United Nations A/CN.9/WG.III/WP.161

General Assembly

Distr.: Limited
4 March 2019

English
Original: French

United Nations Commission on International Trade Law
Working Group III (Investor-State Dispute Settlement Reform)
Thirty-seventh session
New York, 1–5 April 2019

Possible reform of investor-State dispute settlement (ISDS)

Submission from the Government of Morocco

Note by the Secretariat

The present note transmits an initial submission received on 1 March 2019 from the Government of Morocco (see annex I), as well as a complement to this initial submission received on 19 March 2019 (see annex II), in preparation for the thirty-seventh session of Working Group III.

V.19-01295 (E)

Annex I

1. Morocco commends the Commission for its initiative, at its session held in Vienna in July 2017, in considering the topic of reform of the current investor-State dispute settlement (ISDS) regime.

2. There is no denying the importance of that initiative given that it provides developing countries with the opportunity to participate in the reform of a central branch of international investment law related to international arbitration, the existing rules and principles of which were formulated without the involvement of the majority of those countries.

3. Moreover, comprehensive reform of the ISDS regime at the multilateral level should mean that ISDS arrangements would no longer be necessary in bilateral investment treaties concluded by countries that have committed to multilateral reform of the regime, and it would result in harmonized standards and procedures at the international level.

4. Morocco believes that ISDS reform is likely to lead to responsible international investment that will promote achievement of the Sustainable Development Goals. It is also likely to assist in combating the fraudulent practices used by some foreign investors to submit claims against host States to arbitral tribunals with a view to obtaining undeserved compensation.

5. ISDS reform, a topic that has been referred to Working Group III, is aimed at addressing the concerns raised by a number of States around the world about how ISDS regimes work under bilateral investment treaties. Those States include the developing countries, which suffer the negative consequences of such regimes – especially in financial terms – given that they lack qualified personnel to handle and manage ISDS cases.

6. Morocco welcomes the work carried out to date by Working Group III, which has provided an appropriate forum in which to reconcile different countries' positions on the most effective means of ISDS reform.

7. Morocco takes this opportunity to highlight the importance of achieving consensus on reform of the ISDS regime within Working Group III. That reform should be comprehensive and should take into account the concerns raised by various States with a view to achieving a fair and equitable ISDS system that all countries, in particular, developing countries, can rely upon.

8. Morocco has recently prepared a new model bilateral investment treaty that strikes a balance between rights and obligations, both those of investors and those of the host State, and in which it has opted to maintain the existing ISDS system while updating relevant provisions.

9. The main innovations introduced by the new model treaty in respect of ISDS are aimed at:

- Establishing an institutional framework for dispute prevention within which the joint committee established and the focal points designated under the treaty play an important role
- Limiting the types of disputes that may be submitted under the ISDS mechanism and setting a time limit for the submission of claims in order to prevent old claims from being submitted
- Ensuring that domestic remedies are exhausted before a dispute is submitted to international arbitration, since the exhaustion of domestic remedies is a requirement under public international law
- Upholding the right of States parties to the treaty to interpret the treaty's provisions on investment protection even after its entry into force

- Establishing a mechanism for the expedited processing of unfounded or frivolous claims and the consolidation of claims in order to reduce arbitration costs
- Enabling a host State to submit a counter-claim to the arbitral tribunal if an investor fails to comply with one or more of its obligations under the treaty
- Preventing the improper use by foreign investors of arbitration by establishing penalties for the submission of unjustified claims
- Limiting the use of arbitration by investors that engage in treaty shopping
- Strengthening the ethics of arbitrators and improving the functioning and transparency of arbitral proceedings in accordance with the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration
- Enabling the parties to an investor-State dispute to submit the dispute to a multilateral investment tribunal after such a tribunal has been constituted

10. Notwithstanding the efforts made by Morocco to reform the ISDS mechanism in its new model treaty, there are still several aspects of the mechanism that, owing to their nature, require concerted action by a large number of countries around the world.

11. To that end, a multilateral dialogue within Working Group III on the matter of ISDS reform could help to build consensus on the best reform option and the most appropriate way to implement that option.

12. Morocco welcomes this opportunity to submit comments to the Commission secretariat on the reform process under way in Working Group III in relation to the ISDS regime and shares the concerns identified by the Working Group at its session held in Vienna from 29 October to 2 November 2018.

