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Small Economies and Models of Investor-State Dispute Settlement: Interests and Constraints in the Shadow of Reform

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Abbreviations

BIT - Bilateral Investment Treaty

CETA – EU-Canada Comprehensive Economic and Trade Agreement

CIETAC – China International Economic and Trade Arbitration Commission

CJEU - Court of Justice of the European Union

EU – European Union

EUSFTA – European Union-Singapore Free Trade Agreement

EUVFTA – European Union-Vietnam Free Trade Agreement

FDI – Foreign Direct Investment

ICC – International Chamber of Commerce

ICS – Investment Court System

ICSID – International Centre for Settlement of Investment Disputes

IACHR – Inter American Court of Human Rights

IIA – International Investment Agreement

ISDS – Investor-State Dispute Settlement

ITLOS – International Tribunal for the Law of the Sea

LCIA – London Court of International Arbitration

NAFTA – North American Free Trade Agreement

MIC - Multilateral Investment Court

MNC – Multinational Corporation

PCA – Permanent Court of Arbitration

PRC – People's Republic of China

SIAC – Singapore International Arbitration Centre

TEU - Treaty on European Union

TFEU - Treaty on the Functioning of the European Union

TPF – Third-Party Funding

UNCTAD – United Nations Conference on Trade and Development

UNCITRAL – United Nations Commission on International Trade Law

WG III – UNCITRAL Working Group III

WTO – World Trade Organization

Executive Summary

Under the current system of Investor-State Dispute Settlement (ISDS), many International Investment Agreements (IIAs) allow foreign investors to file arbitration claims against states. Under these proceedings, foreign natural or legal persons can file a direct claim against a state within whose territory they operate for the violation of certain standards of treatment, as stipulated in the applicable instrument.

ISDS, which is based mainly on ad hoc international arbitration, has come under increasing scrutiny and criticism over the past decade due to, among other things, its high costs, lack of transparency, concerns about the independence and impartiality of the adjudicators of these claims and their qualifications, and limited grounds and applications of review mechanisms. As a result, many states and relevant stake-holders have proposed, adopted, or intend to implement in the future, various changes to the regime, including reforms on a broad scale.

This memorandum seeks to identify, analyze and assess the range of options available to small economies facing the current wave of changes in the investment dispute settlement system. The memorandum provides a general characterization of the constraints of small economies, and distinguishes between states in the EU, states considering accession to the EU and others. The memorandum identifies five possible models, and then offers recommendations that consider the specific characteristics and needs of small economies. A summary of the key points of the paper is provided as follows.

The five models for investment dispute resolution examined are: Model A - the existing ISDS arbitration system; Model B - replacement of arbitration by an Investor Court System (ICS); Model C - the establishment of a Multilateral Investment Court (MIC); Model D -state to statedispute resolution; and Model E - domestic regulation. Notably, these models are not necessarily mutually exclusive, but will be dealt with separately.

The models are all examined in the light of five parameters that are important for a system of ISDS, in particular for small economies: (1) transparency of the system and its accessibility to states and the public, which are important to mitigate the disadvantage of small economies due to lack of resources; (2) Consistency of the decisions of the bodies settling disputes; (3) The cost and

duration of proceedings. (4) The extent to which adjudicators are independent and bound by unified ethical standards. (5) The existence of mechanisms for reviewing decisions.

Considering more specific categories of states, EU Member States are currently required to terminate their intra-EU BITs and adopt EU standards. Regarding extra-EU BITs of Member States, these may require amendment (or termination), if they include ISDS provisions that contradict EU law. Thus, many EU Member State BITs are currently facing renegotiation, making EU proposals for reform (primarily the ICS and prospective MIC) of key importance. This is especially true with respect to small economies considering negotiating a BIT or IIA with the EU.

Small economies in the special situation of considering accession to the EU, are facing the dilemma of whether to terminate or renegotiate their current BITs (both with EU Members States and with others), and to apply the standards of EU law and policy, or to maintain their own policies. While adoption of and adherence to EU ISDS policy may entail significant costs, requiring the state to renegotiate, terminate or adopt certain new provisions, it would be necessary for future accession.

This memorandum examines the different models and makes observations and recommendations regarding the needs of small economies with respect to recent developments, with the following conclusions and recommendations.

The problems with **Model A(the current ISDS system)** are generally already known, making the status quo option the one with the lowest uncertainty regarding legal and functional implications. It is, however, in the interest of small economies to adapt to the current system through specific changes (using regional cooperation or joint interpretive statements), such as the inclusion of exhaustion of domestic remedies requirements. Small economies should be particularly selective and cautious in signing and ratifying new BITs/IIAs with ISDS, both in terms of partners and in terms of content.

There are also advantages to consider within the other Models:

Model B (ICS), in theory, this is a greatly improved Model of ISDS. However, it is still developing, and its benefits are yet to be proven. In addition, Model B offers an incentive for EU accession, but is probably not directly relevant for small economies not within the EU or without

an IIA with the EU. This model might be more relevant to a regional bloc, or a regional economic union, like the EU.

Model C (MIC), is currently a hypothetical model that is therefore difficult to effectively evaluate. Therefore,we recommend that small economies wait until this model develops, before adapting their ISDS policies thereto.

Model D (state to state dispute resolution) will require renegotiation of existing agreements and is therefore not advantageous for a state seeking EU accession. The mechanism is also impacted by political considerations, potentially influencing legitimacy amongst other states. However, it might be beneficial as states are less likely to challenge certain types of regulatory measures of other states, in comparison to investors.

Model E(The use of domestic regulation) could be advantageous for a small economy as it has certain benefits (e.g., domestic courts will be more familiar domestic issues and needs; ISDS expenses would be reduced). Even so, this system has only been adopted by non-small economies, like South Africa. Because of that it is uncertain what would be the implications of adoption of this model bysmall economies, in terms of investor confidence, for example.

As for specific points relating to EU candidate states, this memorandum finds that it will be beneficial for a small economy that is seeking EU accession, to harmonize their ISDS mechanism with EU investment protection policy. In order to do so, it is recommended that they chose a model along the lines of Model A, or, if possible, Model B, as they are most similar to the EU agenda.

More specific recommendations: If possible, small economies should add exhaustion of domestic measures as a condition for the initiation of ISDS.Small economies, where possible, should consider forming or joining regional or sub-regional economic alliances through which preferred ISDS methods and IIAs can be promoted.

1. Introduction – ISDS reform from the perspective of small economies

The existing regime of international investment law, and particularly of Investor-State Dispute Settlement (ISDS), has attracted significant criticism from states, international organizations, academics and the general public,*inter alia* due to its alleged lack of transparency, its politicization and lack of judicial independence, its lack of consistency and the high costs of proceedings.[1] As a result, a number of parallel attempts to change and improve the system are underway. Current trends may result in significant changes, possibly with genuine reform in some dimensions.

In several respects, the European Union (EU)has taken a central role in the attempts to reform ISDS. In April 2018, the Court of Justice of the EU (CJEU)'s decision in *Achmea*,[2] determined that the ISDS provisions in a Bilateral Investment Treaty (BIT) between two EU Member States (an 'intra-EU BIT') are incompatible with the EU legal system, emphasizing the supremacy of EU law. This decision is likely, and already has had, far-reaching implications not only for ISDS provisions in existing and future BITs, but for the entire system of ISDS in the EU and beyond. Regardless of the *Achmea*decision, the EU has been actively proposing the establishment of a more judicialized Investment Court System (ICS), already evident in some of its newer agreements, and ultimately a more centralized and institutionalized Multilateral Investment Court (MIC), instead of the currently fragmented system of ad hoc arbitration. Indeed, in March 2018, the Council of the EU adopted negotiation directives for a MIC.[3]If the MIC idea is adopted in practice, it will significantly alter ISDS. In parallel, non-EU ISDS reform initiatives are evident, both in international organizations such as UNCITRAL and ICSID,[4] and in the emerging treaty practice of various states. These initiatives aim at curing some of the problems in ISDS, through amendments to the existing system or the creation of new mechanisms.

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[1] *Possible Reform of Investor-State Dispute Settlement (ISDS),* Report no. A/CN.9/WG.III/WP.149, United Nations Commission on International Trade Law Working Group III (Investor-State Dispute Settlement Reform) Thirty-sixth Session, 5 September 2018 [Henceforth: *WG III, September 2018*].

[2] Slovak Republic v Achmea B.V. (CJEU April 24, 2018), Official Journal of the European Union C-284/16. [Henceforth: *Achmea*] (Judgement by the CJEU, ruling on the supremacy of European Law with respect to arbitration between a Dutch investor and the Slovak Republic).

[3] EU Council, 12981/17,"Negotiating directives for a Convention establishing a multilateral court for the settlement of investment disputes", March 20, 2018, http://data.consilium.europa.eu/doc/document/ST-12981-2017-ADD-1-DCL-1/en/pdf.

[4] The United Nations Commission on International Trade Law (UNCITRAL) and the International Centre for Settlement of Investment Disputes (ICSID) are the primary institutions through which investment arbitration take place as set out in the relevant treaty, under the rules of ICSID or through "ad hoc" arbitration under the UNCITRAL Rules.

In this memorandum, we aim at identifying some of the particular interests and constraints of small economies with respect to ISDS reform, with the generalized assumption that small economies are more likely to be affected than larger, stronger economies. As explained below, among other things, small economies may be more vulnerable to ISDS and its impacts, in particular, concomitant legal and economic pressure by Multinational Corporations (MNCs), and throughprocesses or decisions that restrict their regulatory space, i.e., their freedom to regulate public policy areas in ways that conform to their own publicly acknowledged principles. Small economies are also especially vulnerable because of capacity constraints, and the high costs of time-consuming legal proceedings outside of their domestic legal and constitutional system.

In **Chapter 2**, we discuss the existing ISDS system and various developments and trends in emerging policies of states and international organizations, and especially the EU. Next, in **Chapter 3**, we discuss five potential future models of ISDS (including the continuation of the current regime).Then, **Chapter 4** describes the characteristics of small economies. In **Chapter 5**, we overlay the characteristics of small economies with the parameters of the five models in order to understand the interests of small economies with respect to ISDS, and to examine how they are likely to be impacted by changes in ISDS. Finally, in **Chapter 6**, we make recommendations regarding preferred ISDS models for small economies, based on the analysis in the previous chapters.

2. The ISDS system: An overview of current issues and reform trends

This chapter provides a brief background of the existing ISDS system and a review of its current problems.It will then discuss global trends with respect to ISDS, including what particular states have beenproposing or advancing, especially the overallISDS reform that is arguably being led by the EU throughits ISDS agenda and the suggested ICS included in recent extra-EU agreements and the MIC model.[5]Some examples of policy change will be presented, including the idea of creating a MIC and the role of the CJEU in the *Achmea* case (with respect to intra-EU BITs) and in Opinion 1/17[6] (with respect to ISDS in extra-EU IIAs). Multilateral reform initiatives will be presented, focusing on reforms and adjustments that are under discussion in UNCITRAL WGIII. The survey is not intended to be comprehensive, but to provide greater context for the analysis that follows.

2.1. The existing ISDS system and its problems

Under the existing system of Investor-State Dispute Settlement (ISDS), which operates in a web of thousands of BITs/IIAs, foreign investors may under certain jurisdictional and substantive circumstances file direct claims against host states for violations of specified standards of treatment, such as rules on direct or indirect expropriation, national treatment, or fair and equal treatment. These claims are subject to international arbitration conducted under agreed rules, such as those of ICSID or UNCITRAL.

The ISDS system,which is based mainly on ad hoc international arbitration, has come under increased scrutiny and criticism over the past decade. This has been a reflection of the concerns regarding regulatory space,and among other things, the system's high costs, its limited transparency, questions regarding the independence and impartiality of the adjudicators of these claims and their qualifications, and the limited grounds and applications of review mechanisms. These problems exist alongside the various benefits that parties may have thought that these agreements could bring, such as increased investment and economic development.

[5] It is worth clarifying at this early stage of the memorandum the main differences between the ICS and MIC models of ISDS. Both are EU initiatives; the ICS is the establishment of court-like investment tribunals per IIA, as a judicial alternative to the ad hoc arbitration system, including pre-appointed adjudicators and rules of ethics; the MIC is a longer term vision entailing the establishment of a standing international tribunal that would adjudicate investor-state disputes relating to any IIA that designated it for this purpose.

[6] CJEU, *Opinion 1/17 of 30 April 2019*, ECLI:EU:C:2019:341 [Henceforth: *Opinion 1/17*].

2.2.Global reform trends: termination, renegotiation and domestic reform

As a result of the problems above, several trends in the ISDS system are underway. ISDS reform is emerging in several different and concurrent levels of state policy and practice, and also in institutional initiatives.Indeed, in the last few years ISDS has drawn strong 'backlash',[7] due to both changes in perspective and in response to claims in disputes such as *Philip Morris v. Uruguay*,[8]*Piero Foresti, Laura de Carli & Others v. The Republic of South Africa*[9],*Occidental v. Ecuador*[10] and others. In these cases, states were sued by foreign investors, and were in danger, or had to pay, enormous amounts of money (for example, 2.3 billion USD in the Ecuador case, "59% of the country's 2012 annual budget for education and 135% of the country's annual healthcare budget")[11] to the foreign investors. This has led to trends and changes that we will review below.

The following illustration marks a few of the states leading the process of backlash against ISDS, showing a few of those that have terminated BITs over the past years.[12]

[7] Tim R. Samples, "Winning and Losing in Investor–State Dispute Settlement," *American Business Law Journal* 56, (1), 2019, 115-75. https://onlinelibrary.wiley.com/doi/full/10.1111/ablj.12136; Tarek Rahman, "Backlash against Investor-state Dispute Settlement Mechanism." *Bilaterals.org*, 12 June 2019, https://www.bilaterals.org/?backlash-against-investor-state&lang=en.; Kavaljit Singh "ISDS Is Unsuited to Meet Today's Global Challenges, Financial Times Website," *Financial Times*, 8 May 2017. https://www.ft.com/content/ed08cd0c-2fea-11e7-9555-23ef563ecf9a; "Still Not Loving ISDS: 10 Reasons to Oppose Investors' Super-rights in EU Trade Deals," *Corporate Europe*, 16 April 2014, https://corporateeurope.org/en/international-trade/2014/04/still-not-loving-isds-10-reasons-oppose-investors-super-rights-eu-trade.

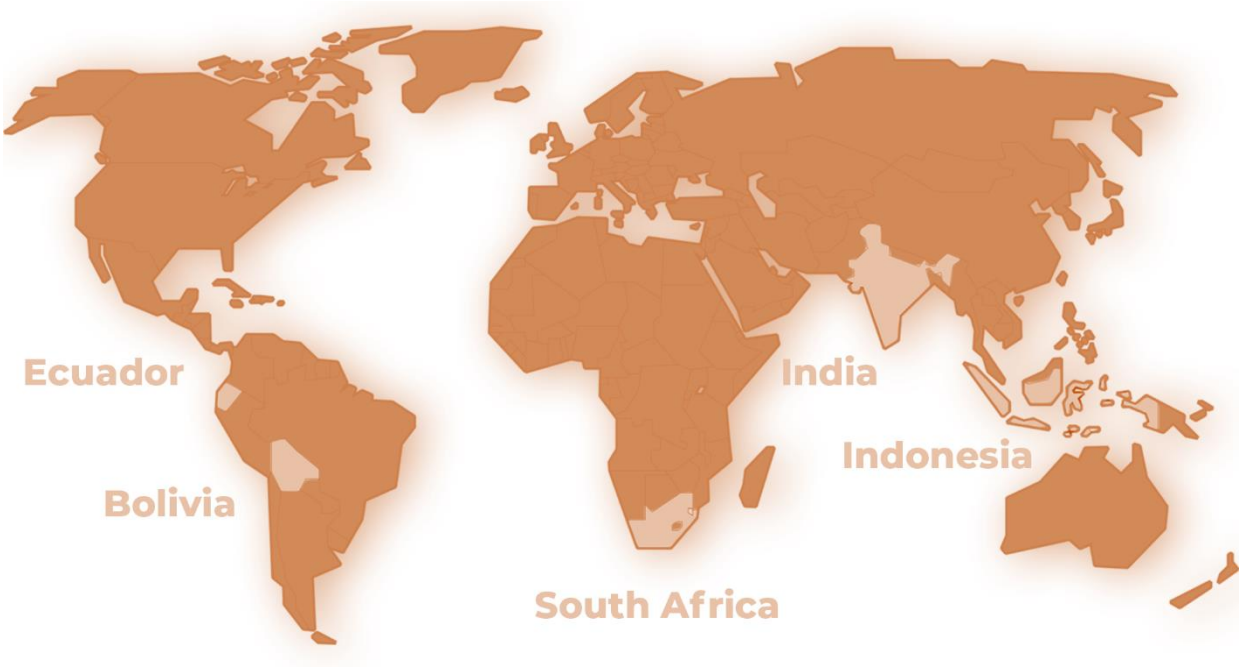
[8] Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay, ICSID Case No. ARB/10/7 (formerly FTR Holding SA, Philip Morris Products S.A. and Abal Hermanos S.A. v. Oriental Republic of Uruguay), https://www.italaw.com/cases/460; Stefanie Schacherer, "Philip Morris v. Uruguay," *IISD*, 18 October 2018, https://www.iisd.org/itn/2018/10/18/philip-morris-v-uruguay/.

