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CCSI Submits Written Views to US Department of State Regarding UNCITRAL's Working Group III

Columbia Center on Sustainable Investment

Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Department of State
Advisory Committee on Private International Law
Via email: pil@state.gov

May 23, 2019

Re: Annual Meeting of ACPIL - Written Views regarding UNCITRAL Working Group III

We at the Columbia Center on Sustainable Investment (CCSI) are grateful for the opportunity to provide written views to the Department of State Advisory Committee on Private International Law on the occasion of its 2019 annual meeting on its work. Our comments will address the ACPIL's work in the context of the UN Commission on International Trade Law's (UNCITRAL) Working Group III on ISDS Reform.

CCSI is a joint center of Columbia Law School and the Earth Institute at Columbia University. Our mission is to develop practical approaches for governments, investors, communities and other stakeholders to maximize the benefits of international investment for sustainable development. One of our areas of focus is on international investment law and policy, and its role in shaping investment flows and the outcomes from those investments. Given our expertise in this area, CCSI has, among other activities, participated as an official observer in Working Group III's 35th, 36th, and 37th sessions, as well as in previous UNCITRAL meetings on transparency in investor-state arbitration.

Our comments below highlight certain specific areas of CCSI's research as it relates to the US government and its work within UNCITRAL's Working Group III.

We thank you for your attention to this submission and remain available to discuss any of the issues addressed herein.

Sincerely,

Brooke Guven

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Columbia Center on Sustainable Investment

A. Introduction

At its 50th Session in July 2017, the United Nations Commission on International Trade Law (UNCITRAL) mandated its Working Group III to explore reform of investor-state dispute settlement (ISDS).[1] This process presents an important opportunity for the United States to leverage its expertise and exercise its historic leadership on investment policy, and to align its stock of older existing investment treaties with modern policies and priorities. A significant share of the US's bilateral and multilateral investment treaties with ISDS were concluded in the 1990s before the rise of ISDS disputes. Over recent decades, as cases have been filed and decided by arbitral tribunals, states have been working to refine their investment treaties to prevent many of the unintended, undesired, and unforeseen uses of those treaties to challenge government conduct and recover damages. Innovations in US model bilateral investment treaties (BITs) and in more recently concluded treaties, such as the United States-Mexico-Canada Agreement (USMCA), reflect this continuous learning, innovation, and updating; and the UNCITRAL process provides an opportunity for the United States to extend to older treaties its current understanding of investment treaties' desired and undesired contents, aims, and implications, updating those older agreements through a multilateral reform process.

The UNCITRAL process could, for instance, be used as an opportunity to better ensure that US investment treaties align with the principle of "no greater rights". United States Trade and Investment Agreement negotiating objectives specify that covered foreign investors in the United States should not be accorded greater substantive rights than domestic investors.[2] While this has been a long-standing aim of US negotiations, experience with international investment law demonstrates that this is not the reality in practice. ISDS reform discussions in UNCITRAL (in addition to steps that could be taken by the US in other negotiating contexts) provide an opportunity to realign investment treaty law with that policy.

B. The "no greater substantive rights" question

Many investment law standards are said to mirror substantive protections under US domestic law. For example, the US model language on expropriation is considered akin to Fifth Amendment protections against uncompensated takings in the US Constitution. While it is indeed true that the language and concept of uncompensated takings under both regimes are similar, in assessing "no greater rights," it is important to look deeper at the manner in which the law is judged and applied. From this perspective, the line that ISDS tribunals may draw between legitimate regulatory conduct and expropriation requiring compensation may look considerably different than that applied by a US court. While one of the US domestic law tests - "*Penn Central*" - is reflected in the US's investment treaties, the several other tests that are used for determining whether a taking has occurred, and wealth of jurisprudence that provide crucial guidance and rules on how to apply those tests, are not.[3]

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[1] Report of the United Nations Commission on International Trade Law, 50th session, July 3-21, 2017, A/72/17, para. 264.

[2] See, e.g., Bipartisan Congressional Trade Priorities and Accountability Act of 2015, 19 USC 4201, § 102(b)(4).

