analysis of a fast-evolving system.*** Roundtable delegates have identified a number of areas where additional analysis has been helpful. In order to fill information gaps with respect to current government policies with regard to investment dispute resolution mechanisms, the Roundtable has produced a survey of ISDS provisions in a sample of 1660 bilateral investment treaties. By mapping the content of the dispute resolution provisions in a large sample of bilateral investment treaties, the Roundtable has helped users of these treaties to size up the body of ISDS provisions. Using a comparative law approach and benefitting from the Roundtable’s access to many national government experts, the Roundtable also outlined the differences between the remedies available to domestic and foreign investors faced with government misconduct in a number of advanced economies (United Kingdom, United States, France, Germany and Japan). Commentators have supplied information about additional jurisdictions in this regard (Australia, New Zealand).
- ***Diverse bilateral investment treaty practice on regulating dispute settlement.*** The Survey of ISDS provisions shows that, although the vast majority of bilateral treaties contain ISDS provisions, their content varies markedly. Statistical results include:
  - 96% of the bilateral treaties contain provisions covering dispute settlement in both domestic courts and international arbitration. ISDS through international arbitration has become a

common feature of bilateral investment treaties – only 108 treaties, or 7% of the sample, do not provide for investor-state arbitration.

- The 1660 bilateral treaties in the sample contain an estimated 1200 different rule sets on ISDS. Thus, variation in treaty writing practice concerning dispute settlement is high and there are major differences in approach to many procedural issues (e.g., selection and regulation of arbitrators) as well as small differences in language. Concerns were expressed about whether these numerous differences reflect different policy choices or whether in many cases they may simply increase complexity and raise costs.
- ***Diverse experiences with regard to exposure to investor claims.*** The countries represented at the FOI Roundtable have diverse experiences with ISDS. Some countries have defended multiple cases while a few have not yet faced a claim. Some have adjusted the ISDS provisions in their model treaty texts and their agreed treaties to reflect their experiences as respondents.
- ***Diverse policies and attitudes.*** It is widely-recognised that sustained attention to evaluating the system is appropriate in light of increasing use of the system and greater political debate about the system in parliaments and societies. Most countries in the Roundtable were of the view that the ISDS system was valuable but could be improved. Several countries stated that they consider that it is important to recognise that the ISDS system has worked well overall. It was also noted that the domestic courts in some countries perform poorly or are inefficient. Some countries participating in the FOI Roundtable voiced fundamental concerns about the design and impact of ISDS. One participating country has never ratified an investment treaty and no longer seeks to negotiate them. It pointed to its substantial inward investment flows in the absence of treaties and expressed the view that its domestic judicial process already provides appropriate protections for foreign investors. It cited concern about frivolous claims and the impact of the system on state sovereignty. Another country has recently adopted a policy of no longer seeking ISDS provisions in its trade agreements notably due to concerns about distorting competition between foreign and domestic investors by providing the former with greater substantive and procedural rights than those available to domestic investors. Questions were also raised about whether the commercial arbitration dispute resolution system is well adapted to the issues of public interest raised in ISDS cases. Some other countries strongly supported ISDS as currently constituted. One highlighted, in the context of its handling of a recent ISDS claim, the value of the heightened incentives for finding mutually agreeable settlements for investor state disputes when such negotiations are conducted in the “shadow of international arbitration”.

Thus, policies, practices, attitudes and experiences differ markedly across countries represented at the FOI Roundtable, but there is broad recognition of the importance of the system and the need to evaluate it in light of its increased practical importance and increased public attention. The views shared by countries participating in the FOI Roundtables and supporting background studies by the OECD Secretariat<sup>3</sup> have generated information that is essential for advancing mutual understanding of where countries stand in relation to this increasingly important field of international economic law. The rest of this report describes Roundtable discussions of a range of key ISDS issues.

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<sup>3</sup> See two Secretariat background papers:  
*Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community:*  
[http://www.oecd.org/daf/internationalinvestment/investmentpolicy/WP-2012\\_3.pdf](http://www.oecd.org/daf/internationalinvestment/investmentpolicy/WP-2012_3.pdf) and  
*Dispute Settlement Provisions in Investment Treaties: A Large Sample Survey:*  
[http://www.oecd.org/daf/internationalinvestment/investmentpolicy/WP-2012\\_2.pdf](http://www.oecd.org/daf/internationalinvestment/investmentpolicy/WP-2012_2.pdf).