[9] Piero Foresti, Laura de Carli & Others v. The Republic of South Africa, ICSID Case No. ARB(AF)/07/01 https://www.italaw.com/cases/446 [Henceforth: *Piero v. South Africa*].

[10] Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador, ICSID Case No. ARB/06/11, https://www.italaw.com/cases/767 [Henceforth: *Occidental v. Ecuador*].

[11] Cecilia Olivet, "Why did Ecuador terminate all its Bilateral investment treaties?," *TNI*, 25 May 2017 https://www.tni.org/en/article/why-did-ecuador-terminate-all-its-bilateral-investment-treaties [Henceforth: *Olivet*].

[12] "Termination of Bilateral Investment Treaties Has Not Negatively Affected Countries' Foreign Direct Investment Inflows," *Public Citizen*, 2019. https://www.citizen.org/article/termination-of-bilateral-investment-treaties-has-not-negatively-affected-countries-foreign-direct-investment-inflows/.



2.2.1. Termination and renegotiation of existing investment agreements

One of the trends in the reform of ISDS, and investment law as a regime more broadly, focuses on the termination and renegotiation of provisions that exist in many BITs.[13] This trend is reflected in the decision of various states, to terminate some or all or, alternatively, renegotiate some of their BITs (even though they are still bound by the terms of termination and "sunset clauses").

One strong example of this trend is India. India has had a negative experience with arbitration, most pointedly, the 2011 *White Industries* award which required India to pay approximately USD 4 million to a foreign investor in the coal sector.[14] As a result, in 2015 the Government of India commissioned the Law Commission of India to examine its draft model BIT.[15] The Law Commission's conclusions led to a new 2016 Model BIT,[16] and to the termination of 58 BITs in 2017. In cases in which India did not have a viable option to terminate, the Law Commission

[13] Tomer Broude, Yoram Haftel and Alexander Thompson, "Who Cares About Regulatory Space in BITs? A Comparative International Approach", in Anthea Roberts, Paul B. Stephan, Pierre-Hugues Verdier, and Mila Versteeg (eds.), *Comparative International Law* (Oxford: Oxford University Press, 2018).

[14] White Industries Australia Limited v. The Republic of India, art. 16. https://www.italaw.com/cases/documents/1170. The monetary value of the award may not be so dramatic, but its effect as the first adverse award against India was pronounced in public policy terms.

[15] Analysis of the 2015 Draft Model Indian Bilateral Investment Treaty http://lawcommissionofindia.nic.in/reports/Report260.pdf.

[16] Model Text for the Indian Bilateral Investment Treaty https://www.mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf.

proposed issuing joint interpretative statements with counterpart states. Such statements serve to guide investment arbitration tribunals in interpreting the provisions of agreements. By doing so they limit the interpretive space of ISDS tribunals.[17] Joint statements can also be considered as another point on the spectrum of global ISDS trends. India's 2016 Model BIT allows for ISDS, but with a limited scope, requiring exhaustion of local remedies and placing procedural and temporal limitations. The purpose of this new ISDS mechanism is to balance the rights of the investor with the rights of the state, thereby expanding state regulatory space.[18]

In 2010 Ecuador approved the termination of three of its BITs.[19] In 2012, after it lost an ISDS arbitration with 2.3 billion USD awarded to the claimant (see above), it decided to carry out a further review of ISDS.[20]A governmental commission established in 2013 concluded that BITs do not benefit the country, but only increase risk and costs. The commission found that BITs not only did not help attract FDI to Ecuador, but that the investors that sued the country under the BITs had gained disproportionately.[21] Therefore, in May 2015, Ecuador terminated all of its remaining BITs, and declared that it would negotiate new BITs/IIAs under a new model. According to Cecilia Olivet, Chair of the commission, the new model espouses an approach whereby the rights of investors would be restricted while the state's right to regulate would be better protected. One aspect of this would be that future Ecuadorian treaties would exclude ISDS and rely instead on national courts for dispute resolution.[22]

South Africa's experience with ISDS in cases like *Piero Foresti, Laura de Carli & Others v. The Republic of South Africa*[23] led to a 2009 Position Paper in which the South African government decided to terminate all BITs, and offer all former parties to its BITs the option to renegotiate

[17] Sanyukta Chowdhury, "Investor State dispute settlement provisions in India's model bilateral investment treaty: a critique", *Indian Journal of International Law*, (2019), 3, https://link.springer.com/article/10.1007%2Fs40901-019-00099-4.
[18] Ibid, 4.
[19] Javier Jaramillo, "New Model BIT proposed by Ecuador: Is the Cure Worse than the Disease?", *Kluwer Arbitration Blog*, 20 July 2018, http://arbitrationblog.kluwerarbitration.com/2018/07/20/new-model-bit-proposed-ecuador-cure-worse-disease/.
[20] *Occidental v. Ecuador*, *supra note* 10.
[21] Ecuador governmental decision, http://www.caitisa.org/index.php/home/enlaces-de-interes.
[22] *Olivet*, *supra note* 11.
[23] *Piero v. South Africa*, *supra note* 9; A claim that a SA legislation in 2004 to increase the participation of historically disadvantaged South Africans effectively extinguished the mineral rights of several Italian citizens and a Luxemburg corporation without providing adequate compensation. The claim was based on the BIT between SA and Belgo-Luxemburg and the BIT between SA and Italy.

according to a new model.[24] The Position Paper determined that existing BITs focused too much on the interests of investors from developed countries while intruding too far into the state's regulatory space without preserving sufficient flexibility for the state in critical policy areas. It also concluded that ISDS tribunals played too active a role in the implementation and interpretation of BITs.[25]

Under its new BIT policy, the South African Government would only enter into BITs if it had compelling political or economic reasons to do so.[26] After this, the Government decided not to renew 12 BITs with EU member states in 2010, and let other EU BITs expire. Alongside this policy, domestic legislation on investment was reviewed and revised, with the aim to 'provide for the protection of investors and their investments [and] to achieve a balance of rights and obligations that apply to all investors'. Foreign investors would receive the same treatment as national investors, and disputes would be resolved through mediation or domestic courts.[27]

The option of termination and renegotiation has led different states down different paths, but we can see an overarching trend of dissatisfaction with the current ISDS system, and the adoption of new models using termination or renegotiation.

2.2.2. 'New generation' investment instruments: Facilitation rather than protection of investments

Brazil concluded several BITs in the 1990s, but they were never ratified by the Brazilian government.[28] Since then, Brazil has opted to focus on a more collaborative investment dispute settlement approach called the Cooperation and Facilitation Investment Agreement (CFIA),

[24] *SA Protection of Investment Act 22 of 2015* https://www.gov.za/sites/default/files/gcis_document/201512/39514act22of2015protectionofinvestmentact.pdf.
[25] *SADC Model Bilateral Investment Treaty Template*https://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf [Henceforth: *SADC model BIT*].
[26] Xavier Carim, "Lessons from South Africa's BITs review", 109 *Columbia FDI Perspectives* 1, 1-3, 2013.
[27] *South African Protection of Investment Act No. 22 of 2015*, 2, art. 6, art. 13, https://www.gov.za/sites/default/files/gcis_document/201512/39514act22of2015protectionofinvestmentact.pdf [Henceforth: *South African Protection of Investment Act*].
[28] Henrique ChoerMoraes and Felipe Hees, "Symposium on the Brics Approach to the Investment Treaty System Breaking the BIT Mold: Brazil's Pioneering Approach to investment agreements", 112 *AJIL Unbound* 197, 20, 2018, https://www.cambridge.org/core/journals/american-journal-of-international-law/article/breaking-the-bit-mold-brazils-pioneering-approach-to-investment-agreements/5ED7690A4775619CEA584743D1E02FE2.

focusing on the facilitation of investments rather than a dispute-oriented approach that is concerned with protection of investments.[29]

Instead of the standard ISDS format, that is concerned with the "resolution of disputes", CFIAs establish "Joint Committees" where investors can voice concerns regarding a given investment so as to *prevent* disputes. If the dispute is not resolved through the specified procedure, the CFIAallows for state to state arbitration, but not ISDS.[30]

The People's Republic of China's (PRC) early BITs did not include ISDS provisions but used state to state dispute settlement instead (such as the 1982 China-Sweden BIT). Over time, the PRC has increasingly incorporated ISDS in its IIAs.[31] The PRC started ISDS reform in 2015, in several parallel spheres including the development of a new international court mechanism to deal with disputes involving the Belt and Road Initiative, a review of arbitration rules, and changes to SCIA and CIETAC and Cooperation with ICSID.In 2015, the PRC expanded the jurisdiction of domestic arbitration institutions to include foreign investment disputes.[32] In 2018, the PRC announced that disputesrelated to the BRI (Belt and Road Initiative) would be settled under a BRI dispute settlement mechanism, and decided to create an international commercial court.[33] The PRC is also working on the creation of joint arbitration centers to resolve investor-state and commercial dispute settlements with other regions (similar to the idea of a China-Africa Joint Arbitration Center, that reportedly has five locations, two in Africa and three in China).[34] These developments are likely to influence global ISDS trends, and indeed, can be viewed as creating a new, alternative dispute settlement system in which small economies may participate.

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[29] Ibid; José Henrique Vieira Martins, " Brazil's Cooperation and Facilitation Investment Agreements (CFIA) and Recent Development", *Investment Treaty News*, 12 June 2017, https://www.iisd.org/itn/2017/06/12/brazils-cooperation-facilitation-investment-agreements-cfia-recent-developments-jose-henrique-vieira-martins/.

[30] Ibid, 200; *Cooperation and Investment Facilitation Agreement between the Government of the Federative Republic of Brazil and the Government of the Republic of Angola*, art. 15 https://www.iisd.org/sites/default/files/publications/comparison-cooperation-investment-facilitation-agreements.pdf.

[31] Diane A. Desierto, "China as a Global ISDS Power", *Investor Claims*, 24 August 2018, http://oxia.ouplaw.com/page/715 [Henceforth: *Desierto, "China as a Global ISDS Power"*].

[32] Huiping Chen, "China's Innovative ISDS Mechanisms and Their Implications", 112 *AJIL Unbound* 207, 2018, 207-208, https://www.cambridge.org/core/journals/american-journal-of-international-law/article/chinas-innovative-isds-mechanisms-and-their-implications/33F0921107DBB7AB742393D43CC38B31 [Henceforth: *Chen, "China's Innovative ISDS Mechanisms"]*.

[33] *Desierto, "China as a Global ISDS Power", supra note* 31.

[34] *Chen, "China's Innovative ISDS Mechanisms,"supra note* 32, 209.

Other countries, such as Bolivia, Venezuela, and Indonesia, are also reevaluating their approach to ISDS. Some states have eliminated ISDS, and turned to state to state dispute settlement as an alternative (for example, the investment chapters of the Australia–United States FTA and the Australia–Japan Economic Partnership Agreement).[35] State to state dispute settlement can be considered as another model for investment dispute settlement, and possibly an option for small economies.

2.3.Reform trends in the EU at the center of debate

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The high degree of integration between EU Member States, is amongst other things, also reflected in the relatively high number of intra-EU BITs – over 290 by the end of the first decade of the

[35] Trishna Menon and Gladwin Issac, "Developing Country Opposition to an Investment Court: Could State-State Dispute Settlement be an Alternative?", *Kluwer Arbitration Blog*, 2018, http://arbitrationblog.kluwerarbitration.com/2018/02/17/developing-country-opposition-investment-cIsourt-state-state-dispute-settlement-alternative/, [Henceforth: *Menon and Issac, "Developing Country Opposition to an Investment Court"*]

[36] Source: istock, n.d. https://www.istockphoto.com/es/vector/bandera-de-la-unión-europea-y-la-designación-en-mapa-mundial-gm467379414-61040554.

21st century.[37] Moreover, externally, the EU generally champions multilateral cooperation.[38] The EU is now at the center of calls to reform the existing system on a multilateral basis.[39]

A move towards unification of EU investment policy can be seen clearly in the Treaty of Lisbon.[40] Through the Treaty, EU member states transferred some of their independent economic authority relating to investment in the EU. Amongst other things, this has raised numerous questions regarding the status of existing BITs and the investment relations of the EU member states both with each other and with the rest of the world.

2.3.1 EU policy following the 2/15 (EUSFTA) Opinion

Recognition of the EU's extensive authority to interpret the Lisbon Treaty and to give ascendency to EU law,[41] appeared in the CJEU's 2/15 Opinion[42] which determined that the EU had the power to conclude the EU-Singapore Free Trade Agreement (EUSFTA). Amongst other issues, the Opinion discussed Article 3(1) to the TFEU (Treaty on the Functioning of the European Union)[43] that provides the EU with exclusive authority to terminate or modify the economic agreements of its Member States with other States, subject to the fundamental norms of the EU. According to the Opinion, although the EUSFTA does not fall wholly within the EU's exclusive competence, it did not necessarily take away the ability of the EU to regulate the internal agreements of the EU member states. Thus, the EU could order the modification of an existing agreement if there is a substantive contradiction with EU laws and compliance with statutory tests.[44]

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[37] Hanno Wehland, "Intra-Eu Investment Agreements And Arbitration: Is European Community Law An Obstacle? Corrigendum," *International and Comparative Law Quarterly* 58(4), 2009, 297, https://www.jstor.org/stable/20488292?seq=1#metadata_info_tab_contents.

[38] See e.g. Article 21 of the Treaty on European Union (TEU): "the EU shall… promote an international system based on stronger multilateral cooperation…" European Union, *Consolidated version of the Treaty on European Union*, 13 December 2007, 2008/C 115/01, https://www.refworld.org/docid/4b179f222.html; Elena Lazarou, *The Future of Multilateralism: Crisis or Opportunity?* Report no. 603.922, European Parliamentary Research Service, http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/603922/EPRS_BRI(2017)603922_EN.pdf.

[39] European Parliament. "REGULATION (EU) No 1219/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL." L 351/40. EUR-Lex. 20 December 2012, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32012R1219.

[40] European Union, *Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community*, 13 December 2007, 2007/C 306/01, https://www.refworld.org/docid/476258d32.html.

[41] Gavin Michael Barrett,"Analyzing the Impact of the Treaty of Lisbon on the 'Final Provisions' of Earlier Treaties," *SSRN*, 2008.

[42] CJEU, *Opinion 2/15 of 16 May 2017*, ECLI:EU:C:2017:376.

[43] Art. 3(1) TFEU provides that "The Union shall have exclusive competence in the following areas: … (e) common commercial policy".

[44] Marise Cremona,"Shaping EU Trade Policy Post-Lisbon: Opinion 2/15 of 16 May 2017: ECJ, 16 May 2017, Opinion 2/15 Free Trade Agreement with Singapore," *European Constitutional Law Review* 14(1), 2018.

2.3.2 The *Achmea* Case – The shift from intra-EU investment arbitration to a system based on national courts and a new multilateral system

One of the factors that led to the change in EU policy was the ruling of the CJEUin the *Achmea* case, which is considered a turning point in the relationship between EU law and investment tribunals. The *Achmea* case[45] dealt with a contradiction between EU law and the arbitration clause in an intra-EU BIT agreement. The basis of the case was a dispute between a major Dutch health insurer, *Achmea*, and Slovakia, arbitrated under the Netherlands-Slovakia BIT. In March 2018, the CJEU issued its judgment, and clarified the controversial legal question of settling contradictions between intra-EU member state's BITs and EU law, finding that the ISDS arbitration clause in an investment agreement between two EU members is incompatible with EU law. This indicated that a major change in the regulation of intra-EU investment protection was required, focusing on the validity of BITs between EU Member States.