[3] US jurisprudence on indirect expropriation has developed in a way to be relatively protective of government regulatory powers. Indirect or regulatory takings claims have a relatively low success rate. See, e.g., Carol Necole Brown & Dwight H. Merriam, On the Twenty-Fifth Anniversary of *Lucas*, Making or Breaking the Takings Claim, 102 Iowa Law Review 1847 (2017) (finding a 1.6% success rate for "*Lucas*-type" takings claims, in which the government is alleged to have wiped out all economically beneficial or productive use of land); James E. Krier & Stewart E. Sterk, An Empirical Study of Implicit Takings, William & Mary Law Review 35 (2016) (categorizing different types of takings cases, finding low-success rates across the different categories (i.e., *Lucas*, *Penn-Central*, exaction, and other), albeit with some variations, and concluding that the "courts almost always defer to the regulatory decisions made by government officials, resulting in an almost categorical rule that *Penn Centr*al-type regulatory actions do not amount to takings"); Adam R. Pomeroy, *Penn Central* After 35 Years: A Three-Part Balancing Test or a One Strike Rule?, 22 Federal Circuit Bar Journal 677, 692 (2013) (finding a roughly 12% success rate for cases

Moreover, when interpreting treaty language, ISDS tribunals are not bound by the intent of the parties to those treaties, or the US's desire to tie the standards to domestic law. Indeed, in some cases, tribunals have shown considerable willingness to demonstrate their freedom depart from the treaty parties' expressed positions.[4]

Similar comparisons could be made for other substantive standards included in US investment treaties. The "fair and equitable treatment" standard, for example, is frequently interpreted and applied to condemn state behavior beyond the customary international law minimum standard of treatment, and empowers ISDS tribunals to engage in *Lochner*-type judicial scrutiny of economic regulations that have been largely discredited in the US since the 1930s. Similarly, the non-discrimination standards in US treaties have been interpreted to go well beyond prohibitions on discrimination under US law,[5] and can entail more searching scrutiny of agency action, and order significantly different remedies, than would be permitted in US courts.[6] Thus, the ISDS mechanism gives rise to difficult challenges in terms of implementing a "no greater rights" policy. Even when the substantive standards embodied in treaties are not intended to and do not necessarily give rise to greater substantive rights for covered investors than domestic constituents, it is difficult in practice to ensure that tribunals, and the standards the pronounce, are appropriately constrained. These issues are further outlined below in our comments, which focus on the implications of differences in (1) procedural rights and rules for substantive outcomes, (2) approaches to third-party funding, (3) treatment of the rights and interests of non-parties to disputes, and (4) settlement of cases involving government defendants. Each of these issue areas also relates to the various concerns identified for multilateral reform within the context of UNCITRAL's Working Group III,[7] providing an opportunity for the US government to better align its existing treaties with modern policies and priorities.

1. Procedural rights as greater substantive rights

UNCITRAL's Working Group III has decided to focus its reform efforts on procedural, not substantive, issues. Because of the ways in which procedural rules and advantages can impact substantive rights and outcomes of claims, and the fine line between issues of substance and procedure, it is important to take a broad view of what is "procedural" in the UNCITRAL negotiations in order to ensure the principle of "no greater rights" is given meaningful effect.

US domestic law includes complex procedural principles and rules that are often determinative in the success of judicial claims, including:

- Who can bring claims? (e.g. doctrines of standing that may prevent suits)
- Under what circumstances? (e.g. ripeness, statutes of limitation, exhaustion, joinder of indispensable third parties)

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decided on the merits; the success rate drops to 4% when considering cases that were dismissed on jurisdictional grounds).

[4] See, e.g., cases discussed in Lise Johnson, New Weaknesses: Despite a Major Win, Arbitration Decisions in 2014 Increase the US's Future Exposure to Litigation and Liability (CCSI 2015), http://ccsi.columbia.edu/files/2014/03/Brief-on-US-cases-Jan-14.pdf.

[5] Id.

[6] Id. See also *Bilcon of Delaware et al v. Government of Canada*, PCA Case No. 2009-04, Award on Jurisdiction and Liability, March 17, 2015.