## C. Key issues

### 1. Access to justice for different types of foreign investor

An effective system of adjudication provides wide access to a range of potential claimants. In order to shed light on which kinds of investors have had recourse to international investor-state arbitration under ICSID and UNCITRAL, the Secretariat looked at a sample of 95 arbitration cases. The survey shows that investor-claimants range from individuals with quite limited international experience (e.g. an association of retirees) to major multi-national enterprises with tens and thousands of employees and global operations.<sup>4</sup>

More specifically, the survey shows that:

- ***Small investors are present as ISDS claimants.*** Far from supporting the view that smaller claimants are excluded from ISDS, the survey shows that 22% of the claimants in both ICSID and UNCITRAL cases are either individuals or very small corporations with limited foreign operations (only one or two foreign projects).
- ***A third of the cases in the sample were brought by investors about which there is little or no public information.*** Information on this category of investor comes from the arbitration case itself (awards and analyses) – little or no other public information about these investors is available.
- ***Medium and large multinational enterprises account for about half of the cases surveyed.*** These entities vary in size from several hundred employees to tens of thousands of employees. Extremely large multinationals – those appearing in UNCTAD’s list of top 100 multinational enterprises account for 8% of the total claimants in the sample.
- ***Nationality – are investors from emerging/developing/transition economies represented as ISDS claimants?*** The nationality of investor claimants is not always easy to determine. This is because, in some cases, the nationality of an international investor is inherently ambiguous and because, in others, very little information about the investor is available. In response to a request from an FOI participant, a conservative determination of the nationality of investor claimants was made with a view to estimating the proportion of investor-claimants that are from developing countries.<sup>5</sup> This determination sought to identify the nationality of the controlling entity based on publicly available information – for example, the nationality of the Middle Eastern subsidiary of a South African corporation bringing a claim under a BIT between two Middle Eastern countries is counted as “South African” under this methodology. In cases where this designation was ambiguous or impossible to make, no determination was made – therefore, this estimate can be considered to be the minimum number of emerging market/developing country claimants that appear in the sample. Using this methodology, it was found that at least 14 of the 95 arbitration

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<sup>4</sup> The survey identified the number of different types of investor claimants, but did not address how they fared after filing their cases; some participants have expressed interest in further analysis in this area.

The analysis also focused on foreign investors because generally only foreign investors have access to investor-state arbitration. The issue of the comparative treatment of foreign and domestic investors is addressed below.

<sup>5</sup> This study uses the World Bank definition of a developing country as one that appears in any of the first three categories in the World Bank 4-part typology of development. Under this typology, economies are divided according to 2010 GNI per capita, calculated using the [World Bank Atlas method](http://data.worldbank.org/about/country-classifications). The groups are: low income, USD 1,005 or less; lower middle income, USD 1,006 – USD 3,975; upper middle income, USD 3,976 – USD 12,275; and high income, USD 12,276 or more. For more information, see: <http://data.worldbank.org/about/country-classifications>.

cases were brought by investors from economies classified by the World Bank as low income, lower middle income and upper middle income.<sup>6</sup>

## **2. *Access to justice for other victims of State misconduct***

Governments that have consented to ISDS have made a unique mechanism for dispute resolution available to foreign investors to resolve claims of a state's failure to meet its international commitments, which provides monetary incentives for states to honour their treaty commitments. It is modelled upon commercial arbitration, employs party-appointed arbitrators, entails high costs and potentially large awards, and is limited to international investors.

Some commentators have raised concerns about why such an option for redress has been made available to foreign investors and not to other non-state actors aggrieved by a state's failure to meet its international commitments. Other non-state actors must rely on their home States for espousal of international claims; or they may attempt to have recourse to what is still a fairly rudimentary legal framework for international tort actions. Domestic dispute resolution systems, especially courts and administrative review mechanisms, should, in principle, provide effective redress for victims of abuse of state power. However, where these systems do not work well, claimants have little or no effective access to justice.

## **3. *Costs and the development of third party financing of investment arbitration***

High costs were identified as one of the two greatest disadvantages of international arbitration in a recent survey of in-house counsel at leading corporations. The Roundtable noted generally that: (i) costs are high and some reform efforts are underway to try to reduce them; and (ii) rules for allocating these costs among the parties are very flexible and are a source of uncertainty for both claimants and respondents.

Although information about costs is limited, it appears that legal and arbitration costs for the parties in recent ISDS cases have averaged over USD 8 million. In a recent case involving mass claims, the parties had spent almost USD 40 million in legal fees alone by the time the tribunal decided it had jurisdiction to decide the merits. The largest cost component is the fees and expenses incurred by each party for its legal counsel and experts which are estimated to average about 82% of total case costs. Arbitrator fees average about 16% of costs. Institutional costs payable to organisations that administer the arbitration and provide secretariat services – such as ICSID, the Permanent Court of Arbitration (PCA), or the Arbitration Institute of the Stockholm Chamber of Commerce (SCC) – are low in relative terms, generally amounting to about 2% of costs.

Many explanations have been offered for the high costs of ISDS. Some commentators attribute high costs to limited arbitrator availability, itself resulting in part from parties' tendency to nominate the same small group of arbitrators who allegedly take on too much work; or weak case management by arbitrators who allow the parties to run up costs before they focus on the case shortly before the merits hearing. Other explanations point to the nature and role of counsel and their approaches to litigation, attributing high costs to the increased role of large law firms that mobilise teams of lawyers using expensive litigation techniques borrowed from corporate litigation practices; the high billing rates for arbitration lawyers running to USD 1000 an hour; the substantial time spent on the selection of arbitrators including intensive research on each potential arbitrator; the proliferation of procedural, jurisdictional and discovery issues; and expanded use of high-cost party-appointed experts on a wide range of issues. Other explanations focus on: i) the nature

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<sup>6</sup> The breakdown of countries was as follows: PR China (2), Russian Federation (5), Azerbaijan (1), Turkey (2), Indonesia (1), Peru (1), South Africa (1), and Malaysia (1).



of the cases and applicable law, citing, for example, unresolved legal issues that need to be readdressed in detail in each case; ii) high damages claims, which are correlated with high tribunal costs; and iii) uncertain cost shifting rules.