In accordance with the *Achmea* decision, in January 2019, EU member states signed a declaration on the legal implications of this ruling, and determined, *inter alia*, that they would terminate all BITsbetween them.[46]

2.3.3 Opinion 1/17

In April 2019, the CJEU issued Opinion 1/17 of the court,[47] which dealt with the compatibility of Chapter F of Chapter Eight of the EU-Canada Comprehensive Economic and Trade Agreement (CETA),[48] in particular the compatibility of a Canada-EU ICS with EU law. Even though the judges declared CETA to be compatible with EU primary law, the CJEU limited the ability of other (non-EU) tribunals to interpret EU law. Thus, the opinion is significant in clarifying the relationship between CETA's ICS (and hence, future such institutions) and the EU legal order, stating that EU law is supreme and not to be interpreted by external tribunals.

This series of CJEU decisions is likely to have a significant impact on the international investment legal system, but the extent is not yet clear. It is reasonable to assume that potential and present

[45] *Achmea*, *supra note* 2, EU:C:2018:158.
[46] *Declaration of the Member States of 15 January 2019 on the legal consequences of the Achmea judgment and on investment protection*, 17 January 2019, https://ec.europa.eu/info/publications/190117-bilateral-investment-treaties_en [Henceforth: *Declaration of the Member States of 15 January 2019*].
[47] *Opinion 1/17, supra note* 6, ECLI:EU:C:2019:341.
[48] *The Comprehensive Economic and Trade Agreement (CETA),* a trade agreement between the EU and Canada, Council of the EU [Henceforth: *CETA*].

EU candidate states will have to reconsider the fate of their BITs with Europe (before accession), while their existing BITs remain in effect.[49] The *Achmeacase* is also likely to have additional implications for existing and future BIT arbitration clauses with non-EU members.

2.3.4 The EU and its ISDS agenda: towards a more coherent system?

Statements made by high-level officials in the European Commission,[50] suggest that in parallel with its effort to strengthen the World Trade Organization (WTO) through reform,[51] the EU is seeking to create a multilateral alternative to deal with international investment dispute settlement. The motivation to continue to support multilateralism, was reflected in the Transatlantic Trade and Investment Partnership (TTIP) negotiations that aimed at liberalizing EU-US trade and investment.[52] The TTIP negotiations, the ensuing widespread public interest and opposition, and their breakdown, were later reflected in the CETA, and may also help explain the movement away from the current ISDS system, towards a new, more coherent system.

At the center of the EU's plan for reform regarding international investment dispute settlementis its call for the establishment of a standing MIC which will significantly change the way in which conflicts between investors and states are resolved. [53] Cecilia Malmström, the European Commissioner for Trade, outlined in 2018 the principles behind the EU's establishment of a MIC: predictability and consistency; experience (in judging); effectively addressing costs and duration: removing the costs of arbitrator selection and reducing costs and duration of proceedings; assuring equal representation – both geographical and of women (that are currently both under-

[49] Jens Hillebrand Pohl, "Intra-EU Investment Arbitration after the Achmea Case: Legal Autonomy Bounded by Mutual Trust?" *European Constitutional Law Review: EuConst* 14(4), 2018, 767.
[50] Speech by European Commissioner for Trade Cecilia Malmström, "A Multilateral Investment Court: A Contribution to the Conversation about Reform of Investment Dispute Settlement," European Commission. Brussels, November 22, 2018. [Henceforth: *Malmström Speech*].
[51] "WTO modernization, introduction to future EU proposals - concept note", 29 January 2018, http://trade.ec.europa.eu/doclib/docs/2018/september/tradoc_157331.pdf.
[52] Hanns Ullrich, "The Transatlantic Trade and Investment Partnership (TTIP) : Extending Trade Policy to Domestic Markets", *Revue Internationale De Droit économique*30(4), 2016, 421, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2900083.
[53] Submission of the European Union and Its Member States to UNCITRAL Working Group III, "Establishing a Standing Mechanism for the Settlement of International Investment Disputes," European Commission, 18 January 2019, http://trade.ec.europa.eu/doclib/docs/2019/january/tradoc_157631.pdf [Henceforth: *EU to WG III*].

represented).[54] According to the European Commission,[55] this is the only way to effectively achieve the needed changes.[56]

Ultimately, the intention is for the MIC to replace the existing ISDS mechanisms in EU agreements, in agreements between EU Member States and third countries, and even in trade and investment treaties between non-EU members.[57] Through various actions over the last decade, the EU has been seeking to build a unified structure for its member states.[58] In so doing, the EU argues that it aims to restore the legitimacy of investment dispute resolution.

2.3.5 ISDS in recent EU agreements - the ICS

The EU's approach, thus far, has been to draft treaties[59] that establish a new framework for ISDS, and in this way, address the problems of the existing system and pursue a "multilateral investment tribunal".[60] The EU has been seeking to establish an ICS that will encourage investment, while ensuring that it is done in a way that is fair, effective and transparent.[61] However, some critics claim that the new ICS, only partially deals with the issues. Moreover, in their view, it does not solve the core issue of the existence of a parallel legal system for corporations, and the fact that in business risk is transferred to the public.[62]

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[54] *Malmström Speech, supra note* 50.
[55] "The EU Moves Forward Efforts at UN on Multilateral Reform of ISDS," *European Commission – Trade*, 18 January 2019, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1972.
[56] *EU to WG III supra note* 53.
[57] "Commission Proposes New Investment Court System for TTIP and Other EU Trade and Investment Negotiation," *European Commission – Trade*, 16 September 2015, http://trade.ec.europa.eu/doclib/press/index.cfm?id=1364.
[58] *Menon and Isaac, "Developing Country Opposition to an Investment Court", supra note* 35;" Commission to Consult European Public on Provisions in EU-US Trade Deal on Investment and Investor-State Dispute Settlement," *European Commission - Press Release*, 21 January 2014, https://europa.eu/rapid/press-release_IP-14-56_en.htm.
[59] Amongst them: *CETA, supra note* 48, art. 8.29; *The European Union-Singapore Free Trade Agreement*, 12 October 2018, art. 3.12 [Henceforth: *EUSFTA*]; and *the European Union-Vietnam Investment Protection Agreement*, 26 June 2018, art. 3.38 [Henceforth: *EUVFTA*].
[60] *CETA, supra note* 48, art. 8.29; *EUSFTA, supra note* 59, art 3.12.
[61]"European Court of Justice Confirms Compatibility of Investment Court System with EU Treaties," *European Commission - Trade - Press Release*, 30 April 2019, http://europa.eu/rapid/press-release_IP-19-2334_en.htm.
[62] "EU-Canada Comprehensive Economic and Trade Agreement (CETA)", *Trade Justice Movement*, https://www.tjm.org.uk/trade-deals/ceta-the-new-eu-canada-trade-deal, [Henceforth: *TJM CETA*].

2.3.6 Global Reform Initiatives: UNCITRAL Working Group III

Due to the increasing international and public concern, in 2017 the UNCITRAL WG III was established so as to work on the possible reform of ISDS.[63] The UNICTRAL WG III's main goal is to minimize the tensions between establishing a new judicial framework and maintaining the current ISDS framework.[64] According to the WG III, the *ad hoc* nature of the current system of ISDS has problematic, systemic implications in terms of predictability, consistency, coherence and correctness. The suggestions made within WG III are based on the three main concerns that were raised before the conference: (1) inconsistency and incorrectness of decision-making;[65] (2) problems with arbitral diversity and independence;[66]and (3) the cost and length of proceedings.[67] These above-mentioned concerns currently represent the agenda of UNICTRAL WG III, but have no actual impact on the existing system, and indeed might not lead to unified multilateral reform, but rather to piecemeal changes. During the WG III consultations, the following are some of the possible adjustments to the current ISDS systemthat have been discussed:

1. **The creation of an appellate body** – the establishment of a permanent or at least semi-permanent appellate body. This could be a possible way to achieve greater coherence and consistency in the decisions, as well as legal correctness.[68] Nevertheless, this suggestion with regards to establishing an appellate body still has at least two potential problems. First, the permission to appeal might become the norm, as the losing side might use the possibility to appeal in bad faith or to deter the other party from further legal action.

[63] UN Comm'n on Int'l Trade Law, "Possible Reform of Investor-State Dispute Settlement (ISDS)", *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.149 ,5 September 2018, https://documents-dds-ny.un.org/doc/UNDOC/LTD/V17/065/24/PDF/V1706524.pdf?OpenElement.
[64] Ibid, 6-15.
[65] UN Comm'n on Int'l Trade Law, "Possible reform of investor-State dispute settlement (ISDS): Consistency and related matters", *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.150, 28 August 2018, http://daccess-ods.un.org/access.nsf/Get?OpenAgent&DS=A/CN.9/WG.III/WP.150&Lang=E [Henceforth: *"Possible reform of investor-State dispute settlement (ISDS): Consistency and related matters"*].
[66] UN Comm'n on Int'l Trade Law, "Possible reform of investor-State dispute settlement (ISDS) Arbitrators and decision makers: appointment mechanisms and related issues", *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.152, 30 August 2018, http://daccess-ods.un.org/access.nsf/Get?OpenAgent&DS=A/CN.9/WG.III/WP.152&Lang=E.
[67] UN Comm'n on Int'l Trade Law,"Possible reform of investor-State dispute settlement (ISDS) — cost and duration," *Note by the Secretariat*, UN Doc. A/CN.9/WG.III/WP.153, 31 August 2018, http://daccess-ods.un.org/access.nsf/Get?OpenAgent&DS=A/CN.9/WG.III/WP.153&Lang=E.
[68] UN Comm'n on Int'l Trade Law, "Possible Reform of Investor-State Dispute Settlement (ISDS)", *Submission from the European Union*, 6, UN Doc. A/CN.9/917, 20 April, 2017, https://documents-dds-ny.un.org/doc/UNDOC/GEN/V17/023/69/PDF/V1702369.pdf?OpenElement.

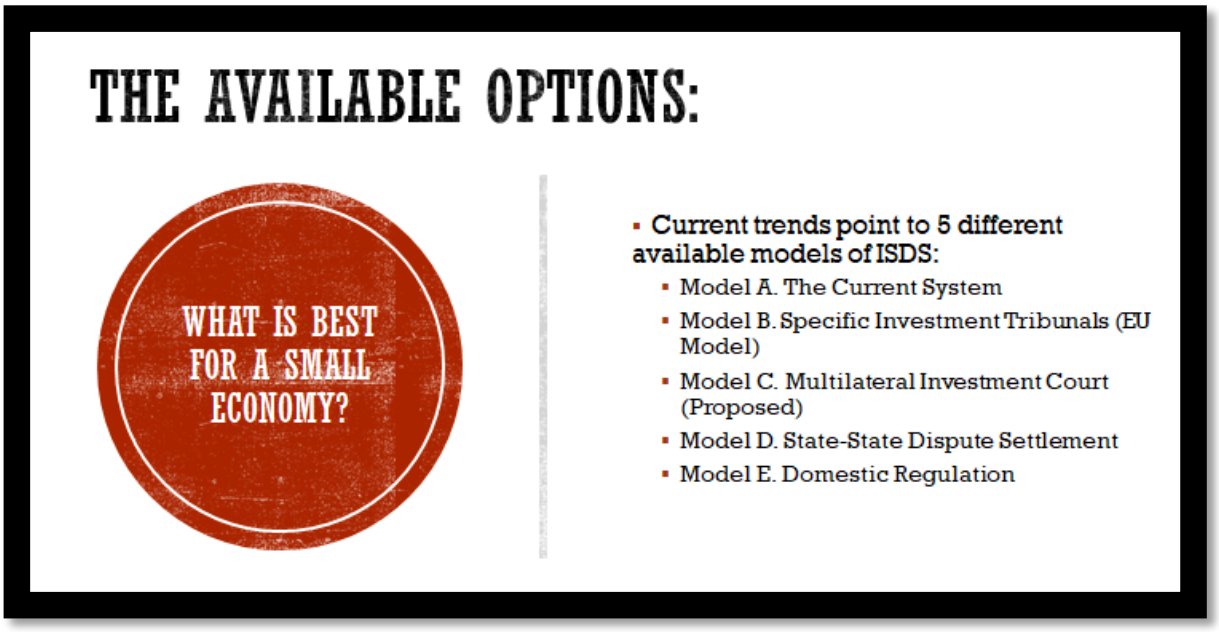
Second, appeals may extend the time of the arbitral process and impose additional expenses on the parties.[69]

2. **Appointment of arbitrators** – the lack of diversity and the absence of transparency are two of the primary criticisms of the existing ISDS regime. Thus, possible adjustment to the current system could consist of setting up a new mechanism for appointing arbitrators, similar to what exists in national court systems, insofar as the disputing parties do not choose the adjudicators.[70]
3. **Code of conduct** – concluding codes such as Annex 7 of the EUSFTA,[71] can ensure respect for high ethical and professional standards. In addition, such codes also include concrete steps to determine whether a conflict of interest could arise or has arisen.[72]
4. **Setting up an International Investment Court** – this is the more far-reaching option which includes the creation of a permanent body, composed of tenured members tasked with resolving investment disputes. Such a court would generally be established through a founding legal instrument, the statue, to which states would become party. Such an International Investment Court could either be based on a two-tier adjudicative system or only a one-tiered system, without a built-in appellate body.[73] Creation of such an international body could raise questions regarding the adjudicators,[74] review mechanism,[75] enforcement and cost.[76] Notably, some of the adjustments suggested in the Working Group, are also put forth by the arbitration institutions themselves.

[69] Ibid, 7.
[70] Ibid, para 25-27.
[71] *EUVFTA*, *supra note* 59, Annex 7.
[72] Piero v. South Africa, *supra note* 9, para 28.
[73] Ibid, para 29-31.
[74] Ibid, para 33-39.
[75] Ibid, para 40-45.
[76] Ibid, para 46-57.

3. Policy options for investment dispute settlement: Five models

In this chapter we will compare five models for investment dispute settlement, existing and proposed:



Notably, these models are not necessarily mutually exclusive, but will be dealt with separately.

Each model will be analyzed in the light of the following parameters:

Transparency – ahighlytransparent system is one in which the decisions of the system are published and there is public access to procedures.[77] This parameter's scope ranges between very high transparency on the one hand, where legal documents are published, includingopen

[77] Marc Bungenberg and August Reinisch, "Targets for the Reorganization of the Investment Protection Regime," In 'From Bilateral Arbitral Tribunals and Investment Courts to a Multilateral Investment Court', *European Yearbook of International Economic Law*, Special Issue, Springer, Cham, 2018, 15-23 at19-20.

hearingsand essential procedural documents. On the other hand, there can be extremely low transparency that does not include any access to the documents or hearings (except by the involved parties).

Consistency of Decisions - When in similar cases there is the same judicial interpretation, then there is a high consistency of decisions. This parameter has a scope between on the one side, extremely high consistency of decision that includes a set of interpretive rules that obligate the system. On the other side, there is extremely low consistency of decisions - here there are no interpretive rules, and the result of even identical cases can be different.[78]

Litigation (Cost and time) - This parameter has a scope between on the one side, extremely high efficiency of litigation, with minimum procedural costs, a short amount of time for decisions. On the other side, very low efficiency, with very high costs and a long procedure. The cost of the system, can be affected by several factors, such as a need to establish the system or maintain it, the question of whether the loser pays the costs, and the duration of proceedings.[79] Duration can also be affected by several factors, such as the workload of the adjudicators or arbitrators, and the amount of control they have over the proceedings.[80]

Adjudicators (qualification, ethics, availability, permanent adjudicators or ad hoc arbitrators) - this parameter is defined by several aspects: repeat or permanent actors, independence and neutrality,[81] qualifications and the ethical commitments that bind the judges.

Review Mechanism (challenging awards) – Under this parameter there are basically two options, either the system has a process of appeal, or it does not.

In conjunction with chapter 4 below that will analyze concerns of small states, this chapter sets the stage for chapters 5 and 6, where we will examine the different models in light of the specific challenges facing small economies, to recommend which models are optimal for a small economy.