[7] See Report of the United Nations Commission on International Trade Law, Working Group III on Investor-State Dispute Settlement Reform, 37th session, April 1-5, 2019, A/CN.9/970.

- What level of scrutiny or deference must be applied by the decision-maker? (e.g. is the claim challenging an administrative decision? A lower court decision? An decision on law? A decision of fact?)
- What rules of evidence and privilege apply?
- What can a court consider? (e.g. new evidence? Only evidence in administrative record? Only evidence introduced at trial?)
- What remedies are available (e.g. remand? removal of the measure? Declaratory relief? Compensatory damages? Punitive damages?)
- Do doctrines of abstention limit claims or require a specific forum? (e.g. Rooker-Feldman doctrine; Burford abstention doctrine)

In some cases, these procedural barriers may be unfavorable to a foreign investor. In such cases, foreign investors can "forum shop" by repackaging domestic law claims as treaty claims and access ISDS, effectively bypassing more restrictive domestic courts. For example, a Constitutional takings claim can be framed as a treaty-based indirect expropriation; claims of substantive due process framed as expropriation, FET, or "umbrella clause" claims; and challenges under the Administrative Procedures Act reframed as expropriation, FET, non-discrimination, or umbrella clause claims.

The substantive standards contained in US investment agreements, along with the ISDS mechanism through which they are interpreted and applied, result in foreign investors having greater rights than they would otherwise enjoy under US domestic law. This system offends long-settled principles of US legal doctrine.

In *Erie v Tompkins*, the US Supreme Court expressly denounced a two-tiered legal system when it overruled previous doctrine that had enabled non-citizens of any US state to access greater rights than citizens by electing to take their claims to federal rather than state court. While the two-tiered system had been designed to prevent "discrimination in state courts against those not citizens of the State" it instead "introduced grave discrimination by non-citizens against citizens" because it gave non-citizens the "privilege of selecting" whether to take their disputes to federal courts and benefit from more favorable federal law. Such a system, the Supreme Court declared in this 1938 case, "rendered impossible equal protection of the law" and gave rise to injustice and confusion.

ISDS raises exactly the same issues. And although ISDS cases are not brought with the frequency of analogous cases under domestic law, several factors (e.g., increased awareness of the mechanism among investors and counsel, litigation advantages offered by ISDS, the rise of third-party funding (discussed below), and efforts to make ISDS faster and cheaper, such as reform processes ongoing in UNCITRAL and at the International Centre for Settlement of Investment Disputes (ICSID)) may drive continued increases in ISDS cases. In light of these issues, it is important to further consider how to ensure that the procedural mechanism of ISDS is not used to unduly distort the scope of substantive investor protections.

2. Third-party funding

Third-party funding is rapidly increasing in the context of ISDS claims. In exchange for investing in a claim, a third-party funder is entitled to a return or other financial interest in the outcome of a dispute, which can take the form of a share in the award. Some funders also will have contractual rights to remain involved in, and potential even control, certain aspects of how a case is managed by an investor-claimant. As a general matter, due in large part to the asymmetrical nature of ISDS, third-party funders invest in claimant claims and not respondent defenses.

A wide variety of policy issues, many unique to the ISDS context, arise when third-party funders are introduced into these cases. Currently, third-party funders and third-party funding is largely unregulated at the treaty level. UNCITRAL's Working Group III has identified the issue of third-party funding in ISDS

as a concern meriting multilateral reform. This work provides an opportunity for the US to assess how the issue of third-party funding aligns with its negotiating and other applicable objectives, including issues of "no greater rights."

As a general matter, US states, along with other common law jurisdictions, historically applied doctrines prohibiting maintenance (the support of a third party's litigation) and champerty (supporting litigation in exchange for a share in the proceeds of the claim). While the strict application of these doctrines has been relaxed in many US jurisdictions, this not to say that third-party funding in domestic litigation is now unregulated. For example, various states prohibit funders from controlling the management of claims.

Moreover, when assessing questions of "no greater rights", analysis of how third-party funders and funding are treated generally in US jurisdictions is not the correct inquiry. Rather, the question should be how the issue of third-party funding is treated in claims *against the US government*.