Some Roundtable participants noted that the high costs of ISDS or the threat of such costs can have a dissuasive effect on States and that investors can use the spectre of high-cost ISDS litigation to bring a recalcitrant State to the negotiating table for purposes of achieving a settlement of the dispute. Similar effects may also exist for investors. It appears that a number of ISDS claims by investors have been discontinued due to the refusal or inability of the investors to pay the costs. It was recognised that high costs will likely generally play to the advantage of financially stronger parties (including third party sources of funding – see below) on either side.

Recent reforms have sought to rein in costs. Due in part to perceived problems with ISDS arbitration including high costs, there is also growing interest in dispute prevention and alternative dispute resolution (ADR) in ISDS, and UNCTAD has recently examined these issues.

Cost allocation refers to decisions by arbitrators ordering one party to pay the other party money to defray its legal and/or arbitration costs; the costs allocation becomes part of the enforceable award. The applicable rules differ depending on the arbitral rules and forum although the arbitrators generally have significant discretion. It is widely recognised that outcomes on cost shifting in ISDS cases are highly uncertain. High arbitration costs (and the generally only very partial recovery of claimed damages) mean that costs can often be a significant part of the total amounts awarded in cases.

Third party litigation funding is a new industry composed primarily of institutional investors who invest in litigation frequently in return for a percentage of any recovery on the claim. Commercial third party litigation funding has emerged and expanded rapidly in recent years in a number of national jurisdictions and in international arbitration. With regard to domestic litigation, it is subject to a wide range of approaches in national jurisdictions ranging from broad acceptance to prohibition. The high costs and potentially high damages awards characteristic of ISDS may make it an attractive market for third party funders.

The Roundtable recognised that third party funding raises a number of policy issues. It promotes access to justice by providing an additional means of funding litigation and, for some parties, the only means of funding litigation. It may affect the types of remedies or settlements that claimants and/or funders would seek and claimant incentives to exit the host country rather than work out an agreed settlement involving a continued presence. Additional issues include the possibility of arbitrators unknowingly having close relationships links with undisclosed funders and the question whether funders who finance and/or direct unsuccessful claims should be liable for costs awards and how any such liability should be enforced. A number of participants expressed interest in further examining third party funding and issues such as its possible impact on claimant incentives to exit the host country rather than work out an agreed settlement involving a continued presence.

#### ***4. The question of a level playing field between foreign and domestic investors: remedies and treaty shopping***

The Roundtable has discussed the question of the possible impact of ISDS on a level playing field between foreign and domestic investors including in particular with regard to available remedies and the issue of “treaty shopping”. In addressing the question of remedies for investors from a comparative

perspective, participants noted that advanced national administrative law systems<sup>7</sup> have many functions similar to ISDS (controlling State power, upholding the rule of law and providing remedies to regulated entities and persons for State misconduct).<sup>8</sup> Both systems cover many similar fact situations for investors (e.g. wrongful or arbitrary denial of licences, failure to accord due process, as well as expropriations and changes in regulatory or tax policies, etc).

Pecuniary remedies such as monetary compensation are dominant in investment arbitration. In contrast, advanced systems of administrative law (United Kingdom, the United States, Germany, France and Japan) rarely grant pecuniary remedies to investors. Except for cases of expropriation, advanced national systems strongly emphasise so-called "primary", "judicial review" remedies which are non-pecuniary (annulling illegal action, prohibiting or requiring specified government action, etc.); these remedies (but only these remedies) are often available in specialised proceedings. In contrast, damages remedies for investors are rare. The Roundtable noted that the legal doctrines, rules and approaches that have the effect of favouring primary remedies and making damages difficult to obtain for investors vary between the countries surveyed, but the outcome in terms of remedies is uniform in all countries surveyed. Participants have considered the reasons for the different approach to remedies between ISDS and domestic law. They have also discussed some issues and questions raised by the use of primary remedies in ISDS (in both domestic courts of the host state or international arbitration).

Foreign investors, which may generally choose between domestic fora or ISDS, have a wider range of options and available remedies against governments than do domestic investors faced with similar government action. In addition to having access to monetary damages, foreign investors can frequently go directly to international arbitration without having to resort to national courts or administrative remedies if the investor considers arbitration to be more advantageous. Some domestic investors have sought to benefit from investment treaty protections by investing through a foreign vehicle with occasional success. A number of investment agreements employ "denial of benefits" provisions to seek to limit claims on behalf of claimants with no substantial business activity in the country where they establish such a vehicle.

Roundtable participants recognised that some ISDS cases involve efforts by domestic investors to use treaty shopping to get access to investment treaty arbitration (rather than being limited to their domestic courts).<sup>9</sup> They noted that this phenomenon also raises the question of whether there is a level playing field between domestic and international investors.