[78] Ibid, 16.
[79] Ibid, 18.
[80] Ibid,20.
[81] Ibid, 17-18.

3.1 Model A: The existing ISDS arbitration system

3.1.1 Transparency

The existing ISDS arbitration system, as has been discussed earlier,[82]has significant disadvantages in the area of transparency, with these challenges being made particularly acute with regard to small economies. The system is currently moving towards reform,[83] with the adoption of UNCITRAL transparency rules and ICSID's 2017 public consultation regarding amendment to its arbitration rules.[84] However, there still remain serious concerns, as neither of these have been put into force. The current situation, is such that neither UNCITRAL rules, nor ICSID rules, require public access to information during the proceedings. Under both sets of rules, the hearings are usually closed to the public, with both sides holding veto power to prevent open hearings. Furthermore, under UNCITRAL rules, there isn't even a provision for notification to the public regarding the commencement of proceedings. The publication of awards is also not guaranteed by UNCITRAL rules.

All these provisions, lead to a situation in which the public doesn't know what is going on behind the closed doors of the arbitration – in situations where states and large corporations are involved – meaning that there should be significant public interest in transparency since – on behalf of the states, it is the taxpayer that will be paying the investor compensation.[85]

3.1.2 Consistency of decisions

The inconsistency of decisions in the current system of ISDS is the result of a number of factors including the lack of transparency, the ad hoc nature of the proceedings and the limited status of legal precedent. Since the arbitrations take place behind closed doors and their decisions are often not publicized,[86] it is hard to predict what the arbitrations will decide regarding interpretation of contracts and legal standards leading to contradicting decisions on the same (or similar) treaty clause. This is most famously seen through the different interpretations of the Argentinian

[82] *WG III, September 2018, supra note* 1.
[83] "United Nations Convention on Transparency in Treaty-Based Investor-State Arbitration," *UNCITRAL*, 2015, http://www.uncitral.org/pdf/english/texts/arbitration/transparency-convention/Transparency-Convention-e.pdf.
[84] "World Investment Report 2018: Investment and New Industrial Policies", *United Nations Conference on Trade and Development. Geneva: United Nations*, 2018, 100-10.
[85] Nathalie Bernasconi-Ostherwalder and Lise Johnson, "Transparency in the Dispute Settlement Process: Country Best Practices," *Bulletin #2*, International Institute for Sustainable Development, February 2011.
[86] *"Possible reform of investor-State dispute settlement (ISDS): Consistency and related matters",supra note* 65, 15.

protections in very similar circumstances and under ICSID. In *Argentina v CMS*, CMS received an award[87] and in *Argentina v LG&E* where no award was granted as 'necessity' was deemed to be a legitimate criterion for circumscribing the Fair and Equitable Treatment Standard.[88] A specific area where inconsistency is commonplace, is in the interpretation of the vital term 'investment' - some tribunals interpreting the term based on the 'objective' *Salini*[89]test allowing for more varied interpretations while others limit interpretation to the definition under the specific treaty.[90]

The fact that there are a number of independent dispute settlement bodies and sets of rules (UNCITRAL, ICSID, ICC, etc.) adds to the challenge of being able to predict the arbitrators' decisions in a consistent manner when drafting treaties, as these bodies are not dependent one on another and can potentially render contradictory interpretations.[91]

3.1.3 Litigation

The current system of ISDS is costly, but in spite of large-scale criticism of arbitrators and 'the system' – arbitrator fees stand at approximately 16% of costs and institutional costs at 2%. The main expense (82%) in the current system is incurred by the parties (legal counsel and experts),[92] and this would not decrease significantly under other systems. The fact that it is a system that is already operating, also means there is no cost of establishing a new system. The lack of consistency of decisions, can mean that the legal proceedings are drawn out,[93] making the system inefficient in terms of time and cost.

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[87] CMS Gas Transmission Company v. Argentina, ICSID Case No. ARB/01/8, Award, 12 May 2005, 44 ILM https://www.italaw.com/cases/288.

[88] LG&E Energy Corp., LG&E Capital Corp., and LG&E International, Inc. v. Argentine Republic, ICSID Case No. ARB/02/1, Award, 46 ILM, https://www.italaw.com/cases/62; See also cases regarding the US-Czech Republic BIT. In *CME Czech Republic BV v The Czech Republic*, Final Award, UNCITRAL, 14 March 2003, damages were awarded. But in *Ronald S Lauder v The Czech Republic*, Award, UNCITRAL, 3 September 2001, the case was dismissed. The discrepancy existed even though both applied UNCITRAL rules to the same measure.

[89] SaliniCostruttoriSpA and ItalstradeSpA v Kingdom of Morocco, Decision on Jurisdiction, ICSID Case No ARB/00/4, 31 July 2001 at para 52, https://www.italaw.com/cases/958.

[90] Anglia Auto Accessories Ltd v Czech Republic, Final Award, Stockholm Chamber of Commerce (SCC) Case V 2014/181, 10 March 2017 at para 153, https://www.italaw.com/cases/5415.

[91] See 8 areas in which tribunals reached inconsistent decisions, by applying different interpretive approaches to similar facts and treaty provisions, as identified by University of Ottawa TradeLab team - Ibrahim Jamie Arabi, John D. Norman, Sarah Rajguru, and Erik Shum, *Evaluating (In)Consistency In Investor-State Arbitration*, Faculty of Law, Trade Lab: University of Ottawa, 30 April 2018.

[92] European Commission, "Investor-to-State Dispute Settlement (ISDS): Some Facts and Figures," *European Commission – Trade*, 12 March 2015.

[93] David Gaukrodger and Kathryn Gordon, "Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community", *OECD Working Papers on International Investment*, March 2012, OECD Publishing, 71, http://dx.doi.org/10.1787/5k46b1r85j6f-en [Henceforth: *OECD, Gaukrodger*].

3.1.4 Adjudicators

The current system has an under-representation of arbitrators based on region and gender.[94] The system is mainly led by male arbitrators from developed countries.[95] ICSID uses a pre-nominated roster of arbitrators which are then selected by the sides in the specific cases, which are in practice quite limited, which can lead to a decrease in the independence of the arbitrators.[96]

3.1.5 Review mechanism

The current system does not allow for an appeal of the awards. The fact that ICSID,[97] LCIA[98] and others render awards that cannot be appealed,[99] is seen by investors as holding an advantage over litigation, as it decreases the risk and the cost of appeals. On the other hand, it is also seen to be a limitation to justice in the form of due process and fair trial and equal access to tribunal which is particularly emphasized in the case of small economies that rely on the support of the justice system.[100]

3.1.6 Other considerations

The current system is seen by many to be biased against states and other stakeholders, as it is only investors that can file claims and receive awards in ISDS.

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[94] Won Kidane, "Alternatives to Investor-State Dispute Settlement: An African Perspective," *Africa Portal*, 31 January 2018, 8, https://www.africaportal.org/publications/alternatives-investor-state-dispute-settlement-african-perspective/.

[95] Ibid; Though there has been a move in the LCIA (London Court of International Arbitration) and the ICC to increased gender diversity, the situation is still such that in 2017, women represented only 24% in the LCIA and 17% in the ICC. The arbitrators are nominated on an ad hoc basis, meaning they are not necessarily experienced as adjudicators. In practice, they are selected from a relatively small pool of arbitrators, nominated usually by mega-corporations. The LCIA for instance, used 241 arbitrators in 2017. See LCIA, "2017 Case Work Report," *LCIA: Arbitration and ADR Worldwide*, 10 April 2018, 15, https://www.lcia.org/News/lcia-releases-2017-casework-report.aspx.

[96] "Selection and Appointment of Tribunal Members - ICSID Convention Arbitration," *ICSID*, https://icsid.worldbank.org/en/Pages/process/Selection-and-Appointment-of-Tribunal-Members-Convention-Arbitration.aspx.

[97] "ICSID Convention, Regulations and Rules," *ICSID*, April 2006, art. 53, https://icsid.worldbank.org/en/Documents/icsiddocs/ICSID Convention English.pdf [Henceforth: *ICSID Regulation and Rules*].

[98] *LCIA Arbitration Rules (2014)*, LCIA Arbitration and ADR Worldwide, 1 October 2014, art 26.8 and 29.2, https://www.lcia.org/Dispute_Resolution_Services/lcia-arbitration-rules-2014.aspx.

[99] Other than under the ICSID Convention, awards are enforceable under the New York Convention, which doesn't allow for *de facto* review on the merits, only a refusal to enforce or recognize an award if one of the grounds for refusal were violated – only in serious circumstances. See International Council for Commercial Arbitration. *ICCA's Guide for the Interpretation of the 1958 New York Convention: A Handbook for Judges*, 2011, 78-79.

[100] UN General Assembly, *International Covenant on Civil and Political Rights*, 16 December 1966, UNTS 999, p. 171, art. 14 and 16, https://www.refworld.org/docid/3ae6b3aa0.html.

3.1.7 Conclusion – Current system

The lack of transparency and accountability impairs the legitimacy of the current ISDS. The ability of independent arbitrators that are appointed through an allegedly biased system to place heavy burdens on domestic tax payers, particularly with respect to questions that limit regulatory space, also puts into question the legitimacy of the current system. There is also a lack of unified rules – and the absence of an appellate body.[101]

In spite of the faults, its mere existence means the current system offers greater predictability than any new untried system.

3.2.Model B: Replacement of arbitration by an Investor Court System (ICS)

3.2.1 Transparency

Under this model, the EU has made a great effort to increase transparency in its dispute settlement mechanisms in IIAs - CETA, EUSFTA and EUVIPA.[102] As for today, this model has the most extensive transparency clauses, even after the incorporation of UNCITRAL Rules on Transparency in some BITs. This increased transparency is reflected in the following measures: first, there is a principle that all hearings shall be open to the public.[103]Second, it provides for the publication of documents before the constitution of the arbitral tribunal.[104] Third, it allows interested third persons to make submissions to the Tribunal.

3.2.2 Consistency of decisions

The model makes use of several means in order to enhance the consistency of decisions: first, it requires the consent of the parties to arbitrators' appointment in advance, prior to the disputes and not in an ad-hoc fashion. This appointment is to be on an equal and standing basis and for a limited

[101] For instance, under ICSID, one cannot appeal an award. One is limited to the other options under Articles 49-52 of the *ICSID Regulations and Rules*, *supra note* 97.
[102] *CETA*, *supra note* 48*; EUSFTA*, *supra note* 59*; EUVFTA*, *supra note 59*.
[103] Art. 58.36(1),(5),(4),(2) incorporates by cross-reference the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration
[104] Including the request for consultations, the determination of the respondent, the agreement to mediate, the request for and the decisions on arbitrator challenges, as well as the request for consolidation among the list of documents to be systematically published

time.[105] Furthermore, the establishment of a more permanent system should encourage the creation of a more consistent judicial body, providing consistent interpretation of treaties.[106]

The increase in the consistency of decisions and a joint interpretation, invariably means that the legal proceedings will become more predictable, making the system more efficient in terms of time and cost.

3.2.3 Litigation – cost and duration

The expenses under this model can be divided into two: the short run and the long run. Regarding the short term, there is no establishment cost in implementing this model, because the main ISDS form of arbitration is still retained. However, there is one major expense for the parties in this model, being the appointment of investment adjudicators, each party in the agreement paying equally for a monthly retainer fee.[107] Regarding the long term, the presence of the plan to establish a MICincluding an appellate mechanism in the model may lead to establishment costs that will be imposed on the parties.[108]

In addition, the model seeks to define the boundaries between the domestic and the international legal procedure. The model explicitly limits the jurisdiction of the ICS to the examination of breaches of the agreement's provisions.[109] Claims for breaches of contracts alone or for breaches of the domestic law of the host country are subjected to the jurisdiction of the domestic courts of the parties.[110]Regarding proceedings that may relate to the same dispute, the model follows the approach of "no-U-turn",[111] under which claimants may turn directly to ISDS but would then not

[105] The CETA Joint Committee shall, upon the entry into force of this Agreement, appoint fifteen Members of the Tribunal. Five of the Members of the Tribunal shall be nationals of a Member State of the European Union, five shall be nationals of Canada and five shall be nationals of third countries. *CETA, supranote* 48, art. 8.27; The Committee shall, upon the entry into force of this Agreement, appoint six Members to the Tribunal. For the purposes of this appointment: (a) The EU Party shall nominate two Members; (b) Singapore shall nominate two Members; and (c) The EU Party and Singapore shall jointly nominate two Members, who shall not be nationals of any Member State of the Union or of Singapore. *EUSFTA, supranote* 59, art 3.9(2).
[106] CETA Joint Interpretative Instrument (n. 12). [Henceforth: *Joint Interpretive*].
[107] *CETA, supranote* 48, art 8.27(12-13)
[108] Tim R. Samples, "Winning and Losing in Investor–State Dispute Settlement," *American Business Law Journal* 56(1), 2019, 149.
[109]*CETA, supra note* 48, art. 8.18(1); unlike more broadly drafted dispute settlement clauses of many existing investment treaties that confer jurisdiction to ISDS tribunals over "any dispute".
[110] *CETA, supra note* 48, art. 8.18(5).
[111] André von Walter and Maria Luisa Andrisani, "Resolution of Investment Disputes," In: Makane Moise Mbengueans Stefanie Schacherer (eds), Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA). *Studies in European Economic Law and Regulation* 15, 2019, 201 [Henceforth: *Walter*].

be able to return to domestic courts, encouraging them to first seek remedies before domestic courts before turning to the ICS – incorporating a form of exhaustion of domestic remedies.[112]

3.2.4 Adjudicators

This model contrasts with ad-hoc tribunals, where the arbitrators are appointed by the disputing parties on case-by-case basis. Here there is a different approach to the appointment mechanism. Arbitrators are appointed in advance and for a limited period by a 'Joint Committee' that represents each party. In addition, in order to be an arbitrator, it is necessary to fulfill the defined qualification requirements and to act ethically.[113] The model lists a number of obligations to ensure that adjudicators are independent from executive bodies,[114] these obligations including stricter ethical rules for adjudicators than exist in the widespread ISDS system.[115]

3.2.5 Review mechanism

The option to review an award is embedded in this model. The model has a two-stage tribunal system.[116] The Appellate Tribunal is established to review awards rendered by the Tribunal of first instance.[117] Under the model, either disputing party has the right to appeal a provisional award on one or several grounds.[118]

3.2.6 Other considerations

There are a few other considerations that are unique to this model. First, the prohibition of some claims that are usually in favor of the investor. Such prohibitions implemented in the model contribute to increasing states' legitimacy on the ISDS system set out in those agreements.[119] In addition, these prohibitions expand the state's regulatory space and reduce investors' claims of potential harm. Additionally, the model has a clause that the losing party pays all the legal

[112] *CETA, supra note* 48, art. 8.22(1), 8.22(2); This article also extends these rules to claims that could be initiated by companies that are owned or controlled by the foreign investor and which may be affected by the same measures as their owner.
[113] See BeateAntonich, "CETA Joint Committee Adopts Recommendation on Trade, Climate Action and the Paris Agreement," 16 October 2018, Https://sdg.iisd.org/commentary/policy-briefs/ceta-joint-committee-adopts-recommendation-on-trade-climate-action-and-the-paris-agreement/.
[114] *CETA, supra note* 48, art. 8.30.
[115] Joint Interpretative, *supra note 106.*
[116] *CETA, supra note* 48, art.8.27, 8.28.
[117] The aim is to ensure a high degree of legal correctness by establishing an Appellate Tribunal that is competent to hear appeals against the provisional awards rendered by the Tribunal of first instance.
[118] *CETA, supra note* 48, art.8.28(2).
[119] *Walter, supra note* 111, 194-195

expenses.This rule significantly contributes to the reduction of unnecessary arbitrations, as the rule is a deterrent to investors who do not have a strong claim and whose right is not blatantly violated.[120]

Regarding the enforcement of awards, the CETA has an "umbrella clause" as part of the suite of rights for foreign investors. An umbrella clause is far-reaching because it incorporates a host country's other obligations into the foreign investor's rights at the treaty level and thus subjects those other obligations to ISDS.[121] This version of an umbrella clause is more limited than umbrella clauses in some other treaties,[122] but it is still potentially very expansive because it allows ISDS to be constituted as a parallel enforcement system for the state's contracts with foreign investors.[123]

3.2.7 Conclusion - ICS

It is an improvement in comparison with the existing model in many respects,and there are minimal establishment costs, with an increased degree of certainty, potentially enhancing the legitimacy of ISDS. Furthermore, there would be a clear tribunal of adjudicators who are no longer appointed by the disputing parties per case.[124] Moreover, the adjudicators are required to have some qualification requirements.[125] In addition, one of the model's goals is to enable a level of consistency, and increasing transparency. However, this model is limited, as it is currently only a partial model, not applying to all other states that are not part of the aforementioned agreements.