13. Morocco believes, however, that it would be useful to discuss further a number of issues relating to that reform, as outlined below.

I. Reduction in arbitration costs

14. The increase in the cost of arbitration has given rise to growing dissatisfaction with international arbitration, particularly with regard to its impact on the public policies and sustainable development of States. It is therefore vital that Working Group III undertake to identify the best options for reducing arbitration costs and saving time. A number of ways to reduce ISDS-related costs could be considered, such as:

- The establishment of a mechanism to prevent disputes and promote alternative dispute resolution mechanisms that could be used before recourse to international arbitration is sought in order to identify mutually acceptable solutions to the dispute.
- The exhaustion of domestic remedies before international arbitration is initiated. The use of such a remedy could result in a dispute being resolved to the satisfaction of all parties, thus obviating the need for arbitration, which is very costly in comparison with domestic remedies.
- A prohibition on submitting disputes to arbitration if the competent national courts have already delivered a final judgment in respect of the dispute that has the force of res judicata, in order to avoid multiple proceedings and save financial resources.
- The establishment of a mechanism for the preliminary review of unfounded or frivolous claims, including the possibility for the tribunal to order the claimant to pay all costs associated with such claims.
- The setting of time frames within which arbitrators must make a final award, which would encourage arbitrators to work more efficiently. However, those

time frames should not be so short as to force arbitrators to render poor-quality awards that might subsequently be set aside.

- Amendment of the cost-sharing mechanism between the parties to the dispute to include the loser-pays rule, according to which the losing party must bear all the costs of the arbitration.
- The establishment of a fee schedule that reduces arbitration costs by capping the remuneration paid to arbitrators, experts and witnesses.
- The adoption of objective and transparent criteria for determining the compensation payable to investors that have suffered damage. In that regard, it is important that the amount of compensation is commensurate with the actual damage suffered.

II. Precedence of the jurisdiction of domestic courts pursuant to a contract over the jurisdiction of arbitral tribunals pursuant to a bilateral investment treaty

15. In a number of arbitration cases, investors have been allowed by an arbitral tribunal to submit a dispute of a contractual nature on the basis of a treaty, despite the existence in the contract of a specific clause on dispute settlement (the Salini vs Morocco case, for example).

16. In other cases, disputes relating to breach of contract have been submitted to arbitration pursuant to a bilateral investment treaty even in the absence of a contractual clause that grants jurisdiction to the International Centre for Settlement of Investment Disputes.

17. To avoid this overlap, which creates conflicts of jurisdiction between domestic courts and arbitral tribunals, it is proposed to define the conditions governing the jurisdiction of tribunals with respect to arbitration between investors and States and limit that jurisdiction to applications made on the basis of bilateral investment treaties.

III. Support for developing countries in the area of arbitration

18. Owing to their limited financial resources and lack of legal professionals with significant experience in ISDS, developing countries need assistance in that area. It would therefore be highly desirable to establish a mechanism for supporting and assisting those countries in dealing with ISDS cases so as to enable them to better prepare for, handle and manage disputes relating to international investment.

19. In addition, cooperation between national courts and arbitrators should be fostered. National courts play a significant role in the enforcement of arbitral decisions by ensuring that arbitral awards are enforced. They also act as enforcing courts in the event that arbitral awards are challenged.

20. As part of ISDS reform, it is also proposed to establish a role for, and to support, national arbitration centres in order to enable them to carry out their functions and meet the expectations of economic operators.

IV. Prior scrutiny of arbitral awards

21. Most rules on investment arbitration do not provide for a quality control procedure whereby an award can be reviewed before it becomes final.

22. It is important to establish a procedure for the prior scrutiny of arbitral awards, similar to the procedure used by the International Court of Arbitration of the International Chamber of Commerce.

23. Such prior scrutiny, which should be carried out within a short period of time (approximately two weeks), would ensure that each award complied with all formalities, addressed all claims and set out the grounds on which it was based.

24. Furthermore, such a procedure would allow the parties to a dispute to submit written comments to the arbitral tribunal on all aspects of the award before it became final.

25. The prior scrutiny of arbitral awards could be carried out by an independent body under one of the existing arbitration organizations, such as the International Centre for Settlement of Investment Disputes or the Permanent Court of Arbitration.