Participants noted that the question of how ISDS affects the playing field between foreign and domestic investors is of increasing political and economic interest, as illustrated by the recent Australian Productivity Commission report recommending that Australia should seek to avoid accepting ISDS provisions in trade agreements that confer additional substantive or procedural rights on foreign investors over and above those already provided by the Australian legal system; the Commission argued that such

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<sup>7</sup> Administrative law is used here in a broad sense to include damages claims for economic loss against the state (which may be characterised as private law or constitutional claims) as well as judicial review, but excluding contract claims.

<sup>8</sup> See, e.g., Rudolf Dolzer, *The Impact of International Investment Treaties on Domestic Administrative Law*, 37 *NYU J. Int'l. L. & Policy* 953, 970 (2005) ("the jurisprudence of investment tribunals as a whole contains ingredients of a growing system of international administrative law for foreign investment"); *International Thunderbird Gaming Corp v. Mexico*, separate opinion of Thomas Walde, § 129 ("Investment arbitration is in substance a special form of international quasi-judicial review of governmental conduct using as a default the methods of commercial arbitration.")

<sup>9</sup> Treaty shopping under international law occurs when an investor structures an investment in order to seek to qualify for protections conferred by particular investment treaties. The practice typically involves establishing an intermediate corporate entity in a State that is party to a targeted treaty so that the entity can be the claimant.

preferences, if they exist, would distort investment flows. The question of whether investment treaties accord greater substantive and procedural rights to foreign investors has been an important part of the political debate in the U.S. with respect to its treaties in recent years.

Participants recognised that the unique access of foreign investors to arbitration against states for international claims reflected in ISDS is due in part to the historical circumstances surrounding the development of the international investment disputes resolution system. The issue of the impact of the system on a level playing field is an emerging issue in some countries. In giving the issue some initial consideration, some participants were quite comfortable with providing additional rights to foreign investors. Some participants suggested that the risk of bias against foreign investors in domestic courts in the host country is a basis for granting them at least some special substantive and procedural rights compared with domestic investors. Participants expressed differing views about the prevalence of bias against foreign investors in national legal systems and the appropriate working assumptions in this regard. In addition, the need to avoid “gunboat diplomacy” – that is, the threat of or actual recourse to force in order to settle investment disputes – was also cited by some as a rationale for ISDS protection of foreign investment. A more competitive market for foreign as opposed to domestic investment was also identified as a rationale for different treatment, and the voluntary nature of countries’ decisions to enter into investment treaties was underlined. Another participant suggested that comparison of the treatment is problematic because it involves different systems of law, one international and the other domestic. For one participant, the issue was not of great concern for their country because its treaties were essentially focused on protecting domestic investors who were investing abroad.

Other participants considered that the impact of the system on the relative competitiveness of domestic and foreign investors is an important issue and that it raises concerns. Concerns included the impact of preferential treatment for some investors on economic efficiency – it was suggested that granting additional substantive and procedural rights to foreign over domestic investors disadvantages domestic relative to foreign investment and thereby distorts investment flows. One country questioned whether there is any valid rationale for the additional protections offered to foreign investors. Another stated that the question of differential treatment raised issues under its constitution. It was also suggested that in order to ensure the sustainability of the benefits of the system in a context of heightened attention from both domestic companies and the general public, it is important for countries to review their treaty language to ensure that it is not unduly easy for foreign investors to challenge public policies successfully. Other countries have taken the position that adaptations to their investment treaties ensure that, while there are differences, the treaties in fact do not provide greater substantive rights over those afforded by national law.

Participants noted that business views also differed in this area. One business organisation from a country with both substantial inflows and outflows of capital suggested that the contrast between ISDS and domestic remedies should be further studied. It noted that there was support in its national business community for bringing its domestic law property rights protection into line with ISDS. Another business organisation representing a broader group of organisations suggested that the difference between ISDS remedies and domestic remedies did not raise any issue.

## **5. *Enforcement of ISDS awards***

State compliance with ISDS arbitration awards was, until recently, considered to have been good. More recently, some problems have arisen with compliance with both ICSID and non-ICSID awards. A number of Roundtable participants expressed concerns about the issue of enforcement, as have business groups and arbitration practitioners.

Participants noted that, where an investor is faced with a failure to honour an award, it has several options including (i) seeking to enforce the award in one or more enforcement jurisdictions; (ii) seeking diplomatic protection from its home State; (iii) complaining to the arbitral authority primarily in ICSID cases; (iv) selling the award at a discount in a secondary market if one is available; and (v) settling with the respondent State to avoid the need for enforcement proceedings, frequently at a discount. They reviewed the legal and practical regimes governing these options and their effectiveness in practice. Obstacles to enforcement, such as state immunity, have also been considered.

While investment agreements typically do not impose obligations on investors which can be enforced by States through international arbitration, tribunals can order investors to reimburse States for some or all of their legal costs under certain circumstances. Awards of costs in favour of States have not been complied with by investors in some cases. One State has reported that investors have not voluntarily complied with such costs awards in any of its cases and enforcement efforts have been required in each case. States have in some cases sought to obtain security for costs in advance, including where the investor appears to be a special-purpose vehicle with few apparent assets, but apparently without success to date. A number of countries expressed concerns about these practical difficulties in recovery against claimants and/or third party funders of claimants, and their consequences.

