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Procedural versus Substantive Reforms: Is the Work of UNCITRAL WGIII Worth the Wait?

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Calls for investor-State dispute settlement ("**ISDS**") reform have persisted for some time (see blog coverage here). Competing calls for retaining the status quo, modifying the system, or abandoning the system altogether have each gained traction. With a drastic increase in the number of investment cases being brought, accompanied by the "mega" awards, the international community has had to respond.

One of the most prominent global initiatives to address these reforms has been the UNCITRAL Working Group III ("**WGIII**") process (see blog coverage here). WGIII's discussions began in 2017 and, as recently announced, WGIII plans to conclude its reform process by 2025. The question that arises is whether this 8-year reform process will meaningfully address the calls for reform. This is a significant question because if, after undertaking such a long and detailed reform process, criticisms on the basic ideas of ISDS persist, the international community has to consider whether the transaction cost was worth it at all.

What Issues or Reforms Have States Raised?

With the resumed 40th session of WGIII on ISDS reforms in May, we surveyed prior submissions from States during UNCITRAL's ISDS reform process. Our objective was to take stock of the arguments put forward by States and assess whether WGIII will meaningfully address them. Below is a detailed table that captures selected examples of issues or reforms suggested by States. Importantly, WGIII received the mandate to address only procedural, and not substantive, matters. Indeed, recently prominent groups like the Columbia Center for Sustainable Investment have called into question the work undertaken by WGIII, arguing that the limited reforms have the effect of locking in a "broken system." As the table demonstrates, the focus on procedural, rather than substantive, matters results in critical gaps in the reform process.

Selected Examples of Issues or Reforms Suggested by Governments during UNCITRAL's ISDS Reform Process

Reforms Suggested by Governments	Description	Within the scope of the WGIII mandate?
Claimants should be required to exhaust local remedies	Requiring exhaustion of local remedies may reduce the need for arbitration. (e.g., Indonesia, Morocco)	Maybe
Fees and costs should be transparent	Establishing transparent fee structures and budgets for the proceedings may encourage efficient case management and reduce costs. (e.g., South Africa, Thailand)	Yes
Frivolous claims dismissed	Developing a standardized framework and guidelines for identifying and dismissing frivolous claims may prevent investors from filing excessive or abusive arbitration requests. (e.g., Indonesia, Morocco)	No
Timelines should be streamlined	Establishing predetermined timeframes for the proceedings may avoid unnecessary delays and costs, due to existing ad hoc nature of current arbitral timetables. (e.g., Thailand)	Maybe
Third-party funding should be disclosure of banned altogether	Requiring disclosure of, or banning altogether, third-party funding arrangements may obviate otherwise unknown potential conflicts of interest. (e.g., South Africa, Thailand)	Yes
A code of conduct for arbitrators should be standardized	Developing a standardized and widely accepted code of conduct, with clear and enforceable guidelines, may avoid potential conflicts of interest, especially in "multiple-hatting" scenarios. (e.g., Chile, Israel, Japan, Bahrain)	Maybe (parallel work undertaken by ICSID/UNCITRAL)
An Advisory Centre on International Investment Law should be created	Creating an advisory center may help States that struggle to respond effectively to investment disputes because of the lack of resources and institutional capacity. (e.g., Thailand)	Yes
An Appellate Mechanism or Multilateral Investment Court should be created	Establishing an appellate mechanism, with defined procedures and enforcement mechanisms, may enhance access to justice and procedural fairness. (e.g., Russian Federation, South Africa)	No
Counterclaims should be permitted	Permitting counterclaims may counter the perceived imbalance in favor of investors in IIAs. (e.g., South Africa)	No
Third-party intervention should be permitted	Increasing participation from third parties that have legitimate interests in a dispute may foster transparency and equity. (e.g., Ecuador, South Africa)	Yes
Investor obligations should be established	Establishing direct and binding investor obligations in IIAs may counter the perceived imbalance in favor of investors in IIAs. (e.g., South Africa)	No
Regulatory chill should be prevented	Preserving regulatory autonomy may reduce State reluctance to regulate in key domestic areas due to fear of litigation. (e.g., Indonesia, Burkina Faso)	No

Identifying Gaps

Putting aside the merits of the argument that the distinction between procedural and substantive reforms is difficult to make, the reality is that criticisms of ISDS extend to *both* the procedure and substance. Indeed, as is demonstrated in the table above, States continued to raise substantive concerns, even before WGIII began. A reform process that only considers procedural reform addresses merely half of the problem, despite the significant transaction costs associated with the process. Moreover, because certain procedural reforms have a substantive component, it may be shortsighted to only address the procedural component. For example, procedural reforms relating to counterclaims should also be paired with substantive reforms focused on establishing direct and binding investor obligations in IIAs.

While certain reforms put forward by States, such as an appellate mechanism and a code of conduct for arbitrators, are currently under consideration by WGIII, many are not. For example, regulatory chill has been raised often by government throughout the ISDS reform process as a significant barrier, yet WGIII has acknowledged that this is not a procedurally related issue and has chosen not to engage.

As further examples, several reforms suggested by governments specifically relate to drafting IIAs, including establishing direct and binding investor obligations (which remain rare in IIAs). Perhaps because these are issues are substantive in nature, WGIII has not engaged. It appears unlikely that any such issues will be addressed by WGIII before the proposed end-date of 2025. This misses a critical opportunity to collaborate with governments to fully address their stated concerns with the ISDS system. Indeed, it may also have the unintended effect of exacerbating what is often viewed as an investor-focused system, which would have further downstream negative effects on, for example, regulatory chill.

Further, several critical issues arising out of the investment treaty jurisprudence focus on substantive issues and will remain unanswered. For example, can an investor restructure an investment to take advantage of BITs? Does the most-favored-nation clause extend to dispute resolution matters? Are legitimate expectations protected under the minimum standard of treatment? Can an investor select the valuation date in the case of an unlawful expropriation? Such issues are endemic to investment treaty arbitration and subject to a wide-range of highly contested views. But, as these are "substantive" issues, they will not be addressed by WGIII.

The Road Ahead

We are reminded of South Africa's comment during WGIII that "we cannot divorce the procedural from substantive concerns as they are intricately related." In the absence of a holistic reform process that looks at both substance and procedure, problems will persist. Indeed, these remaining gaps, which are primarily substantive, rather than procedural, can provide a helpful roadmap for furthering ISDS reform efforts outside of UNCITRAL and in parallel to it.

Substantive reforms will require concerted engagement by States via their role in

negotiating new IIAs. For example, two of us have highlighted trends in recent IIAs (here) and model agreements (here) that could help to address these gaps. These trends underline a concurrent process by many governments to address both procedural and substantive concerns within their ability to both develop model agreements and enter into investment treaties. Indeed, the recently released Canadian FIPA Model addresses many of these concerns (see blog coverage here).

WGIII could take note of such trends and seek to link procedural reforms by engaging with governments on how best to align procedural and substantive dimensions. For example, a consultation process after the conclusion of WGIII could provide governments with an opportunity to reflect back on WGIII and its outputs, so as to identify any unresolved matters and options for further engagement.

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