3.3.Model C: The establishment of a Multilateral Investment Court (MIC)

3.3.1. Transparency

A MIC has yet to be established, but we proceed on the assumption that if it proceeds it would be drivenby EU policies on several issues, including transparency, as reflected in some aspects ofthe

[120] *Walter*, *supra note* 111, 195
[121] Gus Van Harten, "The European Union's Emerging Approach to ISDS: A Review of the Canada-Europe CETA, Europe-Singapore FTA, and European-Vietnam FTA," *University of Bologna Law Review* 1(1), 2016, 157-159.
[122] Katia Yannaca-Small, "Interpretation of the Umbrella Clause in Investment Agreements", *OECD Working Papers on International Investment*, March 2006, OECD Publishing, Annex 1 http://dx.doi.org/10.1787/415453814578.
[123] "Recognition and Enforcement - ICSID Convention Arbitration," *Recognition and Enforcement - ICSID Convention Arbitration*, Accessed 4 August 2019, https://icsid.worldbank.org/en/Pages/process/Recognition-and-Enforcement-Convention-Arbitration.aspx.
[124] *CETA*, *supra note* 48, art. 8.27(2), (17), 8.28(3).
[125] *Walter*, *supra note* 111, 193.

Mauritius Convention,[126]whose main points were supported by the European Parliament.[127]It is therefore likely that the system structure will include public access to documents and decisions. This type of change has already been done by the EU.[128] In terms of transparency, a MIC would publish online details of its work, will provide open and public hearings and possibly allow third party participation.[129]

3.3.2. Consistency of decisions

According to current proposals, a MIC would be composed of standing and full-time adjudicators, that would provide all judicial services.[130]Because the group of adjudicators would be smaller, and would remain constantly engaged, it might be able to make coherent decisions that would provide greater consistency, in contrast with the existing fragmented system.[131]

3.3.3. Litigation

Cost

Every legal procedure in any form of ISDSmay costs millions of US dollars. The costs are not easily foreseeable, and cause uncertainty for both sides.[132] The basic cost of a standing tribunal doesn't include legal fees, the cost of interpretation and legal experts, and other costs accrued to represent the parties. Besides, in a standing tribunal there will be additional expenses, such as permanent retainers and salaries for the adjudicators, secretariats and more. Fixed expensesof ISDS have not accrued directly to countries in the past,because the existing systems generally do not cost them unless they are sued, but the MIC will probably have fixed membership fees and an initial payment charge to join.[133] Therefore, a state that takes part in the MIC will have to contribute to the establishment costs.

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[126] United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (the Mauritius Convention on Transparency), which was adopted on 10 December 2014 and entered into force on 18 October 2017; which aims to enhance transparency of legal systems.
[127] European Parliament (2013) Resolution of 9 October 2013 on the EU-China negotiations for a bilateral investment agreement (2013/2674(RSP)), para 43.
[128] *See 3.2.1., Transparency.*
[129] Catharine Titi, "The European Union's Proposal for an International Investment Court: Significance, Innovations and Challenges Ahead," *Transnational Dispute Management*, 2017.
[130] *EU to WG III, supra note* 53.
[131] Marc Bungenberg and August Reinisch. *From Bilateral Arbitral Tribunals and Investment Courts to a Multilateral Investment Court Options Regarding the Institutionalization of Investor-State Dispute Settlement*, 2019, 18 [Henceforth: *Bungenberg and Reinisch*].
[132] *OECD, Gaukrodger, supra note* 93.
[133] *Bungenberg and Reinisch, supra note* 131, 86.

Time

One of the main criticisms of the current ISDS system is the long duration of case management. The legal process can take a few years. It may be the case that permanent adjudicators will slightly reduce the load of referrals, especially when the adjudicators have extensive powers during the procedure.

3.3.4. Adjudicators

A MIC would be composed of permanent, qualified and full-time adjudicators, chosen by the states that participate in the MIC.[134] The adjudicators would be permanent and exclusively appointed. Hence, they might be more neutral and freerfrom conflicts of interest.

3.3.5. Review mechanism

While the existing ISDS tribunals allow no grounds for appeal, as annulment proceedings are accepted only with specific allegations of breach of procedural rules or violation of due process, the MIC might function differently - by developing an appeal mechanism.[135] In this case, there might be a separate appellate body from the main court with an entirely different set of adjudicators.[136]

3.3.6. Other considerations

The relationship between the MIC and domestic courtswould need to be clarified. This could include greater clarity regarding exhaustion of domestic remedies, and jurisdictional clauses such as “fork-in-the-road" or “no U-turn” clauses.[137] Another option is a mechanism that includes a combination of domestic and international remedies.[138]

Inclusion of exhaustion of domestic remedies might influence the MIC's decisions. On one hand, domestic courts' solutions might undermine the relevance of the MIC. On the other hand, the more issues that are resolved by state law, the less procedures will reach a MIC, which means significant savings in systemic resources.

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[134] Declaration of the European Commission, "A Multilateral Investment Court", September 2017.
[135] As suggested, e.g., in: *Bungenberg and Reinisch*. *supra note* 131,189.
[136] Sonja Heppner, “A Critical appraisal of the investment court system proposed by the European Commission,*” Dispute Resolution Journal*, 3, 2017.
[137] Andrisani, *supra note* 111.
[138] See frther in Stephan W. Schill,"The European Commission’s proposal of an 'Investment Court System' for TTIP: steppingstone or stumbling block for multilateralizing international investment law?", *ASIL*, 2016.

Thus, the process would best create a combination that would not impair the validity of domestic laws, and at the same time, would not reduce the efficiency of the legal process in the MIC.

3.3.7. Conclusion – MIC

Model C – establishment of a MIC - is not yet an existing option for dispute settlement. Therefore, this option is uncertain and there might be some new challenges after establishing the MIC. However, there is a great likelihood that such a system would improve transparency and consistency of ISDS mechanisms.

A MIC would have to achieve more legitimacy than the existing and controversial system. When dealing with the problem of the adjudicators' legitimacy, it will be necessary to address the claims of their "investor-friendly attitude" and the controversial appointment process. One of the ways to legitimize the adjudicators would be through an institutionalized and controlled appointment process, which includes approval from states. Legitimacy can be also derived from the international treaty on which the dispute settlement is based.[139]

3.4.Model D: State to state dispute resolution

There are two types of state to state dispute resolutions mechanisms. The first is when a state espouses the claims of one of its nationals, suing for damages on behalf of an investor (also known as diplomatic protection), and the second is between the parties on the interpretation or the application of the treaty.[140] The focus of this examination will be on the first type.

There are in fact very few known state to state proceedings in the area of investment. In the treaties, a state to state tribunal is usually composed of three arbitrators. Each state selects one, and the third (the presiding arbitrator) is selected by both appointed arbitrators and depends on both party's approval (often with the requirement that he or she must be a national of a third country).[141] Some

[139] *Bungenberg and Reinisch*. *supra note* 131, 17.
[140] *SADC Model Bilateral Investment Treaty Template with Commentary*, 2012, 53, https://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf.
[141] Nathalie Bernasconi-Osterwalder, "State–State Dispute Settlement in Investment Treaties", *IISD Best Practices Series*, 2014 2-3, https://www.iisd.org/sites/default/files/publications/best-practices-state-state-dispute-settlement-investment-treaties.pdf [Henceforth: *Bernasconi-Osterwalder*].

agreements require exhaustion of domestic remedies before arbitration can be initiated, but this clause doesnot exist in all state to state dispute settlement provisions.[142]

3.4.1. Transparency

State to state dispute resolution is very similar to traditional investor-state dispute resolution in the way of conducting the arbitration. Hence, it is also under criticism for its lack of transparency. Occasionally, state to state arbitration is done in secret, without the knowledge of the public.[143] Most state to state arbitration clauses follow similarly structured rules to ISDS, molded after UNCITRAL arbitration rules.[144] There is a relatively low level of transparency, similar to that of the current ISDS system.

3.4.2. Consistency of decisions

In state to state dispute resolution decisions are made by different arbitrators, regarding different agreements and are not transparent, thus similarly to ISDS, there is a problem with achieving consistency between decisions.[145]

3.4.3. Litigation

In state to state dispute resolution the system is ad-hoc, similar to the classic ISDS mechanism and therefore also has a high cost.[146] As mentioned above, the average time and cost for ISDS procedures are very high.[147] Because of the similarities between the systems, we can assume that there will be similarities in the cost and time (with some reservations, because of the need for exhaustion of domestic remedies that exists in some agreements that include this model).

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[142] *Bernasconi-Osterwalder*, *supra note* 141, 20; *SADC Model BIT*, *supra note* 25, art. 28.1, 28.2.
[143] *Bernasconi-Osterwalder*, *supra note* 141, 4.
[144] Ibid, 3.
[145] Ibid, 21.
[146] Ibid, 4.
[147] "The average expenses that a responding state pays for ISDS comes close to 5 million USD (including expenses and fees of counsel, experts and witnesses, arbitrators and other tribunal costs), and the average time of the process is about 4 years"- Matthew Hodgson and Alastair Campbell, "Investment Treaty Arbitration: cost, duration and size of claims all show steady increase", *Bilateral.org*, 14 December 2017,https://isds.bilaterals.org/?investment-treaty-arbitration-cost&lang=en.

3.4.4. Adjudicators

In state to state dispute resolution the arbitrators are appointed ad-hoc, and are chosen by the parties, which can be a cause for some problems.[148] In addition, there can also be a problem of for-profit appointed arbitrators deciding on disputes that involve states and the public interest. Another problem is the "multiple hats" problem, in which many arbitrators are also counsels in other disputes.[149] Because of the ad-hoc nature of the process there can also be problems with arbitrator impartiality and independence.[150]

3.4.5. Review mechanism

In state to state dispute resolution there is no process of appeal. This can cause a problem of legal correctness of the system (the decision can't be revised if is legally wrong) and impair the predictability of the system.[151]

3.4.6. Conclusion – State to state dispute resolution

It seems that in most cases state to state dispute resolution is very similar to the current ISDS system and for that reason, has similar problems. In addition, there are a few reasons for legitimacy problems in state to state dispute resolution. As mentioned above, there can be a problem regarding the public interest. The lack of transparency can also be problematic as it will affect the legitimacy of the system in the eyes of the public.[152]

3.5.Model E: Domestic regulation

Discussion of this option will be based on the South African model, which includesa policy of not renewing BITs combined with domestic regulation of international investments (using national legislation). Disputes may be solved by mediation between the parties (the mediation is done with South Africa's Department of Trade and Industry),[153] but if this does not achieve results, investors will have to turn to a South African domestic forum.[154] Some provisions in the SADC were also

[148] Like the problems with the current ISDS system, especially because most arbitrators in both systems are from the same circle (*Bernasconi-Osterwalder, supra note* 141, 3).
[149] *Bernasconi-Osterwalder, supra note* 141, 4.
[150] Ibid, 21.
[151] Ibid, 4.
[152] Ibid.
[153]*South African Protection of Investment Act, supra note* 27, art. 13(1).
[154] Hannah Ambrose and Vanessa Naish, "A new approach to investment protection? Recent developments in Africa", *Practical Law Arbitration*, 2017, http://arbitrationblog.practicallaw.com/a-new-approach-to-investment-protection-

changed to replace international arbitration with an obligation to resolve disputes using the domestic court of the host state.[155] There are also clauses that promise that there will be no discrimination between local and foreign investors, and that there will be protection of foreign investors.[156]

3.5.1. Transparency

In domestic regulation along these lines, "the State is committed to maintaining an open and transparent environment for investments".[157] That is, there will be a high level of transparency, including domestic courts' procedures, and the relevant legal documents will probably be published and available for viewing.

3.5.2. Consistency of decisions

According to the South African model, all cases will be resolved in domestic courts so there might be greater consistency in their decisions,[158] and the adjudicators will probably be applying the same rules of interpretation, so it is safe to assume that there will be at least some consistency of decisions.

3.5.3. Litigation

In a domestic regulation system, as in the South African model, dispute resolution will be carried out by "any competent court, independent tribunal or statutory body within South Africa".[159] Even so, there might be a need to establish an institution to deal with mediation claims (in South Africa it is the Department of Trade and Industry), and even if an already existing body were to be used, the establishment of a designated department or employment of more workers will be needed.

3.5.4. Adjudicators

In domestic regulation, domestic courts will be used, and the adjudicators will be permanent (in contrast to ad hoc arbitrators). Their qualification, ethics and availability will all depend on the

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recent-developments-in-africa/; *South African Protection of Investment Act*, *supra note* 27, art. 13(4); "any competent court, independent tribunal or statutory body within South Africa."

[155] *SADC Protocol on Finance and Investment*, 2006, annex 1 art. 28 https://www.sadc.int/files/4213/5332/6872/Protocol_on_Finance__Investment2006.pdf.

[156] *South African Protection of Investment Act*, *supra note* 27, art. 8-9.

[157] Ibid, Preamble.

[158] Ibid, art. 13(2)(a).

[159] Ibid, art. 13(4).

principles of the host state. In the necessary mediation process that comes first, the state will maintain a list of qualified mediators, "who may be relied upon to exercise independent judgment" and are willing to act as mediators.[160] So there will probably be fewer problems of impartiality and independence.

3.5.5. Review mechanism

In domestic regulation there is usually an appeal process in domestic courts, and so the disputes resolved in the domestic courts of the host state will have access to a process of appeal. If the domestic remedies are not sufficient in resolving the disputes, the government may consent to the use of international arbitration.[161] This can be viewed as a sort of appeal mechanism in the system.

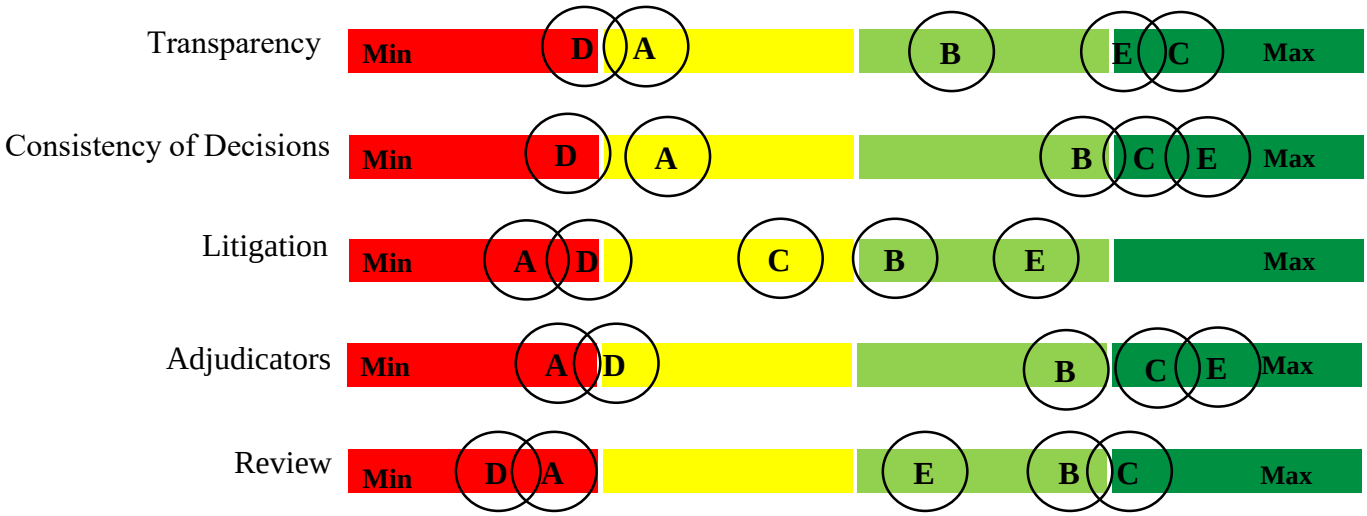
3.5.6. Conclusion – Domestic regulation

The domestic regulation system seems to be on the positive side of most parameters, but it is a fairly new system, and so far, was only adopted by states that are not considered small economies.

