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# Learnings for UNCITRAL WGIII from the WTO's dispute settlement regime

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A NUMBER of governments and commentators have cited the World Trade Organization (WTO) dispute settlement system as a model for a standing two-tier structure of dispute resolution for investment disputes. This note identifies a number of conceptual, legal, practical, development and geopolitical factors that need to be considered when drawing that analogy.

No system exists in a vacuum. The applicability of one to the other needs to be assessed against the objectives of reform. In terms of the mandate of the United Nations Commission on International Trade Law (UNCITRAL)'s Working Group III which is concerned with investor-state dispute settlement (ISDS) reform, that means the specific matters of consistency, coherence and predictability, cost and duration, independence and impartiality of arbitrators, and third-party funding, as well as other matters raised by participating governments – and equally importantly, the legitimacy of the system in the eyes of different stakeholders, including affected publics, and the extent to which developing countries especially can vest their trust in the system.

The WTO system is often referred to in Working Group III at a high level of abstraction. However, the history, nature and content of multilateral trade and bilateral investment agreements are very different. The WTO is the exclusive domain of sovereign states who enter into reciprocal bargains, whereas private foreign investors are the beneficiaries of rights and the litigants in investment treaties. The WTO dispute settlement system applies compulsorily to all its Members over specific agreements. There is no equivalent comprehensive, unitary regime that can apply to investment treaties and realistically there will not be, especially if governments can choose from a menu of reform options, as currently proposed.

The objectives of dispute settlement are particular to each system and influence its institutional and operational arrangements and the kinds of remedies it provides. The WTO 'penalty' has economic, rather than (directly) fiscal, impacts on the non-compliant state, and is prospective, evidence-based and limited in scope, whereas ISDS penalties are pecuniary, retro- and prospective, speculative and subject to compound interest.

All these factors affect the downstream fiscal, economic and public policy impacts of each system, and have generated a deeper crisis of legitimacy in investor-initiated enforcement of investor protections and awards of pecuniary damages. That said, Working Group III participants, especially from developing countries, should also reflect on the long history of difficulty in achieving reforms to the WTO dispute settlement

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system (for more details, see point VI below). For two decades, WTO Members have been engaged in an inconclusive review of its operations, unable to reach consensus on reform. More recently, one Member has issued its own demands and paralyzed the appellate mechanism.

## I. Fundamentally different legal instruments

The WTO Dispute Settlement Understanding (DSU) governs the entire 164-strong WTO Membership in relation to a relatively small and limited universe of covered multilateral agreements, which are specified in its Appendix 1 and with certain additional rules and procedures specified in Appendix 2. Agreements between Members that are made outside the WTO cannot use its dispute settlement mechanism, even where the same rules apply.

The WTO agreements represent a bargain reached between states and provide reciprocal obligations and benefits. Although the negotiations and resulting rules were asymmetrical, even powerful states had to compromise. There is a single set of meta-rules, with several kinds of special and differential treatment, as well as Member-specific schedules of commitments. Jurisprudence has been developed through the application and interpretation of this unitary set of rules over time, albeit without a formal system of precedent. The negotiating history from the Uruguay Round is available to assist interpretation.

By contrast, according to the UN Conference on Trade and Development (UNCTAD)'s latest count, there are 2,337 bilateral investment treaties (BITs) and 314 other agreements with investment provisions currently in force across 234 states.[1] Investment agreements do not involve a bargain between beneficiaries. They confer rights exclusively on investors; there are no guaranteed benefits to the states. The scope, content and legal terminology of their provisions vary significantly between countries and over time. Most agreements closely follow the model investment agreement of the relevant capital-exporting state.[2] There has been very limited scope for low- and middle-income countries to achieve variations, and usually none for least developed countries (LDCs). This imbalance is systemic, allowing capital-exporting countries to operate under essentially the same rules in all their agreements, while capital-importing countries face a multiplicity of different rules and compliance obligations. There is rarely a negotiating history available to support interpretation. These factors will lead to different interpretations in each fact situation, with a disproportionate impact on developing countries, even if there is one body to interpret them.

Proposals for an opt-in agreement that provides different levels of participation by states, as well as different reform options to achieve similar standards, would further fragment and complicate, rather than unify and simplify, the investment treaty regime. The complexities of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI),[3] which appears more applicable to the opt-in approach than the Mauritius Convention, would intensify those problems.