#### **6. *Impact of ISDS on host countries' economies and institutions***

FOI discussions considered in some detail the development impacts of ISDS, including its impact on domestic institutions of public governance. There was support among FOI participants for the view that careful attention needs to be paid to ensuring that ISDS plays a positive role in the development domestic institutions, but there were differences of view as to the nature and importance of ISDS' influence on domestic institutions.

ISDS may have positive effects on domestic institutions of governance. ISDS gives foreign investors the option of side-stepping what may be poorly functioning or biased judicial and regulatory processes. In countries with very serious institutional shortcomings, domestic dispute resolution mechanisms might often, in practice, also include recourse to violence, improper political lobbying and corruption. It is at least a possibility that the availability of ISDS allows international investors to side step these mechanisms and to use instead more orderly forms of dispute resolution. In addition, the monetary remedies for successful claimants under ISDS may create incentives to improve domestic institutions. If States respond to these monetary incentives, then, in principle, this commitment should be followed up with concrete measures to improve domestic judicial and regulatory processes. At the same time, it is noteworthy that, as noted above, advanced administrative systems do not use monetary remedies in this context as a significant part of their efforts to improve the quality of administration.

On the other hand, the availability of ISDS as a supra-national dispute resolution option could lower incentives for both host countries and international investors (who are often important political actors in host countries) to work to improve domestic dispute resolution and regulatory institutions. ISDS makes it easier for host governments to attract international investment without having to put in place effective domestic government and judicial procedures. Likewise, ISDS could result in reduced incentives for international investors – who may be important political actors in the host country – to press for improved domestic systems of investor-state dispute resolution, given the availability of ISDS. The argument is, in a nutshell, that the political economy of ISDS may weaken pressures for reform of domestic dispute resolution procedures and hinder the development of legal expertise on foreign investment matters at the domestic level.

Viewed as a whole, the discussions revealed considerable disagreement and uncertainty among FOI participants as to whether ISDS and related investment treaties are serving development needs. For

example, FOI participants were asked in a questionnaire whether investment treaties help countries attract additional foreign investment. Of the 21 FOI participants that responded to this question about whether investment treaties had helped countries attract foreign investment, 16 participants stated that they were neutral or didn't know, three agreed with the proposition and two disagreed. One country noted, referring to the economics literature, that "available evidence does not suggest that ISDS provisions have any significant impact on investment flows".

Another development impact of ISDS could arise if it facilitates their effective integration into the global economy – it could do this by providing fair ground rules that will encourage them to adopt policies more confidently that "pave the way for further integration" (to quote from a developing country's questionnaire response). In order to explore this question more deeply, FOI participants were also asked about their views on whether respondent states are able to defend themselves at reasonable cost against unreasonable claims and are in a position to manage the legal risks they assume via their investment treaty commitments).

Seventeen countries that responded to this question agreed that this is a "key value" for inter-governmental discussions of ISDS. Two developing countries expressed concerns about what, in their view, are frivolous claims brought under ISDS and suggested the issue as a subject for future discussions in the FOI Roundtable. A few countries have made modifications in their treaties to explicitly provide for expedited procedures for resolving claims deemed by the state to be frivolous in addition to other disincentives like awards of costs. A developed country supported efforts to raise the capacity of countries to abide by their investment treaty obligations and noted the usefulness in this context of the *Policy Framework for Investment*.

## **7. *Light but growing regulation of ISDS in bilateral investment treaties***

The OECD Survey of ISDS provisions in 1660 investment treaties documents a "light approach" to the regulation of ISDS adopted by most States in most treaties. Here, "light approach" refers to one in which treaties are often either silent or contain little or only sporadic guidance on important aspects of the conduct of ISDS. In practice, this may mean that key decisions regarding the conduct of the proceedings are largely left to the disputing parties or to arbitral panels.

The studies of treaties show that some important issues are either not addressed at all or are only lightly or sporadically covered. More specifically, the survey of ISDS provisions in treaties shows:

- ***Most treaties address only a few aspects of ISDS.*** Although ISDS provisions are a very common feature of investment treaties, they are also frequently very general. Most of the treaties deal with a limited number of ISDS issues. Seventeen issue categories were identified in the full treaty sample (e.g. remedies, cost allocation, coordination of international arbitration with domestic proceedings). On average, fewer than three of the 17 issues were addressed by bilateral treaties in the sample. It is extremely rare for a treaty to deal with a comprehensive range of ISDS issues, but recent treaty practice tends to cover more ISDS issues and a few countries now include ISDS provisions that are both comprehensive and detailed.
- ***Investment treaties frequently provide for arbitration under the ICSID arbitration rules or commercial arbitration rules; these rules address some but not all of the lightly-regulated ISDS issues in investment treaties.*** Arbitration rules generally provide for solutions to many procedural issues and/or by paying extensive deference to party autonomy, where the parties can agree, and to arbitrator discretion. However, other lightly-regulated issues in treaties are not addressed by arbitration rules systems. For example, the survey notes that only 7% of bilateral investment treaties in the sample that provide for ISDS establish time limits for the bringing of

investor claims. The issue is not addressed in ICSID, UNCITRAL or in other commercial arbitration rules. In addition, some issues that play a major role in many domestic law and other international law systems that evaluate or judge government action, such as the administrative law concept of “standards of review” of government action, are not addressed at all in investment treaties, ICSID or in commercial arbitration rules. The question of how much deference, if any, the tribunal should accord to states in making decisions for the public good, is not addressed in treaties or rules.

