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# Investment Court System: A Cure for the 'Broken' ISDS

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***Abstract:*** *This paper discusses the EU Commission's proposal to establish a ground-breaking, two-tier Investment Court System in the Section 3 of the Commission' draft TTIP to address concerns about systemic deficiencies looming behind the current ISDS (mainly lack of legitimacy, consistency and transparency) by bringing the private model of investment dispute settlement back to the public domain, as well as providing for an appellate mechanism to harmonise inconsistency in rulings and correct erroneous decisions. This undoubtedly contributes to develop a more coherent investment arbitration body of law, restoring predictability and faith in investment treaty regime, and therefore boosts foreign investments and economic growth.*

***Keywords:*** *Investor-State Dispute Settlement; Investment Court System; Arbitration; TTIP*

## 1. Introduction

Investor-State Dispute Settlement (ISDS) has been in place for a long time. States enter into an agreement providing access to investment treaty arbitration, securing remedy for investors' loss caused by host States' unjustifiable interference. *Ad hoc* tribunals are formed, and decisions concerning public interests that have political and economic consequences have been made in private proceedings before various groups of party-appointed arbitrators who have advocated divergent or even conflicting opinions on the same point of law, with no authority to harmonise these inconsistencies [12].This 'fragmental' feature has opened ISDS to great criticism. However, in September 2015, in an effort to reform ISDS, a proposal was published by the EU Commission to establish an Investment Court System (ICS) as part of its ongoing negotiations in the EU-US Transatlantic Trade and Investment Partnership (TTIP).

This paper analyzes why ICS is considered as a better version of ISDS, starting with Section 2, which outlines some sharpest criticisms against ISDS. Section 3 explains how ICS is designed to resolve those problems. Section 4 concludes by reiterating that a standing investment court might just be the cure for the 'broken' ISDS system [1].

## 2. Systemic Deficiencies in the Current ISDS

### *2.1 Key Flaws in the Selection of Decision Makers in ISDS*

#### *2.1.1 The Legitimacy of Individual Arbitrators Ruling on Public Policy Issues*

International arbitration is built on party autonomy. Each party has an opportunity to select one arbitrator, and the nomination of the presiding arbitrator depends on the agreement reached by the two appointees or by the arbitration institution rules. This is the model used in international commercial arbitrations where public good is not involved.

International investment arbitrations are said to be a transformation of commercial arbitrations. They transplant the private adjudicative model from the commercial sphere into the realm of government, thereby giving privately-contracted arbitrators the authority to rule on what are, in essence, governmental decisions [14], such as mandating plain packaging on cigarettes in order to improve public health. This goes far beyond the confines of the relationship between disputing parties in a single, specific case, trespassing into public interests. Tribunals constituted on a temporary basis are often criticised as being "too far removed from the States to properly consider the public policy implications of the challenged government measure' [17].

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#### *2.1.2 The Impartiality and Independence of Party-appointed Arbitrators*

Another concern regarding the constitution of the tribunal is the insufficient guarantee of the independence and impartiality of individual arbitrators. Parties want to win; therefore it is understandable that a prudent party would carefully choose someone who is more sympathetic to their case. Meanwhile, arbitrators' remunerations depend on party appointments in the future disputes. This means that they would consciously or subconsciously feel an obligation to defend the position of the party who selected them [16]. This self-interest motivation adds to the difficulty in acquiring a balanced and unbiased opinion.

### *2.2 Key Flaws in the Process and Decision-making Outcomes in ISDS*

#### *2.2.1 Inconsistency*

The existing ISDS system is constantly criticised of its recurring episodes of inconsistent findings [8], in cases where similar or identical treaty provisions have been interpreted diametrically differently in the light of similar or identical facts, demolishing the reliability, effectiveness and predictability of the ISDS system and, in the long run, undermining its credibility [9].

The reasons why current investment arbitration case law is incoherent are interrelated. First, the whole regime is a 'patchwork' of mechanisms intended to resolve investment disputes [12]. There is an extensive network of investment treaties that are currently in force, each with slightly different texts yet providing for essentially the same substantive rights. The meanings of some provisions are not settled, leaving a great deal of space for multiple interpretations to coexist.