***There can be no solution to the problems of fragmentation and inconsistency, and embedded development asymmetries, under the current regime of international investment agreements. Unless and until existing BITs and investment chapters in economic integration agreements are terminated or replaced by substantive investor protection rules that genuinely balance the rights of investors and host states and fully respect the sovereignty and judicial systems of host states, those problems will remain endemic to the international investment regime*** *(for more discussion of development asymmetries, see point VI).*

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1 https://investmentpolicy.unctad.org/international-investment-agreements

2 J. Anthony VanDuzer (2019), 'Can International Investment Agreements Be Instruments of Sustainable Development? Systemic Capacity Challenges for Developing Countries' Globalization', in Joost Pauwelyn and Mengyi Weng (eds), *Building Legal Capacity for a More Inclusive Globalization: Barriers to and Best Practices for Integrating Developing Countries into Global Economic Regulation*, The Graduate Institute, Geneva, 31-46

3 These complexities are well described in UNCITRAL Working Group III, 'Possible Reform of Investor-State Dispute Settlement. Submission from the Government of Colombia. Note by the Secretariat', 14 June 2019, A/CN.9/WG.III/WP/173

## II. Sovereignty of state parties

The WTO's Dispute Settlement Understanding was adopted by consensus at the end of the Uruguay Round. It established a clear multi-layered structure with numerous procedural steps, maximum timelines and mechanisms to deal with disputes over implementation. The governance and structure of the WTO dispute settlement mechanism, as well as its rules, reflect the primacy of Members' sovereignty. The entire WTO Membership sits as the Dispute Settlement Body (DSB).[4] Under the DSU, all decisions that the rules and procedures require the DSB to take must be made by consensus.[5] Any amendments to the DSU must also be by consensus.[6]

The Members sitting as the DSB have adopted detailed rules, working procedures and budget allocations for dispute settlement. They have the authority to appoint the Appellate Body (AB) members and establish dispute panels, and are responsible for adopting panel or AB reports and recommendations, overseeing their implementation and authorizing suspension of concessions for non-compliance. In practice, those decisions are usually a formality because there must be a negative consensus not to adopt a report (in place of the previous requirement in the General Agreement on Tariffs and Trade (GATT) for a positive consensus). Nevertheless, the dispute process is formally controlled by the Members themselves, within the broader Member-driven organization.

***The retention of sovereign authority is an even more significant issue for investment disputes, given the substantive imbalance in investment rules in favour of foreign investors and capital-exporting states, the role of investors rather than states as complainants, and the higher stakes in fiscal and public policy terms. It is unclear where institutionally, and how in governance terms, this sovereignty would be exercised in relation to a standing investment dispute body.***

## III. The role of states in dispute settlement

WTO obligations exist between states and are enforceable only by other states. Commercially affected interests have no standing, let alone any ability to bring a dispute (although they are known to have funded states to bring disputes of interest to them). States weigh up diverse factors when deciding to bring a dispute, including a variety of offensive and defensive, strategic, diplomatic and geopolitical considerations. They also have a longer-term interest in the development of the law and the jurisprudence that they may have to rely on in the future.

Foreign investors have narrower, commercially driven motivations for bringing an investment dispute and generally have no regard for the broader social, policy or systemic implications of their claim or remedy. Nor do they have any systemic commitment to the rule of law and the integrity of legal arguments that reflect the intentions of governments when they signed the treaties. The increased prevalence of profit-driven third-party funding in investment claims exacerbates these issues by removing all financial risk of advancing a claim.

***The dynamics of international legal disputes between states are fundamentally different from a system which empowers private foreign investors to sue sovereign states outside their national jurisdictions. Even if ex post filtering mechanisms, such as disqualification of frivolous claims or agreed state party interpretation, were adopted and were effective, the motivations for investor-initiated disputes will always be more aggressive and self-serving than in the WTO.***

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[4] Article IV.5 of the Agreement Establishing the World Trade Organization (Marrakesh Agreement)

[5] Article 2.4 of the Dispute Settlement Understanding

[6] Article X.8 of the Marrakesh Agreement

## IV. The objectives of dispute settlement

The purpose of WTO dispute settlement is to identify whether there has been a breach of trade rules, and if so, to restore the balance in the original bargain. There is initially no penalty for a finding that a government has breached a WTO agreement. The objective, and requirement, is withdrawal of the offending measure. The state has an opportunity to redress the breach without penalty in the interests of a long-term balanced relationship.