- ***Treaties that permit investors to choose between bringing claims in local courts or ISDS and to choose between arbitration options can give investors considerable influence over significant issues.*** 56% of the sample bilateral treaties offer investors a unilateral choice between at least two arbitration fora (most frequently ICSID and UNCITRAL). Although the State has consented to investor choice among alternatives in their treaty, Large variations in applicable rules and the light regulatory approach embodied in most ISDS provisions in investment treaties, combine to give investors significant scope for choosing or influencing the rules or practices governing a variety of important issues (e.g. availability of diplomatic protection, transparency of proceedings and awards, allocation of legal costs).

The relatively less detailed ISDS procedures in treaties contrast both with many domestic dispute resolution systems for damages claims against governments which are frequently detailed. It also contrasts with the detailed regulation of WTO procedures.

The policy rationale for less detailed procedural rules in ISDS appears to have been rarely addressed by states. Within the OECD context, some governments have stated that they are comfortable with less detailed arbitration rules; they highlight their trust in parties to ISDS cases to choose competent and objective arbitrators that will correctly interpret applicable law and make appropriate decisions on procedural matters. Others have noted that they have modified their recent treaties to include more detailed supplementary rules with a view to exercising tighter control on certain aspects of procedure. This is borne out by the treaty survey, which documents a clear trend toward more closely regulating ISDS procedures, with more recent provisions containing more detail than provisions in older treaties.

## **8. *Characteristics, selection and regulation of arbitrators***

As the Roundtable recently stated in its April 2011 communication on Harnessing Freedom of Investment for Green Growth, “[i]t is essential to ensure the integrity and competence of investment arbitrators”. In its discussion about ISDS, the Roundtable has reaffirmed its view that arbitrators are of vital importance.

### **a. *Characteristics of investment arbitrators***

Recent research has sought to identify key characteristics of the population of ISDS arbitrators. Statistics are generally unavailable for non-ICSID arbitration due to non-public cases. Although parties to the dispute generally participate in choosing the arbitrators, some consider that the characteristics of investment arbitrators as a group may influence general trends of interpretation in investment law in ways which affect the legitimacy of ISDS and consistency of awards.

Investment arbitrators are typically drawn from elite members of the legal profession including senior lawyers, professors and former judges. Lawyers in private practice dominate the field, constituting over 60% of ICSID investment arbitrators according to a recent study. About one third of investment arbitrators are full-time academics. Approximately 40% are specialists in public international law (including some lawyers in private practice). Government backgrounds are less represented, although a number of

arbitrators have served as domestic or international judges. It does not appear that government ISDS defence counsel or government investment treaty negotiators have been selected as arbitrators for cases involving other States, in contrast to WTO practice. Few arbitrators have public (administrative or constitutional) law experience.

ICSID investment arbitrators mostly originate from Europe and North America, and approximately 75% come from OECD countries. The geographic origins of arbitrators contrast with the geographic distribution of respondent States in ICSID cases. The lack of gender balance amongst investment arbitrators as a group is also striking: 95 percent of ICSID arbitrators have been male. Roundtable participants noted that some efforts are underway, notably at ICSID, to try to address these imbalances. States have a role to play in this regard including in providing suitable nominees to the ICSID Panel of Arbitrators.

*b. Selection of arbitrators*

Arbitrators must be selected for each case either by the parties or a by a third-party institution, in contrast to national judges who are assigned to cases without party input. The Roundtable reviewed the process for naming arbitrators in ICSID and UNCITRAL cases. Both the ICSID and UNCITRAL rules provide for each party selecting one arbitrator unless the parties agree on another method. There are few limits on parties' choice of arbitrator as applicable criteria are couched in general terms.

Where the parties select the two co-arbitrators, each party generally tries to identify candidates who will be sympathetic to their case and who have the right character, reputation and persuasiveness to convince the other two arbitrators (and in particular the likely presiding arbitrator) of the validity of their case. A number of Roundtable participants emphasised that three-arbitrator panels should produce a balance of perspectives on the issues raised in an ISDS case. In these panels, the Chair plays a critical role. Rules for choosing the Chair vary according to the rules system (ICSID, UNCITRAL and ICC). Generally, the parties or the co-arbitrators either agree on a Chair or the responsibility for appointing the Chair reverts to an appointing authority. Regardless of the exact rule used, the appointing authority is extremely important in ISDS because the parties or the arbitrators, as they try to reach agreement on the Chair, will be negotiating "in the shadow" of the expected appointment by an appointing authority; that is, they know that if they fail to reach agreement on the Chair, the decision will revert to the appointing authority. Because each set of arbitration rules identifies a specific appointing authority (or provides a method to identify it), the investor can influence or, in some cases, choose the identity of the appointing authority if the investor can choose the applicable arbitration rules, as is frequently the case. In some cases, treaties eliminate this power by, for example, defining a single appointing authority regardless of the arbitration rules selected by the investor.