3.6. Summary of the models

This table is intended to summarize the five ISDS models' relative application of the different aforementioned parameters. Each parameter has a specified range which moves from the colors of dark green to red.[162] The table demonstrates that the models most incorporating the five parameters we have examined, are model E (Domestic Regulations) and C (MIC). The models that least incorporate the parameters, are models D (state to state) and A (current system). Model B (ICS) is stable on the light-green range, from which we can infer its rather high application of the parameters, but not the highest.

[160] Ibid, art. 13(2)(a).
[161] Ibid, art. 13(5).
[162] Dark green: the highest degree of application. There are processes and rules for implementing the parameter in the model; Light green: he medium degree of application. There are some processes and implementation of rules, but there is still not full application; Yellow: the medium-low degree of application. There is some progress for implementing the application in the model; Red: the lowest degree of application. There is no progress towards applying the parameter in the model.


Transparency
Min
D
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C
Max
Consistency of Decisions
Min
D
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Litigation
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Adjudicators
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Max

4. Small economies and ISDS

This chapter focuses on the way small economies are impacted by ISDS, and how the reforms and reform proposals that were described in the Chapters above may impact small economies in particular. As a preliminary to this analysis, the discussion commences with a definition of the concept of a 'small economy'. Building on this, the chapter proceeds to describe five specific characteristics limiting small economies as they relate to ISDS. After providing this analytical framework for understanding small economies, we discuss how the changes in the ISDS system are impacting and are likely to impact small economies in the future.

4.1.Defining asmallEconomy

Three main criteria are typically employed to measure the size of economies: (1) Gross Domestic Product (GDP); (2) population or workforce size; and (3) land area.[163] While GDP is used in many studies as it has significant impact on small developing economies, this memorandum follows the practice of the World Bank and adopts population size as a central criterion.[164] The size of an economy is particularly relevant when studying the impact of joining the EU, where relevant, as it propels an economy to go from being a small economy to becoming part of the vast EU economy. While the analysis below references the size of the population as a criterion, the discussion is also mindful of GDP and other factors impacting an economy.

Small economies generally seek to achieve economies of scale as this helps establish a healthy economic basis for growth. Studies have shown evidence of economies of scale in the patterns of international trade, in the provision of public services, and in the propensity of FDI to generate backward linkages.[165] The assumption has been that as trade and FDI flows increase, productivity

[163] Daniel Lederman and Justin T. Lesniak, *Open and Nimble: Finding Stable Growth in Small Economies*. Washington: World Bank Group, 2018, 7 [Henceforth: *Daniel Lederman*].
[164] Viktoria Hnatkovska and Friederike Koehler-Geib, "Sources of Volatility in Small Economies," *World Bank Group: Policy Research Working Papers*, July 2018, 7, doi:10.1596/1813-9450-8526. /en/412821531405512576/pdf/WPS8526.pdf.
[165] *Daniel Lederman, supra note* 163, 19. Backward linkages describe the 'spillovers of FDI' from an investor to a recipient state: buyer-seller relationships between foreign firms and domestic suppliers – that add to economic growth; John Rand, "Understanding FDI Spillover Mechanisms," *Brookings*, 29 July 2016, https://www.brookings.edu/blog/africa-in-focus/2015/11/19/understanding-fdi-spillover-mechanisms/.

increases in the host economy. Furthermore, due to their size, it may be anticipated that small economies will have less of the positive effect of agglomeration[166] than large economies.

Agglomeration has a number of advantages: enhanced efficiency due to labor market pooling; knowledge spillovers among firms; and reduced transport costs for sending goods to market.[167] The absence of such advantages, means that it is harder for small economies to attract FDI, and they therefore tend to specialize in specific areas of export products. The difficulty in attracting FDI will then mean that large economies and MNCs are able to gain even greater leverage in contracts with small economies, including giving less preferable conditions to the state, and higher protection to investors with respect to ISDS. Small economies also tend towards openness to trade, and have a relatively large government sector. Moreover, they are, by definition, 'price takers' in the global economy,[168] as they are too small to significantly influence global prices.

In our analysis, we have sought to focus on small economies that are likely to be most susceptible to the impact of recent developments. Therefore, our analysis focuses less on OECD economies such as Luxembourg and Israel.[169] We focus more on developing economies such as Ecuador[170] or small economies in that are seeking EU accession such as Bosnia and Herzegovina.[171]

4.2.Characteristics of small economies vis-à-vis ISDS

Given the significance of size of the economy for a state's trade and investment policies, particularly in terms of its ability to influence negotiations with larger economies, it becomes important to examine the implications of ISDS on small economies in particular. In this chapter, a number of the most significant issues impacting small economies with respect to ISDS are presented.

[166] Economic agglomeration is where industries gain by being located close to one another. Costs are decreased due to the advantages of being geographically close.
[167] *Daniel Lederman, supra note* 163, 21.
[168] Guerron-Quintana, Pablo. "The Economics of Small Open Economies." *Federal Reserve Bank of Philadelphia - Business Review* 96, no. 4 (2013): 9–18.
[169] OECD, "Members and Partners," *OECD Website*, https://www.oecd.org/about/members-and-partners/.
[170] Sarah Joseph, "Protracted Lawfare: The Tale of Chevron Texaco in the Amazon," *Journal of Human Rights and the Environment*3 1, March 2012, 70–91, https://doi.org/10.2139/ssrn.2305057.
[171] Gill, Anmul Kaur, Fong Han Tan, Lance Junhong Tay and Violet Qianwei Huang, *Reform Options: Bosnia and Herzegovina's Bilateral Investment Treaties*, Memorandum, Faculty of Law, Trade Lab: National University of Singapore, 22 November 2018.

4.2.1. Limited capital

Small economies are often characterized by limited capital (both financial and human). Capital, in turn, is significant for the promotion, facilitation, and protection of foreign investments. Capital is required for the resolution of investment disputes, when and where such arise Additionally, foreign investment is considered to be an important mechanism for bringing in essential capital into the economy for development, and can be done by a number of means. Signing IIAs, which usually include provisions for ISDS, has long been thought to be an important means of attracting foreign investment (see Chapter 2.1 above), especially for small economies where development is of highest priority. Moreover, increased foreign investment subject to IIAs with ISDS provisions may lead to significant risks to the state. This means that ISDS is not necessarily positive for small economies.

Constraints on a small economy stemming from limited capital are particularly apparent in the debate surrounding TPF in ISDS cases.[172] Small economies are not likely to have the capital to

[172] *Report of the ICCA-Queen Mary Task Force on Third-Party Funding in Commercial Arbitration,* Report no. 4, International Council for Commercial Arbitration (ICCA), April 2018, 3-4,https://www.arbitration-icca.org/media/10/40280243154551/icca_reports_4_tpf_final_for_print_5_april.pdf; See also the defense of major TPF investor in lawsuits Burford in their lawsuit with Napo- Burford, "Burford Capital Response to Muddy Waters," 8 August, 2019, https://www.burfordcapital.com/wp-content/uploads/2019/08/2019.08.08-Burford-Capital-Response-to-Muddy-Waters-FINAL-1.pdf.

fund lengthy and expensive ISDS proceedings. The fact that the domestic legal practice that deals with ISDS is fairly small means that many of the national legal systems lack the expertise to deal with ISDS cases, leading them to rely on expensive international law firms.[173] Therefore, TPF can be helpful for small economies to cope with the financial burden of defending against a claim, for example the funding for Uruguay in the *Philip Morris v Uruguay* case.[174] However, the asymmetries of the system may be exacerbated when TPF is brought in, as third parties are able to diversify against risk with a portfolio of cases, leading to more risky claims. Moreover, the support of claimants by TPF may further tilt the scales against small economies in the ability to amass the capital necessary to deal with ISDS, particularly as the nature of the system, whereby the claimants are always the investors, makes it less likely that third parties with financial motives will want to invest in states as they are less likely to make profits from successfully defending their claims.[175]

According to a 2018 OECD report, the average legal cost per side to settle an ISDS dispute is 4.5 million USD.[176] High costs, were cited as a reason for the world's third largest economy – Japan – to reject the ICS. This is even more significant for small economies as the cases will take up a greater proportion of the economy.[177] The known example relating to *Chevron v Ecuador* and involvingbillions of dollars,[178] may demonstrate the massive financial burden that states could be opening themselves up to when entering into the current ISDS system. Many of these far-reaching implications of signing IIAs with ISDS clauses were not necessarily known at the time of their signing.[179] For example, in 2002, CDC filed a claim against Seychelles based on a treaty signed in

[173] *OECD, Gaukrodger, supra note* 93, 20.
[174] Victoria Shannon Sahani, "Revealing Not-for-Profit Third-Party Funders in Investment Arbitratio," *Oxford University Press Law*, 1 March 2017, https://oxia.ouplaw.com/page/third-party-funders.
[175] *Third Party Funding in Investor-State Dispute Settlement: Round Table Discussion of the ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration: Draft Report for Public Discussion*, ICCA-Queen Mary Task Force, 2017, 5, http://ccsi.columbia.edu/files/2017/11/Third-Party-Funding-in-ISDS-Roundtable-Outcome-Document-FINAL-2.pdf.
[176] Joachim Pohl, "Societal Benefits and Costs of International Investment Agreements," *OECD Working Papers on International Investment*, 19 January 2018, 46, doi:10.1787/e5f85c3d-en.
[177] *Menon and Issac, "Developing Country Opposition to an Investment Court*," *supra note* 35.
[178] *Investor-State Dispute Settlement: UNCTAD Series on Issues in International Investment Agreements II*. Report. United Nations Conference on Trade and Development (UNCTAD), New York and Geneva: United Nations, 2014; Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador, Second Partial Award on Track II, PCA Case No. 2009-23.
[179] David N. Balaam and Bradford Dillman, *Introduction to International Political Economy*, Chapter 7 "The International Trade Structure," Seventh ed. London: Routledge, 2019.

1990.[180] Today, many small economies are signed on to investment agreements that they may not have the capital to defend in complex international litigation.

4.2.2. FDI flows: Capital importers

As stated above, small developing economies often rely heavily on inward FDI and particularly on 'FDI spillovers' in order to spur economic growth and development.[181] The impact of ISDS on FDI flows however, is inconclusive. Although there is some research that has shown a correlation between investment treaties (with ISDS provisions) and FDI flows, there is significant doubt as to whether there is a causal relationship showing ISDS provisions (and indeed investment treaties) lead to an increase in FDI.

Some commentators have suggested that foreign investments protected by investment treaties with ISDS mechanisms, have encouraged a new form of exploitation of countries, through a process known as the 'race to the bottom': investing in those with cheapest labor forces and lowest domestic safety standards. Small economies are more susceptible to this form of exploitation and therefore performance requirements and market access provisions have been inserted into IIAs to encourage 'sustainable investments'. The downside of these protections, is that they limit the host-state's policy space.[182]

4.2.3. Limited bargaining power in Dispute Resolution

In the ISDS system, small economies are often at risk as they have less ability to impact proceedings. The available forms of dispute resolution include negotiation, arbitration and litigation. In any of these, there is significant complexity to the proceedings particularly if the dispute escalates beyond the negotiation stage. The complexities are the result *inter alia* of multiple third-party submissions, evidentiary law, burdens of proof and means to quantify damages.[183]

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[180] CDC Group PLC v Republic of the Seychelles, Award, ICSID Case No. ARB/02/14, 17 December 2003 https://www.italaw.com/sites/default/files/case-documents/italaw6343.pdf

[181] Thomas Farole , Deborah Winkler and Julia Oliver, "Some Types of Foreign Investment Are Better Than Others: A Look at Factors That Help FDI Boost the Local Economy," *World Bank Blogs*, 29 January 201, http://blogs.worldbank.org/trade/not-all-foreign-investment-is-good-a-look-at-factors-that-help-fdi-boost-the-local-economy.

[182] Axel Berger, *Financing Global Development: Can Foreign Direct Investments Be Increased through International Investment Agreements?* German Development Institute, September 2015.

[183] *Possible Reform of Investor-State Dispute Settlement (ISDS) — Cost and Duration*, Report no. A/CN.9/WG.III/WP.153, United Nations Commission on International Trade Law Working Group III (Investor-State Dispute Settlement Reform) Thirty-sixth Session. United Nations, 31 August 2018. [Henceforth: *WG III Cost and Duration*]

In negotiation, the size of the economy naturally means that there is less leverage at the bargaining table as there are fewer alternative disputes which can be used to impact and gain influence in the specific dispute.[184]

In arbitration and litigation proceedings, which ought to offer an advantage to the small party due to the theoretical balancing force of the law, this advantage is lost because of the need for specialization.[185] The proceedings are separate from any other legal system, meaning ISDS requires specialized advice.[186] Consequently, the mere cost of participation (for all sides) is expensive, and where the claimants are large corporations with expert legal advice, they are able to use this to gain bargaining power and to manipulate the proceedings in their favor and against relatively small states.[187]

That said, the system does not entirely work against small economies. A recent experiment testing 257 arbitrators, showed that they had a tendency to grant more favorable judgements to claimants from middle-income over high-income states, and grant further compensation to low-income over middle-income states – an effect the conductors of the research called the 'David effect'.[188]

4.2.4. Concerns over preserving regulatory space

There are concerns that regulators will be 'bullied' by foreign investors, due to the equal standards required by BITs (MFN regime), as these standards include equal protection of foreign investors. Such ISDS mechanisms may threaten democratic processes, for example, by locking in privatization, often with commitments decades ahead, limiting government ability (space) to regulate on behalf of the (often changing) public interest.[189] This system may also threaten the very idea of national sovereignty. In Guatemala, for instance, the Government decided not to close

[184] Kwok Tong Soo, "It's a jungle out there: International trade when bargaining power matters," Working Papers 194613375, *Lancaster University Management School, Economics Department*, 2017, 4-6.
[185] Equality before the law is a universal principle and is found in Article 7 of the Universal Declaration of Human Rights. Universal Declaration of Human Rights: Adopted and proclaimed by UN General Assembly Resolution 217 A (III) of 10 December 1948 Text: UN Document A/810, 1948.
[186] Gottwald, Eric. "Leveling the Playing Field: Is It Time for a Legal Assistance Center for Developing Nations in Investment Treaty Arbitration?" *American University International Law Review* 22, 2007, 260-264.
[187] *Duration and Cost of State-State Arbitration Proceedings: Submitted to UNCITRAL Working Group III*, Report, Permanent Court of Arbitration (PCA). 24 October 2018.
[188] Sergio Puig and Anton Strezhnev, "The David Effect and ISDS," *European Journal of International Law* 28(3), 2017, 733, doi:10.1093/ejil/chx058 [Henceforth: *Puig and Strezhnev*].
[189] *TJM CETA, supra note* 48; The public interest is liable to change due to changing circumstances. Thus, what may be beneficial to the public of a state at the time of signing a BIT, may no longer be in the interests of the same public at a future stage. The BIT regime limits state's ability to adapt regulation based on changing public interest.

a controversial mine owned by the Canadian corporate investor 'Goldcorp', even though the IACHR (Inter American Court on Human Rights) had recommended to close the mine down. According to some sources, the government's decision was highly influenced by the threat of an investor-state dispute.[190] Regulators in small economies are particularly susceptible to these limitations due to the fact they start off with less diversity of options in the first place (see chapters 4.1.1 and 4.1.2), and because any potential case would involve a larger proportion of the economy and the government's available resources (see example of Ecuador in chapter 2.3.1).

4.2.5. Reliance on regionalism

Due to their size, small economies rely significantly on regionalism[191] in order to increase economies of scale and regional diversification of business, and thus increase investment potential.[192] Therefore, any ISDS decision could have implications on the ability of the region to continue to function – both in terms of shared industries and in terms of specialized industries within the bloc.[193] Arguably, since investment arbitration is an *ad hoc* system, the arbitrators are not required or equipped to take into account the broader regional implications of their decisions.

Furthermore, the limited transparency of the proceedings alongside the limitations on third party interventions[194] mean that a dispute with broad implications on various stakeholders may be resolved in a manner that does not fully account for third parties, such as civil society and other stakeholders that are impacted by the proceedings.