A penalty may arise only after a further hearing that follows demonstrable non-compliance with a WTO ruling.[7] Any penalty is prospective only and involves withdrawal of reciprocal concessions under the relevant agreement, or potentially another agreement, based on evidence-based assessment of the impact of the breach. The penalty applies at a country rather than firm- or industry-specific level, and is intended as temporary pending compliance. The degree of retaliation through withdrawal of concessions is determined in a specific arbitral process and calibrated to neutralize the benefit arising from the breach and no more. There is rarely any pecuniary compensation and only where the parties agree.

Beyond the specific parties to a dispute, the longer-term interest of WTO Members in panel and Appellate Body determinations is reflected in the large participation of Members as third parties in many disputes.

In comparison, investment disputes enforce corporate rights, even where the investor's bad behaviour or breach of the law has precipitated the measure or judicial decision that is being challenged. In many cases, a dispute signals a breakdown and termination of relationships with the host state. Penalties are financial, immediate, speculative, retro- and prospective, can carry compound interest, and may have a punitive element. Individual investors have no long-term investment in the sustainability or legitimacy of the system *per se.*

***The purpose of investment dispute settlement is fundamentally different from that of WTO dispute settlement. The current legitimacy crisis facing ISDS arises in part from the magnitude of pecuniary awards sought and secured by private investors who often have nothing to lose. The WTO dispute system does not address those factors and is not built to do so.***

## V. Intrusions on public policy

Public policies, such as health or environmental measures, may be targeted directly as breaching WTO rules. However, the bulk of the nearly 600 WTO disputes lodged to date involve measures adopted to support particular industries or economic interests. Even then, WTO agreements generate controversy because the rules are pro-business and subordinate public policy considerations, obligations under other international law instruments and even national constitutions. The core WTO agreements recognize this tension, but mainly through limited exceptions to the trade rules that impose multi-layered conditions and put the burden of proof on the respondent government. Consequently, the General Exception provisions in the GATT and the General Agreement on Trade in Services (GATS) have reportedly succeeded only once in the 44 times Members have relied on them in the WTO dispute process.[8]

Investment disputes intrude more deeply into public policy and affected communities. According to UNCTAD, the majority of known investment disputes have involved sensitive sectors like mining and energy, finance, telecommunications and construction, including public-private partnerships.[9] Most disputes are brought under agreements that lack even minimalist exceptions, meaning there is even less room for pro-policy interpretation even if the tribunal was so inclined.

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7 Provisions on anti-dumping and subsidies and countervailing measures are a special case with a specific rationale.

8 Public Citizen (2015), 'Only One of 44 Attempts to Use the GATT Article XX/GATS Article XIV "General Exeception" Has Ever Succeeded: Replicating the WTO Exception Construct Will Not Provide for an Effective TPP General Exception', August 2015, http://www.citizen.org/documents/general--exception.pdf

9 https://investmentpolicy.unctad.org/investment-dispute-settlement

***Intrusion on the sovereign right to regulate and conflicts with national policy priorities are an inevitable consequence of an unbalanced international investment regime. Given the Working Group's decision not to address the substantive content of investment rules, the lack of public policy protections will remain problematic. Experience in the WTO indicates that an appellate body or standing dispute mechanism, even with WTO-style exceptions, will not produce more public-policy-sensitive outcomes.***

## VI. Development asymmetries in dispute settlement

Developing countries have long criticized the WTO dispute settlement system. Concerns include its extended duration and failure to meet deadlines; adjudicators who exceed their powers and usurp the right of Members to interpret rules; lack of retrospective compensation for breaches; abuse of retaliatory powers by powerful states and failure to comply when they lose; the high cost of and dependency on foreign legal experts; no award of costs to successful complaining or responding states; unrepresentative and pro-North panel and AB members; unaccountability and improper dominance of the dispute settlement secretariat; and the need for special and differential treatment and flexibility for developing countries and LDCs.[10] Three of these matters are looked at here.