Roundtable participants noted that the possible consequences of the repeated interactions of arbitrators and their multiple roles as arbitrator, legal counsel and expert have been the subject of active debate in recent years. The concerns expressed by some commentators in this regard include perceived risks that (i) "mutual back-scratching" (between the arbitrators or between arbitrators and counsel) could lead to cases being decided on grounds other than the merits; (ii) party appointments could allegedly encourage unhealthy compromise solutions, as the presiding arbitrator seeks to achieve a unanimous decision that will be seen as more legitimate and improve his /her reputation as an arbitrator; (iii) suggestions by some that a significant number of party-appointed arbitrators do not in fact act as neutrals as required under most modern arbitration rules; and (iv) misconduct in arbitration is allegedly more likely to arise with party-appointed arbitrators than with more institutional systems.

Other commentators disagree. They and many practitioners strongly support the arbitration system and party selection of arbitrators. Commentators and practitioners supporting the system emphasise the

importance of the parties being able to choose an arbitrator as a core attraction of arbitration. Each tribunal is selected by the parties to the dispute, with the result that both parties can ensure that the tribunal is both unbiased and expert in international investment law. The market for arbitrator selection is seen as operating powerfully to maintain and improve standards. They further contend that the vast majority of party-appointed arbitrators act as neutrals as required and misconduct relating to party-appointed arbitrators is rare. The alternatives to party-selection, and in particular institutional selection of arbitrators, are criticized as in some cases worse than the perceived problem. Some experts have defended party-appointed arbitrators for commercial arbitration, but find the criticism more pertinent with regard to ISDS.

The Roundtable also heard an expert describe what she perceived as a problem of unequal information or "information asymmetries" between different parties with regard to arbitrator selection in ISDS. From this perspective, information about potential arbitrators is seen as a highly valuable commodity which constitutes proprietary information for law firms and arbitration institutions. This gives rise to what has been described as a "grey market" in arbitrator information to which parties frequently have unequal access. Senior partners in law firms, for example, will typically have easier and better access than outsiders to the system to informal information exchange with colleagues with experience with particular potential arbitrators, including in non-public cases. Some participants noted that this problem could largely be addressed by hiring top lawyers with arbitration experience although it was noted this was an expensive solution.

*c. Arbitrator incentives*

As noted above in the section on costs, arbitrators and arbitration counsel are very highly paid. It was suggested during the Roundtable discussions that arbitrators have a structural conflict of interest in deciding on whether they have jurisdiction to hear each ISDS dispute because they are in effect deciding whether they will continue to be active (and be paid) for substantial additional work on the case in question. In addition to its economic impact in the case at hand, expansive rulings on jurisdiction may contribute to expanding the scope of ISDS arbitral business in the future. NGOs have recently sought to highlight the alleged impact of economic incentives on the outcomes in particular cases by publicly writing to the arbitrators to request information about additional arbitrator fees expected to be earned by the arbitrators if they decide they have jurisdiction to continue the case until a full hearing on the merits.

A second possible economic incentive for arbitrators that has been identified in Roundtable discussions is a broader interest in preserving a lucrative ISDS industry. It was noted that this might heighten arbitrators' sensitivity to potential ethical issues. In contrast, It was also noted that some critics of the ISDS system have contended that because only investors bring claims, the interest in system-preservation (and competition between arbitrators and arbitral institutions for investor business) leads to undue attention to investor interests.

While a number of potential economic incentives can be identified, it is difficult to determine their impact in practice. Many arbitration commentators consider that arbitrators' strong interest in their reputation for good and impartial decision-making (and effective case management) trump these economic incentives to the extent they exist. In some cases, it appears that perceptions differ between the arbitration bar and outside observers with the latter being more critical of current practices without being able to precisely identify the scope of actual problems. However, because investment law itself is based on expectations about the power of economic incentives to affect behaviour – the risk reduction provided by investment treaties is expected to encourage investment by lowering its expected cost – the possible impact of economic incentives on arbitrators should be considered.



*d. Regulation of arbitrators*

International arbitrators are regulated by various rules and standards, which are found in international treaties, domestic laws and arbitral rules. In general, these sources of law do not provide detailed rules about arbitrators. The limited scope of arbitral regulation has led to the development of soft law complements by the commercial arbitration industry, such as the 2004 “IBA Guidelines on Conflicts of Interest in International Arbitration” (IBA Guidelines) or the AAA/ABA Code of Ethics for Arbitrators in Commercial Disputes, as revised in 2004. Both the IBA Guidelines and the AAA/ABA Code were developed primarily for commercial disputes, but their drafters consider that they also relevant to ISDS cases and the IBA Guidelines in particular have been regularly cited in ISDS cases. Some commentators have underlined that some serious concerns about ISDS arbitration are not addressed by existing ethical rules or standards.