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[190] Inter-American Commission on Human Rights, "Resolution 1/17: Human Rights and the Fight Against Impunity and Corruption," 12 September 2017, https://www.oas.org/en/iachr/decisions/pdf/Resolution-1-17-en.pdf.

[191] Katarzyna Kolodziejczyk, "Poland in the European Union. Ten Years of Membership," *Revista UNISCI* 40,January 2016, doi:10.5209/rev_runi.2016.n40.51803; The clearest example of a successful economic bloc, whereby states have used the bloc to strengthen their economic bargaining power, increasing FDI flows and multiple other benefits, is the European Union. States such as Poland have been able to make significant gains by functioning within this bloc.

[192] See for example the WB6 MAP, "Multi-annual Action Plan for a Regional Economic Area in the Western Balkans – MAP," *Regional Cooperation Council*, July 2017, https://www.rcc.int/priority_areas/39/multi-annual-action-plan-for-a-regional-economic-area-in-the-western-balkans--map. [Henceforth: *WB6 MAP*]; see also: CAREC 2030 strategy, "Central Asia Regional Economic Cooperation Program Senior Officials' Meeting," Central Asia Regional Economic Cooperation (CAREC)," 28 June 2019, https://www.carecprogram.org/uploads/2019-CAREC-SOM-Summary.pdf.

[193] In a shared industry, an ISDS procedure will impact the industry of all of the states doing business with the specific investor. In a specialized industry, an ISDS case that takes a heavy toll on the industry of one state, will mean that other states will not be able to rely on the specialization within the region and will lose the advantage of being able to focus on specializing in other industries where they have the comparative advantage.

[194] ICSID, "Decisions on Non-Disputing Party Participation," *Decisions on Non-Disputing Party Participation*, https://icsid.worldbank.org/en/Pages/process/Decisions-on-Non-Disputing-Party-Participation.aspx; The mere fact that amicus curiae participation in proceedings requires court permission and is often denied, demonstrates the system's approach by which third party opinions and regional considerations are often given very limited weight.

5. Implications of ISDS reform for the interests of small economies

The ISDS models surveyed above cannot be viewed as stand-alone concepts, as they have different implications for different states, depending on the states' characteristics and the models' parameters. To achieve a full picture of the concerns of small economies with an emphasis on the EU, we will need to also analyze, briefly, the effects of the developments following the *Achmea*case and the other CJEU judgments discussed in Chapter 2.

In order to understand and analyze the pros and cons of each model in the context of small economies, we will pursue the following path: First, we will integrate between the characteristics of small economies and the five models discussed previously.[195]Second, we discuss the situation of IIAs in the EU context, distinguishingbetween three different groups of small economies: EU member states; EU candidate states; and non-European states. Finally, specific recommendations for small economies will be suggested (in the final chapter).

5.1.Comparison and Analysis of the Models vis-à-vis the interests of small economies

Both the models and small economies are defined by unique characteristics.[196] In the coming paragraphs we will analyze the parameters of the models in light of the features of small economies.

5.1.1. Limited capital[197]

There are several parameters that are impacted by the restriction of capital, but generally we will analyze them from a cost-efficiency point of view (the least expensive process).[198] Greater **transparency** will facilitate the proceedings, render them more credible, and reduce corporate corruption.[199] In turn, this will prevent false claims by investors and also reduce the cost of attaining information. **Consistency of decisions** increases security and predictability for states.

[195] Chapters 3-4.
[196] Characteristics of small economies: Limited capital, FDI flows: capital importer, limited bargaining power, reliance on regionalism, preserving regulatory space. Parameters of dispute settlement models: transparency, consistency, judges, legitimacy, exhaustion of domestic remedies, enforcement and the right to appeal.
[197] We include the limited capital (chapter 3.2.1) and limited capacity and resources for complex litigation (3.2.6) in our analysis here.
[198] limited capital: there is a need to handle resources in a limited way. Therefore, we chose to analyze from a cost-efficient point of view.
[199] U.N. CONF. ON TRADE & DEV, "World Investment report 2015: Reforming International Investment Governance" 114 (2015), http://unctad.org/en/Publications Library/ wir2015_.en.pdf.

Unpredictability for future cases creates more legal expenses:[200] "Consistency can increase the cost-effectiveness of dispute settlement for parties to disputes and potential disputes".[201]

Due to the lack of resources there is a need for a quick and inexpensive process. Regarding **adjudicators**, in an ad-hoc system, the marginal costs are higher than in a permanent system, but the fixed cost is higher in the permanent system. So, a permanent system can be more expensive if there aren't many cases (as the ad hoc is an "expense per case" system).[202] In an ad-hoc system with arbitrators, the lawyers of the parties will have to spend time selecting their arbitrators and trying to predict the outcome with regards to different arbitrators that they might chose, adding to the legal expenses of any particular case.[203] In general, **the ability to review** is beneficial for any country, but in some cases it might not profitable.

5.1.2. FDI flows: capital importer

There are several parameters that are impacted by FDI flows. Higher **transparency** will increase reliability for both investors and states,[204] and as a result, it may increase foreign investments as the investors will know the system and will feel more assured when joining it. For the same reason, **consistency of decisions**is also very important.[205] Regarding **litigation,** studies show that the more efficient the dispute settlement system, the less claims are brought against the host state.[206]We can infer that there is more assurance of the investors in the system, so the efficiency may have a positive effect on FDI flows. Regarding **adjudicators**, it can be assumed that once the system has

[200] Anthea Roberts and ZeinebBouraoui, "UNCITRAL and ISDS Reforms: Concerns about Costs, Transparency, Third Party Funding and Counterclaims," *EJIL:Talk!*, 6 June 2018, https://www.ejiltalk.org/uncitral-and-isds-reforms-concerns-about-costs-transparency-third-party-funding-and-counterclaims/ [Henceforth: *Roberts and Bouraoui*].
[201] Organization For Economic Cooperation and Development [OECD], "Government Perspectives on Investor-State Dispute Settlement: A Progress Report." 14 December 2012, 17-18, http://www.oecd.org/daf/inv/investment-policy/ISDSprogressreport.pdf [Henceforth: *OECD, ISDS Progress Report*].
[202] Susan D. Franck, "Arbitration Costs: Myths and Realities in Investment Treaty Arbitration," 23 April 2019, https://www.amazon.com/Arbitration-Costs-Realities-Investment-Treaty/dp/0190054433/ref=sr_1_1?keywords=arbitration+costs&qid=1559073275&s=books&sr=1-1.
[203] *Roberts and Bouraoui*, *supra note* 200.
[204] "Transparency," UNCTAD Series on Issues in International Investment Agreements I, 2009, 6-9, https://unctad.org/en/PublicationsLibrary/unctaddiaeia2011d6_en.pdf.
[205] *OECD, ISDS Progress Report*, *supra note* 201, 17.
[206] Roderick Abbott, Fredrik Erixon and Martina Francesca Ferracane, "Demystifying investor-state dispute settlement (ISDS)", *ECIPE Occasional Paper* 5, 2014, 10-11.

a permanent appointment it becomes more consistent and predictable and therefore the whole system becomes more legitimate and secured, with potential increasesin FDI-flows.[207]

5.1.3. Limited Bargaining Power

A **transparent** system will ensure that small economies with low bargaining power will be able to rely on earlier decisions and achieve better results, similar to those achieved by larger economies with greater bargaining power. The lack of transparency can create "discrimination" between states with different amounts of bargaining power.[208]

Regarding **consistency of decisions**, it seems that it is only relevant in a multilateral system, where small economies will be able to rely oncountries with more bargaining power, giving the state the ability to develop legal and negotiating capacity.[209]

Research shows that in an ad-hoc system, **adjudicators** are more inclined to favor the weaker party, or in this case small economies because of their biased views (for example, it seems that small economies are more likely to receive recovery of legal expenses after arbitration).[210]

The same logic can be identified regarding the **process of appeal** as it is more beneficial to the host state and there would be a necessity of strong bargaining power in order to include such clauses in the investment agreement.[211]

5.1.4. Reliance on regionalism

It seems that reliance on regionalism can solve the existing problems with **transparency, consistency** and **adjudicators**, as regional agreements can create more consistency and require higher standards (regarding those issues) in investment agreements. Even so, this agreement can

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[207] B. Peter Rosendorff and Kongjoo Shin, "Importing transparency: The political economy of BITs and FDI Flows," *Manuscript, New York University Political Science Department*,New York, NY: NYU, 2012, 3, https://files.nyu.edu/bpr1/public/papers/RosendorffShinAPSA2012. Pdf.

[208] As an inference the lack of transparent prices may also contribute to price discrimination, which can cause different customers to pay higher prices, an outcome that may be acceptable in some markets but may lead to undesirable consequences in others. For example, if the customers with the least bargaining power also tend to be those with the least ability to pay, such discrimination may be deemed particularly undesirable; AndrewD. Austin and Jane G. Gravelle, "Does price transparency improve market efficiency? Implications of empirical evidence in other markets for the health sector," 2007.

[209] Model C, para 4.3.

[210] *Puig and Strezhnev*, *supra note* 188, 742, https://academic.oup.com/ejil/article/28/3/731/4616684.

[211] This is our inference from the literature on domestic remedies.

create parallelism (if older agreements are not replaced with the creation of new ones) which then only make the system more complex and may make those problems worse.[212]

Another consideration that can be taken into account is that regionalism is more effective when there is a strong player in the bloc that can lead it. Due to the exit of strong players (like the US and UK) from their regional blocs, we might see some sort of international trend of avoidance of globalization and regionalism in the coming years.[213]

5.1.5. Preserving regulatory space

The need to preserve regulatory space is a pressing need for small economies, and therefore vital to be realized through relevant model features. As a decision will be more **consistent** and **transparent**, it will prevent instances of a chilling effect on regulators due to a lack of knowledge regarding what the judicial body might rule. This will mean limits on regulators are diminished to clear situations.[214]

According to criticism on the bias and conflicting decisions of **adjudicators** in ISDS, these problems also lead to them being too constricting the regulatory space of states.

5.2.Analysis of three groups of small economies

5.2.1. Small economies in the EU: Particular concerns

In this section, we will discuss two types of investment agreements of EU member states: their agreements with other states in the EU (Intra-EU) and their agreements with non-EU states (Extra-EU). We will pay particular attention to the implications of the *Achmea case*.

5.2.1.1.Intra-EU investment agreements

As described above (see Chapter 2.1.5, the Achmea case), the Achmea case called into question the validity of a BIT between two EU member states, arguing that they undermine the supremacy of EU laws. The effect of the case is not yet clear; however, according to the EU member state's

[212] "The Rise of Regionalism In International Investment Policymaking: Consolidation or Complexity?," *UNCTAD IIA Issues Note No.3*, 2013, 4-6, https://unctad.org/en/PublicationsLibrary/webdiaepcb2013d8_en.pdf.
[213] David M. Howard, "Creating Consistency through a World Investment Court," *Fordham International Law Journal* 41(1), November 2017, 11-12.
[214] Jane Kelsey, David Schneiderman and Gus Van Harten, "Phase 2 of the UNCITRAL ISDS Review: Why 'other matters' really matter," *Investment Treaty News*, 23 April 2019, https://iisd.org/itn/2019/04/23/phase-2-of-the-uncitral-isds-review-why-other-matters-really-matter-jane-kelsey-david-schneiderman-gus-van-harten-2/.

declaration in 2019,[215] the countries that are EU members will terminate their BITs within Europe.[216]

Small economies tend to build their foreign relations on BITs with other countries. If the *Achmea* case will be interpreted in a broad manner, the relations of small economies that are members of the EU with other countries may be affected, even if the countries with which they have relations are not EU members. Therefore, if assuming that EU members would have to adjust their ISDS agreements to EU law, they will face a challenge that demands both time and high costs. This challenge will be particularly challenging for small economies that have limited capital.

Besides this, the fact that a small economy is within the EU also effects its regulatory space;[217] on the one hand, small economies may benefit from the protection provided by the EU umbrella. Thus, canceling existing intra-EU BITs, in which the interests of the state were not embodied for various reasons (lack of understanding of the implications of the agreements, lack of strong bargaining power, etc.) will enable small economies to accept agreements that improve their economic position, as soon as they adopt the EU agreements. Therefore, the effect of the superiority of the EU law can help a small economy, since these countries usually have moderate or low bargaining power.[218]

On the other hand, the judicial system of the EU and its BITs can undermine the ability of a small economy member state to regulate its own internal affairs. thus, a small economy may adjust its legislation or regulation in a way that will make her subject, in a certain extent, to the form of activity of the EU, which is not necessarily incompatible with the state's own interests. Additionally, there is the meager bargaining power of a country with a small economy, which may have more difficulty than others in negotiating.

5.2.1.2.Extra-EU investment agreements

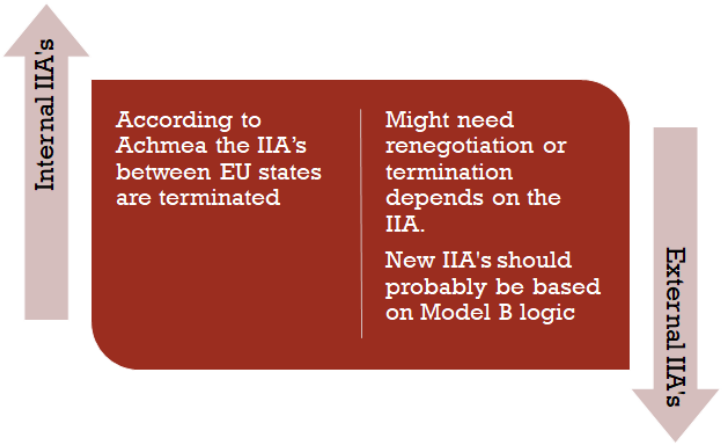
As mentioned, after *Achmea* most EU member states issued a joint declaration to terminate all intra-EU BITs.[219] This can have an effect on extra EU agreements, due to the incompatibility of

[215] As mentioned in *2.1.5*.
[216] Ibid..
[217] Jens H Pohl, "Intra-EU Investment Arbitration after the Achmea Case: Legal Autonomy Bounded by Mutual Trust," *European Constitutional Law Review: EuConst* 14(4), 2018.
[218] Manav Chadha, "The Principle of Autonomy of EU Law and Its Interpretation in Achmea", *SSRN*, 2018, 13-14.
[219] *Declaration of the Member States of 15 January 2019, supra note* 46.

the ISDS provision with the principle of the autonomy of the EU (this problem can also occur with extra-EU agreements).[220] This can influence small economies, as they might have to renegotiate the terms of their extra-EU agreements, if they are a part of or a potential candidate to the EU.

It seems that the effect of *Achmea*on extra-EU BITs might be dependent on whether the BIT gives the arbitrational tribunal that is meant to deal with the disputes authority to apply and interpret EU law. If the tribunal doesn't have to apply and interpret EU law, then it doesn't undermine the autonomy of the EU (one of the main concerns that was raised in *Achmea*) and so it is probably valid (there is no need for termination or renegotiation). BITs that use interpretation of international law can also be problematic, as EU law counts as international law. Agreements that explicitly apply and interpret EU domestic law are also invalid. [221]

The following illustration demonstrates the impact of recent developments on the existing and future IIA's of EU member states:



5.2.2. EU candidate states: Particular concerns

Some states are interesting inacceding to the EU, as there are significant benefits to be gained from EU membership.[222]In order to become a member of the EU, the potential candidate needs to meets

[220] AngelosDimopoulos, "Achmea: The principle of autonomy and its implications for intra and extra-EU BITs," *EJIL: Talk*, 27 March 2018, https://www.ejiltalk.org/achmea-the-principle-of-autonomy-and-its-implications-for-intra-and-extra-eu-bits/ [Henceforth: *Dimopoulos*].
[221] Quentin Decleve, "Does Achmea Invalidates All Intra-EU BITs? Not necessarily!," *International litigation blog*, 24 July 2018, http://international-litigation-blog.com/does-achmea-invalidates-all-intra-eu-bits-not-necessarily/.
[222] Entering the EU is expected to raise output and growth rates by stimulating entrepreneurship, foreign direct investment (FDI), and technology transfers. It is also one single market with no border in the EU; A. Moravcsik and M. A. Vachudova, "National interests, state power, and EU enlargement," *East European Politics and Societies*, *17*(1), 2003 47-49.

the Copenhagen criteria[223] and fully adopt the EU *acquis*. Therefore, EU candidate states must take significant actions in order to be accepted as EU Members. One of the many requirements that need to be met in order to accede to the EU is the condition regarding the adoption by the candidates of the EU *acquis*,[224] meaning they need to accept and comply with all EU commitment and agreements. Such a requirement can be very difficult to fulfill, especially for small economies because of their limited resources to undergo such changes (whether it be financial or human resources). The adaptation of local legislation to that of the EU raises difficulties not only in terms of the legislation itself, but also in terms of obligations and agreements.