**Biased representation of adjudicators:** Developing countries in Working Group III have repeatedly called for greater diversity of arbitrators, alongside independence and expertise in international and investment law. The DSU has a diversity requirement: panel members should be selected with a view to 'ensuring a sufficiently diverse background' as well as independence and experience. Yet the nationality of panellists is overwhelmingly from developed countries.[11] The Appellate Body is meant to be 'broadly representative' of the Membership, but a majority have been from developed countries[12] and their appointment to particular cases is by a secret formula.[13]

***One question to consider is if, and how, developing countries could be more successful in ensuring diverse representation in an investment court than in the WTO, especially if the main criteria of independence and expertise favour the existing arbitral elite.***

**An unaccountable and all-powerful secretariat:** On one hand, the WTO secretariat's limited resources are blamed for long delays and a serious backlog of reports. At the same time the secretariat and its long-term director are criticized as too powerful and unaccountable to Members.[14] The secretariat proposes the panellists for the initial panel hearing and the parties can only oppose those nominees for 'compelling reasons'.[15] Recent research concludes that the secretariat has significantly more influence over the drafting of the reports than the panellists themselves.[16] This influence is seen to affect the role of precedent and the limited number of dissents, and extends the length of proceedings and scope of reports.

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10 Chakravarthi Raghavan (2000), 'The World Trade Organization and Its Dispute Settlement System: Tilting the Balance Against the South', Third World Network, https://www.iatp.org/news/dispute-settlement-understanding-of-wto-criticized-by-third-world

11 Louise Johannesson and Petros Mavroidis (2017),'The WTO Dispute Settlement System 1995-2015: A Data Set and Its Descriptive Statistics', Research Institute of Industrial Economics, Paper 1148, http://www.ifn.se/wfiles/wp/wp1148.pdf, page 46, Figure 3.4

12 https://www.wto.org/english/tratop_e/dispu_e/ab_members_bio_e.htm

13 Johannesson and Mavroidis, page 49. Even these well-connected researchers were unable to secure much information on how the secretariat functions.

14 Hannah Monicken (2019), 'Appellate Body's future could depend on whether its director keeps his job', *Inside U.S. Trade,* 5 December 2019, https://insidetrade.com/daily-news/appellate-bodys-future-could-depend-whether-its-director-keeps-his-job

15 Article 8.6 of the DSU

16 Joost Pauwelyn and Krzysztof Pelc (2019), 'Who Writes the Rulings of the World Trade Organization? A Critical Assessment of the Role of the Secretariat in WTO Dispute Settlement', 6 October 2019, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3458872

***What the WTO system offers is no better than the current system of party appointments or arbitral appointments through the World Bank or Permanent Court of Arbitration. If the unaccountable WTO secretariat has been allowed to dominate the appointment and selection of arbitrators, and has more influence over the determination of disputes than arbitrators, how would an investment mechanism be managed to avoid that, while providing efficiency, coherence, consistency and some degree of precedent?***

**Paralysis of inbuilt reviews:** In theory, these and other concerns of developing countries could have been addressed through a process of inbuilt reviews. Even though the basic framework for the WTO dispute settlement mechanism adapted the ad hoc arbitration under the GATT, various states were reluctant to concede power of decision making to the WTO. The Decision on the Application and Review of the Dispute Settlement Understanding 1994 required a full review of the dispute settlement rules and procedures to be completed within four years after entry into force, followed by a decision whether to continue, modify or terminate those rules and procedures.

That review has never been concluded because there is no consensus on reform. The Doha Declaration 2001 extended the original negotiations until 2003, when the chair of the process reported very limited convergence and no chance of consensus.[17] No new deadline was set. Negotiations resumed in November 2016 around 12 thematic issues. The 2019 chair's report identified the challenges confronting the review as: low expectations on prospects for success, a lack of political will and unwillingness of proponents to compromise, and the negotiating group's lack of confidence in itself.[18]

The UNCITRAL Working Group III review of ISDS was initiated because the existing system faces a crisis of legitimacy. The causes for that crisis run far deeper than the problems confronting the WTO, and the costs to states from continued failure of the system are in many cases far higher. There are currently major disagreements in Working Group III about the shape of reform, even at an abstract level, and governments have yet to address crucial institutional and operational questions that would determine how a new system of appeal or a standing disputes body would work in practice.