Second, international investment arbitration uses only a 'soft' rule of precedent. Tribunals do not have to follow past awards made by other tribunals and are free to give their own opinions. Even for tribunals which do comply with the duty to 'adopt solutions established in a series of consistent cases' in order to promote the harmonious development of investment law [6], concerns are still expressed about whether they are simply 'cherry-picking' precedents that conform more closely to their views, ignoring unfavourable ones. This problem is aggravated by the absence of an appellate mechanism, whose authoritative pronouncements can put an end to long-term disputes regarding the proper interpretation of laws [21].

A further factor giving rise to unacceptable inconsistency in ISDS is that of conflicting decisions in parallel proceedings. The corporate structure and nationalities of multinational enterprises are often carefully planned so that it is possible to make use of the potentially more favourable provisions in investment treaties between different countries. In *Lauder* case [3] [5], the American investor, Ronald Lauder, in order to challenge certain of the host State's measures that had adversely affected his investment, initiated a claim against the Czech Republic under the US-Czech BIT in his name, while simultaneously submitting the same facts to arbitration in the name of his Dutch investment vehicle, CME, under the Dutch-Czech BIT. Eventually, the two tribunals came to different conclusions, interpreting the similar provisions in the two treaties differently. This is a typical example of a situation where concurrent proceedings have added even more unacceptable inconsistency to the ISDS system.

#### *2.2.2 Lack of a Control Mechanism*

As mentioned above, under the control of an appellate body, precedents would have greater weight in subsequent cases, and a clear direction could be provided by appellate facilities, allowing both parties and future adjudicators to know exactly how the law should be interpreted [8].

Conversely, the absence of a control mechanism leads not only to inconsistency but also to the incapability to reverse erroneous decisions. The current 'review' mechanism, including annulment proceedings under the ICSID Convention, and national courts proceedings that seek to set aside an award, or resist its enforcement, is weak and unsatisfactory. The grounds are usually restricted to procedural aspects of an arbitration, the main objective of which is to control the integrity of awards rendered by tribunals [9] instead of offering a substantive review. In *Lauder* cases, the host State, Czech Republic, was issued with two inconsistent awards, one from London and the other from Stockholm. When the Czech Republic asked the Swedish courts to set aside the Stockholm award, the courts declined, ruling that they had no jurisdiction to reconcile the conflicting decisions because there were different parties involved who were making submissions to different tribunals who, in turn, rendered awards under different treaties signed by different sovereign States. They were unable to remedy the situation [12]. Another example, *CMS v Argentina*, demonstrates the failure by the ICSID Annulment Committee to correct manifest errors of law in a final award. The Committee stated that it

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had only a limited jurisdiction under Article 52 of the ICSID Convention, which allows annulment as an option only when certain specific conditions exist, and that it could not simply substitute its own view of the law and its own appreciation of the facts for those of the tribunal [4]. This means that erroneous decisions rendered within the current ISDS system are sometimes left uncorrected.

#### *2.2.3 Insufficient Transparency*

As mentioned above, international investment arbitration has incorporated international commercial arbitration procedural framework [14]. Proceedings can be held confidentially behind closed doors, if desired. However, in investment arbitrations, as regulations implemented for public welfare have increasingly been the subject of investment disputes and costs of defending claims and financing compensation awards would inevitably draw on public funds [10], non-transparency is unacceptable. The lack of public access to arbitral proceedings and the participation of non-parties have been the main criticisms raised against ISDS.

## 3. The Investment Court System Proposed in the TTIP

### *3.1 Moving Away from Private Dispute Resolution and Returning to the Public Domain: A Standing Court*

In its submission to the UNCITRAL Working Group III regarding possible reform of ISDS, the EU has summarised some of the key features of the investment treaty regime. First, it resembles public law, in that it is largely concerned with the treatment of investors and, hence, the relationship between individual actors and the states [7]. Second, by permitting challenges to governmental conduct to be made directly, investment treaty regime provides individual actors with protection against States' acts that can be enforced in a manner reminiscent of judicial review under domestic administrative law [19]. The EU has therefore drawn the conclusion that, instead of *ad hoc* tribunals in which private arbitrators only work for a 'one time deal', it is far more appropriate to have investment disputes settled by a permanent body, with judges elected by sovereign States for fixed terms. This would restore faith in the investment treaty regime, as it gives public law matters back to a public court-like forum. Vague treaty provisions, including questions of international public law, will be clarified by the consistent and coherent interpretation of an authority that has been recognised as legitimate [20].

