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Hong Kong is Mapping the Way Forward in ISDS Reform

Rutger Metsch (Herbert Smith Freehills LLP) · Friday, March 29th, 2019 · Herbert Smith Freehills

The year of the pig was off to a good start in Hong Kong at the Investor-State Dispute Settlement (ISDS) Reform Conference organised by the Hong Kong Department of Justice and the Asian Academy of International Law on 13 February 2019. Like the fabled pig, ISDS reform has been slow in coming, and the aim of the conference was to explore possible improvements to the existing ISDS system. The line-up of speakers was promising and these expectations were fully met in a day of interesting discussions, (actual) double hatting, and, most of all, mapping the way forward.

As proof, a highlights clip and photos are available here. A conference proceeding is scheduled for publication in June 2019.

Opening

Secretary for Justice Teresa Cheng SC opened the conference by commenting on the importance of looking at ISDS reform on an international level as well as on a domestic level, in part due to Hong Kong's role as a leading global investment hub and its unique position as a bridge between investment into and from mainland China (the *PRC*).

Dr Jiang Chenghua (PRC Ministry of Commerce), Dr Sun Jin (PRC Ministry of Foreign Affairs) and Dr Anthony Neoh (Asian Academy of International Law) respectively followed by setting the scene for the conference discussions. They commented on the crossroads the ISDS system appears to be at, with UNCITRAL Working Group III considering ISDS reform, the International Centre for Settlement of Investment Disputes (ICSID) conducting a consultation on amending its rules, and several States considering alternatives to the current system of investment treaty arbitration. A state of flux, however, also creates opportunity. With these thoughts in mind, the panel sessions started.

Investment Mediation

(Professors Lucy Reed and Jack Coe, Dr Anthony Neoh as moderator, and Paul Starr as commentator. Discussion paper[1)] prepared by David Ng)

The first panel considered opportunities for the increased use of mediation in investor-State disputes. The speakers observed that not all investment treaty disputes could be settled through mediation, but that many more could than is currently the case. The use of investment mediation could be incentivised by, among other options, highlighting the available range of remedies compared to arbitration (including getting new deals, reinstatement, etc), publishing successful examples of investor-State mediations with sensitive information redacted, and building mediation procedures into protocols and treaties so there is no loss of face for a State official if mediation is attempted.

The panel agreed that mediation could be attempted at any stage during the life of the arbitration, operating as a 'shadow process' running concurrently with the dispute as it proceeds through its natural phases. Regarding the number of 'neutrals' that should be involved in the dispute, the default approach might be three arbitrators and one mediator, but a sole arbitrator shadowed by two mediators could also be considered given the potential benefits in terms of the speed and efficiency of the process. During the Q&A of the panel session, the innovative mediation mechanism under the CEPA Investment Agreement between the PRC and Hong Kong was mentioned as one of the reference models for the design of an effective investment mediation protocol.

Appeal Mechanism for ISDS Awards

(Professors Albert Jan van den Berg and Zhang Yuejiao, Matthew Gearing, Paul Tsang as moderator, and May Tai as commentator. Discussion paper prepared by Antony Crockett)

The second panel considered whether an appeal mechanism for ISDS awards is desirable and practicable.

Regarding the balance between finality and consistency of ISDS awards, the panellists observed that finality was generally preferred over consistency in commercial arbitration. In ISDS, however, consistency played a more important role than in commercial arbitration because (1) the deemed higher public interest in investment disputes and (2) the system will be brought into disrepute if apparently inconsistent decisions exist.

Creating an appeal mechanism was seen as one possible way to address consistency issues in ISDS. However, should such a mechanism be introduced, a possible side effect might be that it would lead to an increase of further proceedings by parties. Currently, about a third of ICSID arbitrations proceed to annulment proceedings, despite the narrow grounds upon which annulment is possible. If there is a possibility to appeal the merits of a decision, this percentage is likely to go up.

Moreover, creating an appeal mechanism raises some complex (and interesting) issues, such as the form and nature of the mechanism and its interaction with existing international instruments. Design of the appeal mechanism could involve an amendment of the ICSID Convention, an *inter se* amendment of the ICSID Convention between two or more Contracting States (as suggested by Professor van den Berg in his conference speech), an avenue for appeals in national courts (for non-ICSID ISDS arbitrations), or a separate mechanism through a new treaty establishing an appellate body (in line with the proposal by Gabrielle Kaufmann-Kohler and Michele Potestà). An additional consideration is, however, how effective the mechanism would be (if at all) in achieving consistency if the appellate body is applying inconsistent substantive provisions in the over 3,300

international investment agreements.