***Any new ISDS regime would be experimental and need to be reviewed periodically. A two-tiered system could be even worse than the current regime, especially if the appeal is built upon and legitimizes the status quo. Despite party autonomy, states have already lost control of the investment dispute settlement process. An appellate body will not get it back. There is no consensus at present, even among those UNICTRAL governments who support an appellate mechanism, about what degree of autonomy states would have individually or collectively over the process, let alone what institution and institutional mechanisms might be developed to ensure that states retain an equivalent degree of (even formal) sovereignty in investment disputes. If it has proved impossible for WTO Members to agree on and fix the dysfunctions in the WTO dispute settlement regime as they became apparent, there is a very high risk that a similar lack of consensus could prevent reforms to an appellate or standing investment dispute mechanism.***

## VII. Power over judicial appointments

Consensus decision making by the DSB allows a disgruntled Member with enough power to influence the AB membership by rejecting proposed members. The US Obama administration did this when rejecting the reappointment of its own Jennifer Hillman in 2011 and South Korea's Seung Wha Chang in 2016. A Member could go further and refuse to appoint any replacement members, thereby slowing or paralyzing the appellate element of the dispute process. The Trump administration has done this to the point that the AB has had only one duly mandated member since 10 December 2019. The quorum to hear an appeal is three. A paralyzed appeal system creates perverse incentives for well-resourced states to flout the rules, knowing there will not

17 Dispute Settlement Body – Special Session – Report by the Chairman, Ambassador Péter Balás, TN/DS/9, 6 June 2003
18 Dispute Settlement Body – Special Session – Report by the Chairman, Ambassador Coly Seck, TN/DS/31, 17 June 2019

be a definitive review of a panel decision for some time, if ever. Conversely, it creates disincentives for other states to challenge measures not knowing if there will ever be a final outcome.

It is unclear whether the US intends to hold the WTO to ransom to secure changes to dispute settlement and other matters, such as developing-country self-designations, or whether the current strategy is a precursor to US withdrawal from the WTO. Either way, the dominance of the US in global trade means the dispute settlement system would be ineffectual without it. While reshaping the current system might address some developing-country concerns, for example about timelines and overreach, the US will only support matters of concern to itself.

***If appointments to the appeal body are by consensus, capital-exporting states could block the appointment of developing-country arbitrators or those who are prepared to broaden development considerations in investment jurisprudence; could capital-importing countries realistically do the reverse?***

## VIII. Geopolitics

Many UNCITRAL participating countries express the hope that an appellate mechanism for investment disputes will provide certainty, predictability, efficiency, cost-effectiveness, timely resolution and independence. But there are systemic imbalances in the governance arrangements and rules of both the international trade and investment regimes, as well as their dispute mechanisms. The WTO experience suggests there are real risks that key areas of reform, such as the appointment of arbitrators or processes to review the working of the system, could be captured by powerful players in the investment arbitration regime. An equally important question is where the institution or secretariat would be located. It seems unrealistic to think that powerful capital-exporting countries would agree to site it in the developing world.

Even where governance is based on collective sovereignty, the WTO shows that all countries are not equal in practice. The US has been a complainant or respondent in around 47% of WTO disputes. It has a longstanding antipathy to allowing the WTO to pass judgement on US domestic measures. Under the Uruguay Round Agreements Act 1994, the US President must report to Congress every five years on US participation in the WTO, including dispute settlement. Cumulative unhappiness has led to the current crisis in the dispute settlement system.

The US has also been the home state in 174 of the nearly 600 known investment disputes. Its current policy on ISDS is ambiguous: the US recently terminated or severely limited investment arbitration in the Agreement between the United States, Mexico and Canada, but has taken a more traditional pro-ISDS position in its interventions during Working Group III. There is every prospect that the US, or another major power with offensive interests on behalf of its corporations and defensive concerns arising from intense criticism of investor-state disputes, could behave the same in relation to an investment court.

***If major capital-exporting countries whose investors are big users of ISDS do not participate in an appellate mechanism/standing investment court, the UNCITRAL reforms will fail to meet the mandate. Equally, if they do participate, they could use similar leverage to the US actions at the WTO to ensure, and amend, rules to serve their corporations and protect their defensive interests.***

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