Moreover, ICS judges will have a steady caseload. They are paid a retainer fee every month by the sovereign States to secure their availability on short notice, and providing the volume of cases justifies it, the treaty Parties can decide to move them to a permanent salary [18]. This discourages judges' self-interest motivation and thus enhances their impartiality and independence. Judges would be allocated randomly to cases, eliminating any opportunity for parties to choose adjudicators that best serve their interests.

Improvements have also been made to transparency. The ICS obliges investors and States to abide by the UNCITRAL Transparency Rules and other additional obligations that ensure public access to an ICS division's documents and constitution. The ICS also provides non-disputing parties with the access to hearings, documents, and opportunities to make their own submissions. This has placed adjudication back in the public eye and decisions and relevant documents filed in litigation on the public record [15], thereby increasing the legitimacy of the investment treaty regime.

### *3.2 Establishing a Mechanism for Checks and Balances: Effective Review*

The ICS is comprised of two levels: a tribunal of First Instance and an Appeal Tribunal [2]. ICS judges should have expertise in international public law and international investment law and are appointed by a joint committee formed by the EU and the US. A three-person division from each tribunal is drawn by lots to determine who hear a particular case. After a provisional award is rendered, parties are given 90 days to file an appeal based on errors in the interpretation or application of the law, mistakes concerning the appreciation of the facts or issues with procedural integrity in accordance with Article 52 of the ICSID Convention. This establishes a broad jurisdiction for the supervisory body, allowing the Appeal Tribunal to modify or reverse the legal findings and conclusions in the provisional award, or to dismiss the appeal as a whole if it is not well founded. This significantly decreases the risk of leaving an allegedly erroneous decision unchallenged [13].

Moreover, a hierarchically-structured judicial dispute settlement system will produce a consistent line of jurisprudence and thus reduce uncertainty. The problem of cherry-picking precedents could also

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be mitigated in the case of appellate structures, because tribunals not following previous appellate decisions will find their awards immediately appealed and probably overturned [21]. As a result of such 'counterbalance', the current international investment law regime could evolve into a more settled body of law. Judges' personal opinions or 'inappropriate predispositions' would count for little, as previous precedents would have to be followed [11].

The checks and balances system has also addressed the controversy of parallel proceedings. Investors filing a claim in front of the ICS are required to submit a waiver of their right to initiate any claim or proceeding seeking compensation before a domestic or international tribunal or a court under domestic or international law, including persons who have, directly or indirectly, an ownership interest in a locally established company that claims to have suffered the same loss. This avoids the dilemma encountered in *Lauder*.

## 4. Conclusions

Before ISDS was established, investors had few choices to resolve investment disputes. They could either file a case in the host States' national courts or ask for diplomatic protection. The problem with national courts was that judges hearing the case were often subjected to political influence from the host States and the investors' risk of not having a fair trial was very high, while diplomatic protection escalated investor-State disputes into inter-State conflicts. Political concerns often prevented investors' home States from taking any action, leaving the grievance suffered by the investors unaddressed. Compared with these two options, ISDS gives back the initiative to file arbitration in a flexible, neutral, third-party forum to investors. Despite its many flaws, ISDS is still a good way to resolve investment disputes, and the proposed ICS would make two ground-breaking improvements to the existing ISDS.

First, the establishment of ICS could bring the entire dispute settlement mechanism copied from international commercial arbitration back to a public, transparent, court-like system, where judges are not selected by disputing parties but sovereign States to hear particular cases where issues of public concern are involved. Second, a more coherent investment arbitration body of law could be developed under the control of an appellate review and wrong decisions could be corrected, boosting faith and confidence in the investment treaty arbitration system. This leads to the conclusion that the EU Commission's proposal to establish ICS might just be the cure for the 'broken' ISDS system.

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