Third Party Funding

(Professor Julian Lew, Dr James Ding, and Matthew Hodgson as moderator. Discussion paper prepared by Eric Ng)

The session on third party funding (**TPF**) was especially timely because legislative amendments clarifying that third party funding is permitted in Hong Kong had come into effect just 12 days earlier, on 1 February 2019."

The panel observed that the use of TPF is generally accepted as beneficial in commercial arbitration but that questions as to the propriety of TPF in the context of ISDS have been raised. However, use of TPF in ISDS can also have a significant benefit for the system: ISDS can be very expensive and TPF may help parties get access to justice.

The panel flagged several practical questions that arise from the practice of TPF in ISDS, including whether TPF can give rise to a conflict of interest for arbitrators, whether the existence of a TPF arrangement should be disclosed, whether the funder should be made a party to the arbitration in some form, and whether the existence of TPF should justify an order for security of costs. Answers to these questions are often situation-specific and formulating abstract rules to address these issues may therefore be difficult. The panel agreed that part of the problem is that there is a lack of empirical data available on TPF and, as a result, many debates on how to answer these questions have been based on impressions rather than facts.

Appointing arbitrators

(Meg Kinnear, Stanimir Alexandrov, Professor Brigitte Stern, and Caroline Nicholas and Sun Huawei as co-moderators. Discussion paper prepared by Adrian Lai)

The final panel, which was conducted in "Davos-style", addressed issues related to the appointment of arbitrators.

The panel concluded that party appointment is still strongly preferred in ISDS practice because it gives parties a sense of control over the process and can increase the perceived legitimacy of the arbitration. There are several procedures that parties can use to appoint arbitrators, including:

- a roster (e.g. the ICSID Panel of Arbitrators);
- lists with a strike and rank option (a list of potential arbitrators is created, each party can veto one name and then ranks the remaining names in order of preference with the highest ranking arbitrator being chosen);
- ballot (the parties receive a list of potential arbitrators, each party indicates which arbitrators it can agree to and, if both parties agree to a particular arbitrator, that arbitrator is appointed); and even
- coin flip (although that is not advised!).

The panel also considered whether it was desirable to forgo the system of *ad hoc* arbitrators altogether and instead move to a system of full-time ISDS judges. Professor Stern explained that two of the basic fundaments of ISDS arbitration are (1) parties' consent to an arbitrator (whether directly or indirectly); and (2) the depoliticisation of disputes between host States and investors. A body of full-time ISDS judges could negate these crucial elements of the ISDS framework. Consent to an arbitrator was seen as an effective way to achieve trust in the system by parties and a standing body of judges would therefore come at a high price. Moreover, the process of appointing judges could risk repoliticising ISDS as only one of the parties to the dispute (i.e. the State) would be able to choose the neutrals hearing its case.

Debate on a Permanent Investment Court

The afternoon concluded with an Oxford-style debate moderated by Professor Chin Leng Lim on the motion "*the permanent investment court system is the solution to the concerns over ISDS*".

Professor Shan Wenhua and Emmanuel Jacomy were allocated to argue in favour of the motion and Professors Brigitte Stern and Stephan Schill were requested to argue against the motion. What resulted was a humorous and spirited debate, which included a slideshow with (hardly) anonymised quotes by the conference speakers and Professor Stern wearing three different types of headwear in a literal double-hatting effort. In the end, the 'against' side carried the motion with a 76% majority, according to Professor Lim because "*Professor Stern in a wig proved in the end irresistible*".

Mapping the Way Forward

The conference provided a forum for a diverse line-up of speakers and an engaged audience to consider the future of ISDS by discussing (and challenging) innovative ideas for reform. Such reform seems inevitable and the Hong Kong Department of Justice has demonstrated that it intends to be one of the thought leaders for change. We look forward to seeing some of the ideas discussed at the conference implemented in the future.

References

?1 In preparation for each of the four panel discussions, arbitration practitioners had prepared discussion papers providing an introduction to the topics considered by the speakers. These discussion papers are linked in the post and available to download for those who are interested.

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