V. Third-party funding

26. Third-party funding is an important tool used by many investors – particularly those without sufficient financial resources to cover the costs of arbitration – to bring claims against host States.

27. However, such funding lacks transparency because the entities involved generally prefer not to disclose information on their role to the other parties to the dispute or the arbitrators.

28. Third-party funding cannot play a constructive role in ISDS unless it is regulated.

29. In that regard, rules and procedures should be established to regulate such funding so that it cannot be used in a speculative or abusive manner by investors. Those rules and procedures could provide for disclosure of the third-party funder's identity, the amount of funding and the terms of the funding contract, including the existence or otherwise of an irrevocable commitment by the third-party funder to bear any legal costs that the claimant investor may be ordered to pay, given that investors that seek third-party funding are usually in a difficult financial situation that prevents them from complying with orders to pay legal costs, such non-compliance representing a risk to the host State.

30. Pending the adoption of international rules governing third-party funding, consideration could be given to prohibiting such funding as part of the current reform of the ISDS regime.

VI. Security for costs

31. Security for costs is an effective means of deterring frivolous or unfounded claims. Furthermore, security for costs enables the host State to protect itself against the risk of the investor declaring itself bankrupt before having complied with an order to pay legal costs.

32. It is essential that ISDS reform should include the establishment of a mechanism requiring tribunals to order claimant investors to provide security for costs, especially if there is reason to believe that an investor has structured itself in such a way as to avoid the consequences of arbitration or disposed of assets with the same objective.

33. Moreover, if third-party funding is adopted through ISDS reform, investors using that tool must provide security for costs given that the very reason for their seeking such funding is that they do not have sufficient financial resources to cover the costs of arbitration.

VII. Establishment of a standing appellate mechanism for arbitral awards

34. The creation of a standing appellate mechanism, which would be regarded as a higher judicial authority, would make it possible to:

- Ensure consistency in the interpretation of the provisions of bilateral investment treaties, especially the substantive clauses of such treaties, in order to avoid arbitral tribunals' reaching different conclusions with respect to the same facts and thus develop homogeneous case law that promotes legal certainty
- Make the implementation of the provisions of bilateral investment treaties more predictable for States and investors and thus enhance the legitimacy of investment arbitration
- Rectify errors in awards that could have a significant impact on public funds, particularly since investment arbitration often relates to matters of public interest

Annex II

[Original: Arabic]

1. Investor-State dispute settlement reform is one of the primary concerns arising from the relationship between a foreign investor and the State hosting the investment. It raises a number of legal and substantive issues.

I. Legal imbalance

2. Investment arbitration disputes arise from the host State's obligations, as set forth in the investment treaty, towards the other State party as opposed to the foreign investor. Arbitration disputes hinge on one type of party, namely the State, rather than the other party. Conduct is assessed based on an obligation contained in an investment treaty, which was entered into by a different party, i.e. the other State.

3. The public and open nature of the offer issued by the host State means that any investor can have recourse to arbitration, even in the absence of a direct legal relationship. The offer is directed to parties of which the State has no knowledge or awareness. The State issues offers "into the ether"; this enables a party of which it has no knowledge to bring a claim against it through arbitration. That is not true of contract-based arbitration, in which the parties know and are aware of one another at the time when the conditions for arbitration are agreed. These points have come in a number of cases before the International Centre for Settlement of Investment Disputes, of which Morocco is a contracting State; examples include the *Carlyle Group* case and the case involving the German company Scholz.

4. Only the investor can resort to this arbitration mechanism, and it can determine the timing and arbitration regime that best suit it. It enjoys something of a monopoly on recourse to an arbitral tribunal, whereas the State has no such power. In investment arbitration, there can only be one claimant, namely the investor, and one respondent, namely the State.

5. As a result, investors sometimes resort to arbitral tribunals in an abusive manner. In some cases, their objective is to gain a bargaining chip and pressure the host State to grant them certain privileges, reach a settlement with them, or put a stop to a criminal case against them.

II. Substantive imbalance

6. Investment arbitration is one-sided, in that the investor is granted absolute protection through a set of obligations imposed on the host State. The foreign investor's obligations, on the other hand, are modest or completely non-existent.

7. Moreover, terms such as "investment", "investor", "expropriation of investments" and "fair and equitable treatment" are defined broadly and loosely. Those terms encompass a set of forms of State conduct, including denial of justice, discriminatory procedures, abusive and arbitrary measures, and good faith participation. Arbitration provisions are therefore not consistent; arbitral tribunals lack the guarantees, accountability and transparency of national judicial systems.