Schematically described, ISDS’ approach to choice of arbitrators relies on the self-interest of the parties – investor and responding state – as a basis for obtaining competent and unbiased arbitration panels. Two issues for ISDS arbitrator regulation have attracted particular attention: (i) impartiality and independence; and (ii) avoiding issue conflicts that can arise from the multiple roles played by legal professionals active in arbitration (where they serve as arbitrators, legal counsel and experts in different cases that involve the same issues).

In their discussions of this matter, FOI delegates considered the repeated interaction of counsel, arbitrators and experts within the arbitration context and their multiple roles as arbitrator, legal counsel and expert, including concurrently in different ISDS cases. It appears that over 50% of ISDS arbitrators have acted as counsel for investors in other ISDS cases while it has been estimated about 10% of ISDS arbitrators have acted as counsel for States in other cases. The practical exclusion of government investment law specialists from the arbitral pool, as noted above, may exacerbate the apparent tendency for ISDS arbitrators’ work as counsel in other cases to be significantly more frequently for investors than for States.

In addition to requesting additional analysis with regard to questions of independence and impartiality or arbitrators, delegates raised a number of questions regarding the selection and regulation of arbitrators including whether there are problems with the professionalism and preparation of arbitrators and whether arbitrators from a commercial background have experience with or sensitivity to the public law issues in ISDS. It was suggested that it is important to foster arbitrators who have the requisite background for ISDS.

**9. Consistency of ISDS decisions**

The issue of consistency involves, broadly, the question of whether adjudicatory bodies are resolving the same or similar questions in similar fashion in successive cases. In recent years, a debate has emerged about alleged inconsistency in ISDS -- whether this is a problem and, if so, what should be done about it.

Consistency is an important issue for several reasons. First, one of the main purposes of international rules on trade and investment is to meet the needs of traders and investors for security and predictability. Dispute settlement that generates consistent interpretations helps to meet this need. Second, a reasonable degree of consistency contributes to the legitimacy and perceived fairness of the dispute settlement system. Third, consistency can increase the cost-effectiveness of dispute settlement for parties to disputes and potential disputes. However, consistency, in a context where individual treaties have in some cases consciously been modified by the parties with the intent of differing from the provisions of other treaties on similar issues, is a complex issue. Consistency is not an absolute requirement of effective systems of

dispute settlement – for example, a certain tolerance for inconsistency might be appropriate as dispute settlement mechanisms work out their approaches to unresolved legal issues.

Assessing the degree of consistency of decisions is challenging in a decentralised system like ISDS, which, as noted earlier, is based on approximately 3000 different treaties. These treaties have many similarities but also many differences, both obvious and in detail. While two cases may both address a particular issue, such a fair and equitable treatment provision, they may be addressing different treaties with significantly different wording of the relevant standards. In some cases the different drafting may be intentional to differentiate the intent of the parties from that of another treaty or from how a treaty may have previously been interpreted in arbitration.

The Roundtable's discussion of consistency revealed a range of views. A substantial number of participants described their serious concerns about what were, in their view, inconsistencies in ISDS decisions. It was suggested that the institutional structure of ISDS with ad hoc panels composed of different arbitrators for each case is not designed to achieve consistency, had not done so and was not likely to do so in the foreseeable future. These participants stressed the costs and risks for investors and for states, which, as a result of perceived inconsistencies, could not be sure how their treaties would be read. This was viewed as a particularly serious concern as much of the subject matter of investor-state arbitration touches on important public interest issues. Some delegates suggested that the issue of consistency should be considered in the broader context of addressing the state of substantive investment law, with its numerous variations of legal language contained in treaties. Another participant contrasted what he considered to be the higher degree of consistency in the NAFTA system, due notably to active State interest and participation in the ongoing interpretation of the treaty, with more serious situation regarding consistency in ISDS generally.

Reacting to these concerns, other delegates stressed that problems should not be exaggerated. One noted that he was from a country that has not yet been a respondent, but suggested that FOI participants should have more trust in a system that has shown its value and is fundamentally sound. It was also suggested that the interest of the arbitration bar in preserving the ISDS system might play a positive role in helping the system move toward consistency.

FOI participants noted that a wide variety of tools exist for governments to communicate their views about how treaties should be interpreted, such as joint interpretations by the states parties to investment treaties, interventions in ongoing cases on issues of treaty interpretation by non-disputing state parties or, possibly at a broader international level, restatement-type documents. These could help arbitral panels and other users to understand better States' intent in crafting various elements of investment treaties, thereby helping to eliminate inconsistencies. A number of participants expressed interest in further exploration of these tools.

#### **D. Next steps**

The FOI Roundtable's wide representation of countries makes it an ideal forum for dialogue on international investment law. Recent inter-governmental discussions of ISDS in the Roundtable have attracted significant attention, including in the public consultation. Following its decision to seek public input on ISDS, the FOI Roundtable will pursue its work on ISDS by considering the question of the consistency of ISDS decisions and the role of States in the interpretation of investment treaties in more depth; examining further how investor-state arbitration fits into broader framework of the resolution of investor-state disputes and the effects of investor-state arbitration; and giving preliminary consideration to the general question of how a changed global environment may affect views about optimal investment treaties and investment policy.





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