The US Anti-Assignment of Claims Act[8] prohibits "a transfer or assignment of any part of a claim against the United States Government or of an interest in a claim," as well as "authorization to receive payment for any part of the claim." There are exceptions, such as permitting interest in claims to be transferred *after* they have been determined to be valid and *after* the amount owed has been decided.

The Anti-Assignment aims to serve several policy objectives:

> first, to prevent persons of influence from buying up claims which might then be improperly urged upon Government officials; second, to prevent possible multiple payment of claims and avoid the necessity of the investigation of alleged assignments by permitting the Government to deal only with the original claimant; and third, to preserve for the Government defenses and counterclaims which might not be available against an assignee.[9]

The Anti-Assignment Act applies broadly across various causes of action, including to prohibit voluntary assignments of indirect takings claims[10] and tort claims.[11] That statute, however, would not control treaty-based arbitration tribunals or prevent them from permitting investors to assign their ISDS claims to third party funders.

Consequently, third-party funders could invest in a single claim, or a portfolio of claims, against the US Government and no investment law- or domestic law-based regulations on the practice would clearly apply to the funder or its investment. Not only are there no clear restrictions on assignment, there are also no transparency requirements, no regulations on whether the funder could control the claim, no established standards regarding costs and security for costs as they relate to the funder, and no meaningful conflict-of-interest standards. It is therefore important to consider how this currently flexible and permissive approach to assignment and funding of claims under ISDS corresponds with US law and policy, and use the UNCITRAL process to remedy any misalignment.

3. Non-parties to disputes

[8] 31 USC § 3727.
[9] *Kingsbury v. United States* [1977] 563 F.2d 1019, 1024.
[10] *Bailey v. United States* [2007] 78 Fed. Cl. 239, 267-68 (quoting *United States v. Dow* [1958] 357 U.S. 17, 20).
[11] *See United States v. Shannon* [1952] 342 U.S. 288, 289-90; *Saint John Marine v. United States* [1996] 92 F.3d 39, 46.

The rights and interests of non-parties to ISDS disputes, and how those rights are addressed, or not addressed, in the context of the ISDS dispute, is another issue that raises issues of "no greater rights" for foreign investors.

Non-party interests and rights may arise, and have arisen, in ISDS on the basis of a variety of relationships, including: creditors of ISDS claimants;[12] municipal jurisdictions with interests in land or contracts that are at issue in ISDS cases;[13] communities impacted by the investment (particularly those contesting the investment via domestic processes);[14] individuals with competing claims to property in interest;[15] and adverse parties in domestic litigation;[16] among others. The rights and interests of these non-parties may be triggered in different ways, including: where underlying issues are being heard in different fora (one of which is ISDS);[17] when investors challenge domestic court processes or outcomes;[18] disputes seeking interim or injunctive relief;[19] among others.

When rights or interests of non-parties arise in or are impacted by legal claims, the process and ultimate award (or settlement, addressed in following section) can result in legal interpretations or remedies adverse to the rights or interests of such non-parties, and can create pressure to discount the rights and interests of such non-parties.

US federal and state law have developed standards and mechanisms to evaluate at what level a third-party's interest in a claim is significant enough to warrant actual participation in a dispute, approaches to govern when such intervention is permissible and when it is required, and mechanisms to dismiss claims when all necessary and indispensable parties cannot be joined.

ISDS has no such mechanisms or protections for non-parties' rights and interests. The only way for third-parties to provide input in ISDS proceedings is as *amicus curiae*. Such participation is granted at the discretion of the tribunal and standards applied to *amicus* participation are vague and often difficult to satisfy. For example, standards are generally interpreted to require *amici* to add additional perspectives or information to the proceedings that are at issue but have not been raised by counsel, but potential *amici* are often denied access to the very pleadings that are essential to understand what issues have and have not been raised.