8. Phrases such as "legitimate expectations of the investor" also raise a set of questions. It is unclear what the terms mean: they differ from one arbitral tribunal to another, and their definition sometimes conflicts with the country's political outlook or encroaches on its sovereign right to amend its own national legislation, particularly in the areas of health, the environment, security and cultural diversity.

III. Comments regarding the investor-State dispute settlement regime

9. In view of the foregoing, and in order to strike an equitable balance between the expectations of foreign investors and the host State, we do not believe that the investor-State dispute settlement regime should be completely abandoned. Instead, we propose a gradual reform aimed at developing the arbitration mechanism and focusing on the following points:

(a) Most investment treaties do not entitle the host State to file a request for arbitration against the foreign investor. That situation curtails the rights of the host State. It should therefore be stipulated that States may bring a case against the foreign investor if the latter violates a provision of the host State's national legislation or of international treaties;

(b) The arbitral tribunal's attitude to the investor's legitimate expectations can encroach on the sovereign prerogatives of the host State and, in particular, its right to amend its own legislation. We therefore propose that the obligations incumbent on States should be placed within a detailed context. States should retain the freedom to legislate in certain strictly defined sectors and areas, provided that the investor's acquired rights by force of law are not affected. Those obligations should be spelled out in the investment contract concluded between the host State and the foreign investor, and the legitimate expectation of the investor should not be interpreted as a stabilization clause. Investors cannot invoke the conditions set out in the investment treaty, particularly as regards fair and equitable treatment or legitimate expectations of the investor, in such a manner as to impose an obligation on the State that would render it unable to amend its own laws and national legislation. When a State takes legislative action to protect the public welfare, the economic effect of that conduct on the investor cannot constitute a breach of the State's international obligations;

(c) With regard to the high cost of arbitration, which places a burden on the budget of the State, we wish to make the following proposal:

- A framework should be developed comprising a mechanism to monitor requests submitted by investors with a view to preventing foreign investors from filing excessive or abusive arbitration requests. In order to avoid exposing host States to legal and financial risk, we believe that expedited arbitration should be encouraged and abusive arbitration requests should be automatically rejected.
- Parties should be encouraged to refer investor-State disputes first to national courts, for a specific period (e.g. 12 months), before resorting to the investor-State dispute settlement regime. Competence for considering that type of dispute should rest with national courts. The judges should have the necessary specialized training for such cases, and they should be impartial when the State is a party to the dispute.

(d) There have been instances of lack of transparency or conflict of interests, which jeopardize the investor-State dispute settlement regime. Such situations have arisen because there are relatively few specialists in investment dispute resolution, and therefore only a limited number of people who can be appointed as adjudicators. As a result, the same individuals can combine functions ("double-hatting"): they can be adjudicators, legal advisers and lawyers at the same time. The best example is the recent case of the adjudicator Ms. Malotobi, who recused herself from a dispute between Argentina and an investor after it emerged that her husband was an adviser to Argentina;

With a view to upholding transparency, Morocco proposes that when selecting adjudicators, the geographic dimension could be taken into consideration and a gender perspective could be adopted;

(e) In article 4 of the United Nations Commission on International Trade Law Rules on Transparency in Treaty-based Investor-State Arbitration, it is stated that a

third party (i.e. an *amicus curiae*) can file a submission in an arbitration dispute. That practice raises the following questions:

- Third-party intervention in arbitral tribunals is inconsistent with the principle of the relativity of contracts and arbitration agreements.
- What is the legal status of the third person? Is it litigant, or a party that supports the position of one of the parties to the arbitration case? Are its comments general, or do they pertain to the means adopted by one of the litigants?
- What limits apply to a non-litigant's intervention in the arbitration case? Can it intervene before a national court once an adjudication becomes enforceable, or once its validity is challenged?
- The arbitral tribunal has discretionary authority to accept or reject the third person's comments without consulting the litigants, who are entitled only to submit comments regarding the position of the third persons. This raises questions regarding the arbitral tribunal's criteria for accepting the comments and regarding the tribunal's responsibility, particularly when the main purpose of the third person's intervention is abusive or intended to draw out the proceedings, and particularly if the third person is advised by certain entities or parties.