5.2.2.1. Candidate states' BITs replaced by agreement or chapter with the EU

In accordance with current EU policy in FTA's, the EU member states' previous investment agreements with the candidate states will be replaced and suspended with the new IIA/FTA agreement.[225] According to the suspension the replacement clause in the agreements,[226] the same action of replacing and suspending the agreement must take place within the Candidate states. Hence, EU candidate states should take into consideration the possibility that future disputes will be governed by an ICS clause.[227]

5.2.2.2. Existing and new investment agreements with EU Member States

In accordance with CJEU decision on *Achmea* case and the EU states declaration (2019), two EU Member State will terminate their commonBIT's.[228] Therefore, EU candidate states should consider whether it is beneficial for them to terminate their BIT's with EU member states. On one hand, joining the EU will guarantee equal treatment in legal institutions, since the dispute is not

[223] The Copenhagen Criteria are the rules that define whether a country is eligible to join the European Union. The criteria require that a state has the institutions to preserve democratic governance and human rights, has a functioning market economy, and accepts the obligations and intent of the EU;European Council in Copenhagen, Conclusions of the Presidency, 21–22 June 1993 (DN: DOC/93/3, of 22 June 1993). The criteria were supplemented by the caveat that the Union must be ready and able to absorb new members without compromising the achievements of integration.
[224] Christophe Hillion, "The Copenhagen Criteria and Their Progeny," 6 March 2014, C. Hillion (ed), EU enlargement (Oxford, Hart Publishing, 2004), https://ssrn.com/abstract=2405368.
[225] *CETA*, *supra note* 48, art. 30.8(1); *EUSFTA*, *supranote* 59, art. Art. 4.12(3)(a) ;*EUVFTA*, *supranote* 59, art. 4.20(2).
[226] Ibid.
[227] *CETA*, *supra note 48*, Section F (Chapter 8).
[228] *Declaration of the Member States of 15 January 2019, supra note* 46;See footnote 2.

settled in arbitration. On the other hand, it will limit country's regulatory space because the internal legislation must be adjusted with the laws of the EU.

5.2.2.3. Existing and new investment agreements with non-EU states

As mentioned,[229] it is not completely clear if BITs between EU member states and third parties (non-EU states) are valid according to *Achmea*.[230]Therefore, it is possible that some agreements will need to be terminated or renegotiated when a candidate state joins the EU (as it must comply with all EU laws, and it is possible that some of the agreements do not comply with EU law.

5.2.3. Non-EU States

With regards to non-EU states, the concerns should be somewhat like the ones already stated above. That is, there might be a need to renegotiate or terminate existing agreements (agreements between small states that are non-EU and EU states).

[229] See. chapter 5.2.1.
[230] *Dimopoulos, supra note* 220.

6. General recommendations for a small economy

Given the characteristics of small economies and the necessary considerations impacting the choice of ISDS Model, in this final chapter we will present our recommendations for small economies with regard to the various models.

Model A (existing ISDS) is an existing and operational model. Despite criticism, there is potential for improvement which can be seen through current trends. The fact that the model's problems are already known, means that it is the option with the lowest degree of uncertainty. This is particularly apparent for small economies that have low bargaining power regarding new models, meaning that new agreements relating to the new models will most likely not be in their favor.[231] Therefore, until further models have been tested and proven, it is in the interests of a small economy to best adapt to the current system with appropriate changes.

Some changes that may be appropriate for a small economy seeking to adapt to the existing ISDS system, include the following: renegotiation of existing BITs, specifically through negotiation based on regional cooperation or through joint interpretive statements; limiting current agreements to settlement in a single tribunal (no "fork in the road" clauses), and/or adoption of exhaustion of domestic remedies requirements. Small states should be particularly selective and cautious in signing and ratifying new BITs/IIAs including ISDS.

Although we believe it is in the best interests of a small economy to maintain stability to the greatest extent possible, and therefore use Model A where appropriate, there are also advantages to consider within the other Models.

Model B (ICS)is in theory a greatly improved Model of ISDS, as it looks to improve consistency in decision making, increase transparency, may have loweroverall costs, allows for a process of appeal and encourages domestic remedies. Beyond theory, the model also already exists to a limited extent – on paper - and applies to member states of the EU in some agreements.[232] However, it is still developing, and its benefits are yet to be proven, as it has not yet been implemented. For states that are not currently members of the EU, the model is not relevant in

[231] Although it may be in the interests of small economies to apply a model similar to that of India (see Chapter 2.1.1.1), this is not practical due to the extensive resources creation of such a system would require. This in light of the fact that India is one of the largest economies (see Chapter 3.2).
[232] *Opinion 1/17, supra note* 6.

practice as there is an inherent difficulty in creating their own ICS with non-EU parties – as this requires creating a newtribunal. Thus Model B offers an incentive for EU accession, but is probably not relevant for small economies not within the EU or without an IIA with the EU. This model might be more relevant to a regional bloc, or a regional economic union similar to the EU.

Model C (MIC) is currently still a hypothetical model that is therefore difficult to effectively evaluate. According to the discussion in Chapter 5, this model might be beneficial for a small economy with low bargaining power and low FDI flows. Some of the UNCITRAL WG III and EU proposals seek to offer improvement in these areas and are expected to benefit small economies particularly given the clearer bargaining terms and more equal system. However, there are concerns surrounding the politicization of such a mechanism and the potential costs of maintenance. Therefore,we recommend that small economies wait until this model develops, before adapting their ISDS policies to accommodate it.

There is a likelihood that in the future there will be pressure upon states in the EU and on those signing trade and investment agreements with the EU (large and small economies alike) to adopt the MIC model. However, due to the many changes this would require, the desire for stability means that small economies should tend to first adapt existing and future IIAs within the existing ISDS system (Model A), and to adopt more independent international trends for ISDS. This brings us to our reasoning regarding **Model D (State to state) and Model E (Domestic Regulation)**.

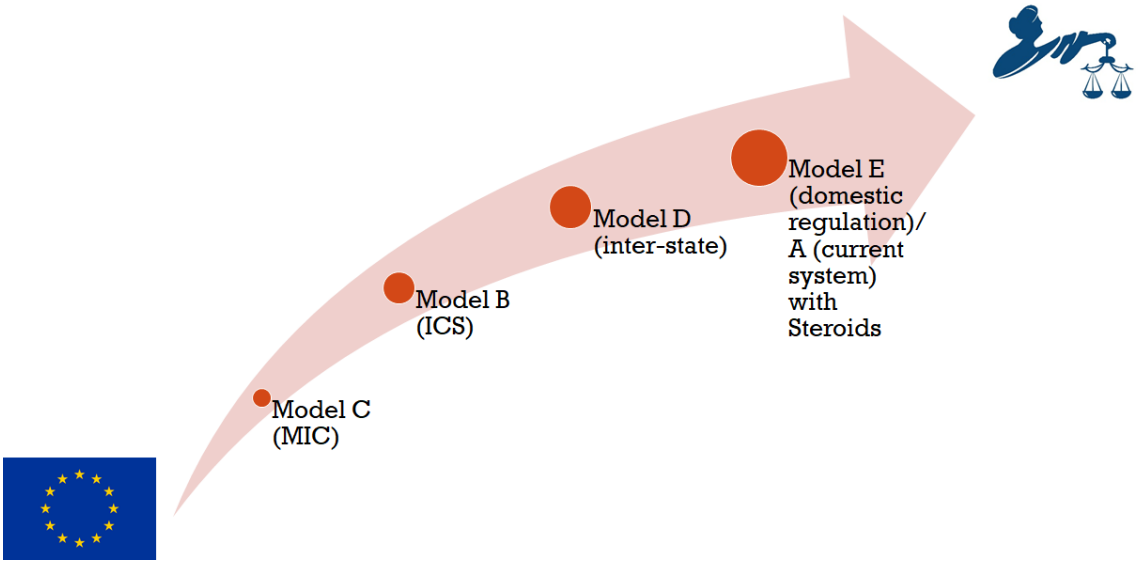
The most advantageous non-ISDS options for dispute resolution are operating via state-to-state investment tribunals or resolving disputes through domestic regulation. A state-to-state system (**Model D**), will require renegotiation of agreements and is therefore not optimal for a state seeking EU accession (as this will terminate existing provisions due to the supremacy of EU law). The state-to-state mechanism is also impacted by political considerations and has an added legitimacy problem to the current system. However, the fact that the model is between two states (and not between investor and state), might be beneficial: "states are less likely to challenge certain types of regulatory measures, or make certain types of legal arguments that could be brought against them in the future."[233]

[233] *Bernasconi-Osterwalder, supra note* 141, 21.

The use of domestic measures by replacing BITs and IIAs with domestic regulation that will protect investors (**Model E**) could be advantageous for a small economy. It is likely that domestic courts will give more deference to state rights. Also, this system cuts many of the ISDS expenses if there is enough protection under domestic law to prevent deterrence of foreign investments (see example of SA in Chapter 2.3.1).

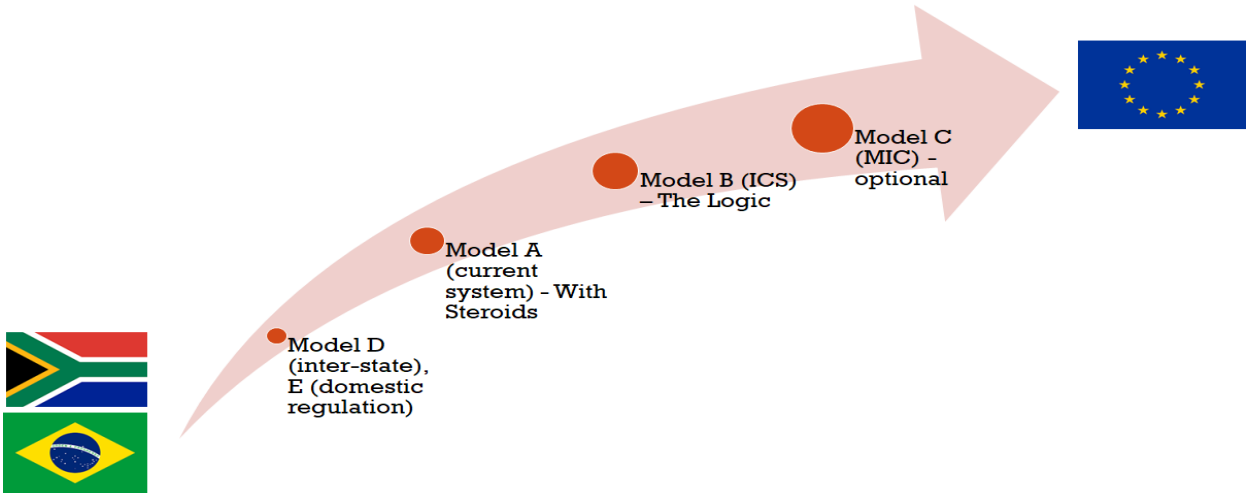
Even so, this system has only been adopted by non-small economies, like South Africa. Therefore, the implications of adoption of this model bysmall economies which might be susceptible to loss of investments should they deviate from the established system (see analysis in Chapter 3.1 and 3.2) remain unclear.

Most appropriate model for Non-EU states:



The above table represents our general recommendations for non-EU states and the most appropriate ISDS mechanism for them. We believe that the current ISDS model (with adopted improvements or "steroids", as discussed earlier) and the use of domestic regulation, are the best options for small economies, and are the ones that can give the most room for the sovereignty of the state. An inter-state dispute settlement model is the next best. Despite its political problems and the issues with its legitimacy, it can still contribute to the regulatory space of the state. We believe that the ICS and MIC models, are best suited to a state that wants to match the EU agenda, but alongside this, we are aware that they are the most restrictive of state sovereignty.

Specific points for EU candidates:



The above table represents our general recommendations for EU candidate states and the most appropriate ISDS mechanism for them. For a small economy seeking EU accession, it will most likely be beneficial to harmonize their ISDS mechanism with the EU investment policy. In order to do so, we recommend that they chose a model along the lines of the current model of ISDS, or, if possible, the ICS model, as they are most similar to the EU agenda. Adopting other models that are inherently different from EU policies, such as the inter-state model or a model emphasizing the use of domestic regulation can be possible as a stage prior to accession, but we believe that it will be a waste of resources as further changes will be required if the accession takes place, and this will be wasteful for small economies with limited capital.

As mentioned (in chapter 5.2.1 and 5.2.2), a condition for accession to the EU will be the termination of IIAs with EU member states, and accession might also require renegotiation or termination of agreements with non-EU states (**this may also be relevant to EU member states**, for reason and explanations see chapters above). In addition, agreement with states that are parties to agreement with the EU (such as Canada in CETA etc.) will need to be terminated and will be replaced by the EU agreements (see more in chapter 5.2.2).

Additional recommendations when drafting ISDS provisions

Exhaustion of domestic measures – we recommend that if possible, small economies should add exhaustion of domestic measures as a condition for the initiation of an arbitration procedures.

A small economy with low bargaining power would benefit from the use of domestic remedies because in comparison to the ISDS adjudicators, the local adjudicators are more likely to be familiar with the needs and constraints of the state.[234] However, in practice, it seems that only states with a high level of bargaining power are able to insert clauses that include the exhaustion of domestic remedies.[235] Exhaustion of Domestic Remedies will give host States with less developed legal systems the ability to promote the rule of law by helping to clarify relevant domestic legal standards.[236] An example of an exhaustion of domestic remedies provision can be found in the 1976 Germany–Israel BIT: "Local judicial remedies shall be exhausted before any dispute is submitted to an arbitral tribunal".[237]

A process of facilitation - we recommend making the small economy more "investor friendly" by removing barriers to investments. Possible forms of facilitation include: providing visas that are easier to acquire for investors, making sure that there are flights between the states, etc. A good example of this is Brazil, whose stated goal in investment agreements, is to "regulate the relationship between foreign investors and host countries".[238] Though Brazil is achieving this goal through a separate system of Cooperation and Facilitation Investment Agreements ("CFIAs"), facilitation does not require an extreme change in the system, but can take place alongside the ISDS mechanism being used by the small economy.

Regional investment agreements - we recommend small economies join a regional or sub-regional economic alliance and together agree on an IIA model. This should be beneficial because of the following reasons: Implementation of IIA's on the basis of regional agreements gives the regional member states stronger bargaining power vis-à-vis the state with which they sign. In these cases, the "size advantage" is more pronounced, as greater economic power allows for receiving better

[234] Jose Daniel Amado, Jackson Shaw, Kern Martin and Doe Rodriguez, "Arbitrating the Conduct of International Investors," 80.
[235] *Puig and Strezhnev*, *supra note* 188.
[236] Matthew C. Porterfield, "Exhaustion of Local Remedies In Investor-State dispute Settlement: An Idea Whose Time Has Come?", *The Yale Journal of International Law Online*, 2015, 5, https://www.law.georgetown.edu/wp-content/uploads/2017/09/Porterfield-Exhaustion-of-local-remedies-2015.pdf.
[237] Treaty between the Federal Republic of Germany and the State of Israel concerning the Encouragement and Reciprocal Protection of Investments, Ger.–Isr., 24 June 1976, art. 10, para. 5, http://investmentpolicyhub.unctad.org/Download/TreatyFile/1344.
[238] Natali Cinelli Moreira, "Cooperation and Facilitation Investment Agreements in Brazil: The Path for Host State Development," *Kluwer Arbitration Blog*, 13 September 2018, http://arbitrationblog.kluwerarbitration.com/2018/09/13/cooperation-and-facilitation-investment-agreements-in-brazil-the-path-for-host-state-development/.

agreement terms. An example of a regional agreement that uses the investment agreement model is the Belgium–Luxembourg Economic Union (BLEU).