Critically, for the "no greater rights" question, is the fact that amicus participation is intended to assist the tribunal in its assessment and determination of the claim; it is not intended to be an avenue by which the rights or interests of non-parties are effectively asserted and addressed in the context of the dispute. Of course, US federal and state courts also grant participation of *amici* to assist courts in their work. However, in contrast to ISDS, those US courts also provide for relatively broad standards of intervention in certain

[12] *Dan Cake S.A. v. Hungary*, ICSID Case No. ARB/12/9 (Decision on Jurisdiction and Liability, 2015).
[13] *Mr. Hassan Awdi, Enterprise Business Consultants, Inc. and Alfa El Corporation v. Romania*, ICSID Case No. ARB/10/13 (Award, 2015).
[14] *Copper Mesa Mining Corporation v. Republic of Ecuador*, PCA No. 2012-2 (Award, 2016; Joint Motion for Stay of the Pending Completion of Settlement Agreement, 2018).
[15] *Border Timbers Limited, Border Timbers International (Private) Limited, and Hangani Development Co. (Private) Limited v. Republic of Zimbabwe*, ICSID Case No. ARB/10/25.
[16] *Eli Lilly and Company v. The Government of Canada*, UNCITRAL, ICSID Case No. UNCT/14/2 (Final Award, 2017); *Chevron Corporation and Texaco Petroleum Corporation v. The Republic of Ecuador*, UNCITRAL, PCA Case No. 2009-23.
[17] *TransCanada Corporation and TransCanada PipeLines Limited v. The United States of America*, ICSID Case No. ARB/16/21 (Order of the Secretary-General Taking Note of the Discontinuance of the Proceeding, 2017); *Copper Mesa v. Ecuador* (n 14).
[18] *Eli Lily v. Canada* (n 16); *Chevron v. Ecuador* (n 16).
[19] *Chevron v. Ecuador* (n 16); *Border Timbers v. Zimbabwe* (n 15).

contexts where the rights of third parties are at stake or stand to be affected by the outcome of a proceeding. For example, rules on mandatory and permissive intervention require or permit joinder to a claim by those who are interested or affected.[20] In certain cases where the rights of third parties may be affected but such parties cannot join, dismissal of some or all claims may be required, or claims, or requests for relief, may need to be reshaped.[21] Distinct from *amicus* participation, in these latter contexts, the third-party becomes an actual party to the case and the party's rights and interests may thus be adjudicated within the context of the dispute.

To the extent a foreign investor is able to bypass the US domestic legal system by reframing a claim as one of alleged treaty violation, such investor is also able to bypass the strong legal protections that the US legal system has developed to ensure that the rights and interests of certain not-parties are adequately heard, addressed and accounted for within the dispute resolution process. This creates concerns for the US government regarding the protection of the rights and interests of its citizens who may be impacted by an ISDS dispute, and also may result in foreign investors benefiting from procedural rules that result in more favorable substantive outcomes. Here again, the UNCITRAL process provides an opportunity to explore and address these issues.

4. Settlement of claims

A significant percentage of ISDS claims are reportedly settled between the parties to the dispute before an award is issued. Settlements can result in certain positive outcomes, such as saving parties the time and expense of arbitration. However, settlement of disputes involving governments, such as occurs in the ISDS context, also require that careful attention be given to certain principles of good governance, particularly those central to the US legal system, such as government accountability, respect for the rule of law, transparency, and respect for citizens' rights and interests.

In the context of ISDS reform at UNCITRAL and elsewhere, issues of settlement of ISDS disputes have received relatively little attention, despite there being a general lack of rules in the investment law context that govern settlement. Given the attention given to this issue under US domestic law, we take this opportunity to highlight this issue in the "no greater rights" context.

As has been recognized by courts and commentators in the context of US domestic litigation, giving the government such broad powers to unilaterally determine what arguments to make and what settlements to adopt can significantly - and negatively - impact the rights and interests of non-parties to the litigation.[22] The U.S. Chamber of Commerce has highlighted a the "sue and settle" problem that arises when government agencies settle, rather than defend, lawsuits by private parties. By entering into settlements, the U.S. Chamber of Commerce states, a government agency commits itself to "legally binding, court-approved settlements negotiated behind closed doors, with no participation by other affected parties or the public," which allows agencies to avoid the legislatively established norms governing the rulemaking process, frustrating the separation of powers and distorting the priorities and duties of the agency in favor of private outside groups.[23]

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[20] Federal Rules of Civil Procedure, Rule 24.
[21] Federal Rules of Civil Procedure, Rule 19.
[22] See generally, Michael T. Morley, Consent of the Governed or Consent of the Government? The problems with consent decrees in government-defendant cases, 16 Journal of Constitutional Law 637, 647–649 (2014). See also Lise Johnson and Lisa Sachs, The TPP's Investment Chapter: Entrenching rather than reforming a flawed system (CCSI 2015), http://ccsi.columbia.edu/2015/11/18/the-tpps-investment-chapter-entrenching-rather-than-reforming-a-flawed-system.
[23] U.S. Chamber of Commerce, Sue and Settle: Regulating behind closed doors (2013) p. 3, https://www.uschamber.com/sites/default/files/documents/files/SUEANDSETTLEREPORT-Final.pdf.

As such, in the US, various rules and mechanisms exist for public and judicial oversight of settlement agreements, including:

- Statutory requirements that apply prior to the formation of a settlement agreement, such as rules requiring the government to give the public notice of and an opportunity to comment on proposed agreements;
- Rules permitting or giving non-parties the right to intervene in disputes and comment on or object to settlements;[24]
- Requirements for judicial approval of certain proposed agreements;[25]
- Doctrines preventing enforcement of settlement agreements that violate the law.

ISDS provisions and arbitral rules, however, provide no similar rules aimed at protecting non-party rights and interests, or mechanisms for ensuring public oversight of proposed settlement agreements. Additionally, to the extent decisions to settle involve counterclaims, concerns about settlement are magnified as the rights and interests of non-parties, and how such rights, interests, or potential claims, may be disposed of in the context of a settlement, remain unaddressed and unclear.

There are certain gaps related to settlement in the investment law context that could be addressed as procedural issues in the context of UNCITRAL's Working Group III (in addition to other contexts).

C. Ways forward

In its April 2019 meeting, Working Group III adopted a three-step process to identify and pursue specific "structural" and other reforms.[26] Those steps, in brief, are: (1) by July 15, 2019, states and observer organizations can make submissions to the UNCITRAL Secretariat on what other solutions to develop and when such solutions might be addressed; (2) at its next session in October 2019, the Working Group would identify which of the solutions to discuss and when, subject to capacity and scheduling; and (3) the Working Group would begin to elaborate and develop potential solutions to be recommended to the Commission.[27]

With respect to its submission on projects, timing and sequence, we recommend two overarching approaches:

First, that the United States advocate for a broad view of the work, one that includes within potential "structural" reforms efforts to limit access to the procedural mechanism of ISDS in order to prevent that mechanism from undermining the "no greater rights" policies. This could be done, as in the USMCA, by working to exclude ISDS for all or some causes of action, and could be implemented through an opt-in convention similar to the Mauritius Convention on Transparency.

Second, that the United States specifically use the UNCITRAL process to address the areas where procedural rules and approaches to issues including, but not limited to, third-party funding, the rights of non-parties, and settlement in ISDS depart from and may be inconsistent with domestic law and policy.

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[24] See, e.g., at the federal level, U.S. Federal Rules of Civil Procedure, Rules 24(a) and 24(b).
[25] See, e.g., 42 USCS § 9622; *United States v. Akzo Coatings of Am.*, 949 F.2d 1409, 1435 (6th Cir., 1991).
[26] The Working Group agreed to develop multiple solutions simultaneously, one of which would be an undefined category of "structural" reform.
[27] Report of the 37th Session (n 7) para. 83.

For further information:

We list here select CCSI papers and projects that are particularly relevant to the issues highlighted above:

ISDS and US law
Investor-State Dispute Settlement, Public Interest, and US Domestic Law (2015)

Third-Party Funding:
The Policy Implications of Third-Party Funding in Investor-State Dispute Settlement (2019)

Rights and Interests of Non-Parties
Investment Disputes and Affected Third Parties: Connections, Issues, and Options for Reform (2019) [powerpoint], which is a part of a broader area of work on issues of the impacts of ISDS on Access to Justice.

Settlement of Claims:
The Settlement of Investment Disputes: A Discussion of Democratic Accountability and the Public Interest (2017)