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MEANINGFUL REFORM OR REARRANGING DECKCHAIRS ON THE TITANIC? REGULATING THE PRINCIPLE OF GOOD FAITH IN INVESTOR-STATE ARBITRATION: MEANINGFUL REFORM OR REARRANGING DECKCHAIRS ON THE TITANIC?

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ABSTRACT

In investor-state arbitration—the principal mechanism enabling foreign investors to bring claims against host-states—the principle of good faith functions as an omnipresent force, intricately woven into the fabric of its proceedings. Its influence permeates every aspect of the field: where the sovereignty of host-states and the conduct of foreign investors are examined, tribunals frequently invoke the principle to construe parties' obligations, with findings of good or bad faith often determining the outcomes of disputes. Despite its integral role, the principle remains susceptible to inconsistent interpretation and uncertain application, reinforcing stakeholders' concerns regarding the urgent need for reform. This article examines the necessity of regulating the application of the principle of good faith in investor-state arbitration and explores potential reforms toward that end. Employing a doctrinal methodology, it draws upon arbitral decisions, UNCITRAL discussions, and relevant literature. The findings reveal that the urgency of regulation is most apparent in contexts involving corruption, treaty shopping, the fair and equitable treatment standard, and the allocation of costs. To address these issues, the article proposes both principle-based reforms—such as adopting a coherent definition of good faith and incorporating it explicitly into bilateral investment treaties (BITs)—and structural reforms, including the adoption of a doctrine of precedent, the establishment of an appellate mechanism, a ban on double-hatting, and the introduction of clear rules on cost allocation. Ultimately, regulating the principle of good faith is vital to ensuring greater predictability, coherence, and legitimacy within the investor-state arbitration system.

Keywords: Investor-state arbitration, principle of good faith, United Nations Commission on International Trade Law.

INTRODUCTION

The principle of good faith is often heralded as the gold standard for assessing parties' conduct in disputes. Yet, at its core, it remains an elusive concept (Stoffel-Munck, 2024; Zeller & Lightfoot, 2018). Like many other ideal precepts, its definition and precise scope are inherently fluid (Abdullah, 2020; Abdullah et al., 2017; Abdullah & Ghadas, 2023). Nevertheless, the principle continues to play a vital role in legal disputes, exerting significant influence across various areas of law, including investor-state arbitration (*Abaclat & Others v. Argentine Republic*, 2011).

Within the realm of investor-state arbitration, good faith operates as a legal principle that regulates both the sovereignty of host-states and the conduct of foreign investors (Sipiorski, 2019, para. 1.51). A tribunal's findings that either party has acted in good or bad faith not only affects its assessment of compliance or breach of express obligations (*Amco Asia Corporation v. Republic of Indonesia*, 1984) but may also influence the tribunal's determination of costs (*Liberian Eastern Timber Corporation v. Republic of Liberia*, 1986).

Despite its pivotal role in guiding parties' conduct, the principle's inherent vagueness renders it vulnerable to inconsistent interpretation and application by arbitral tribunals. Consequently, this has produced inconsistencies and uncertainty in various aspects of investor-state arbitration.

In line with growing stakeholder concerns over the urgent need to reform the investor-state dispute settlement (ISDS) system, this article argues that such inconsistencies in the application of good faith further underscore the necessity for reform (Landau et al., 2023). This article proceeds in three parts. First, it demonstrates how the inconsistent application of the principle contributes to uncertainty in investor–state arbitration. Second, it identifies principle-based and structural reforms that could be adopted to regulate the application of good faith. Finally, it presents the article's overall findings and conclusion.

METHODOLOGY

This article adopts the view that the most appropriate approach for evaluating the principle of good faith in investor-state arbitration is the doctrinal methodology. Accordingly, the research relies on both primary and secondary legal sources that are pertinent to the topic.

Primary legal sources include treaties—such as bilateral investment treaties (BITs), multilateral investment treaties (MITs), conventions, and arbitral institutional rules. These instruments are significant because they often provide the express basis for the incorporation and application of the principle of good faith in investor-state arbitration.

More importantly, investor-state arbitration awards form the principal source of analysis in this article. Within these awards, the parties' arguments and submissions on good faith, the tribunals' analysis and conclusions, as well as individual arbitrators' opinions on the principle are examined. This enables an assessment of how the principle of good faith is understood and applied in investor-state arbitration.

With regard to secondary legal sources, although the available literature is relatively limited, this article considers relevant academic books, journal articles, theses, commentaries, and other publications that discuss (i) the principle of good faith generally, (ii) its role in public international law, and (iii) its application in investor-state arbitration.

URGENCY TO REGULATE THE PRINCIPLE OF GOOD FAITH IN INVESTOR-STATE ARBITRATION

Corruption

It is axiomatic that corruption is "considered the most extreme case of a lack of good faith" (Sipiorski, 2019, para. 4.37). Given that corruption falls within the ambit of criminal law, investor-state arbitration tribunals have conventionally declined jurisdiction on the basis that such matters extend beyond their mandate. Conversely, in the absence of corruption, tribunals generally accept jurisdiction and proceed to determine the merits of the dispute (*Union Fenosa Gas S. A. v. Egypt*, 2018; *Karkey Karadeniz Elektrik Uretim A. S. v. Islamic Republic of Pakistan*, 2017; *MOL Hungarian Oil & Gas Company Plc v. Republic of Croatia*, 2016). However, certain tribunals have deviated from this general approach, leading to inconsistency and uncertainty in how the principle of good faith is applied in corruption-related cases. A well-known example is *World Duty Free Company Limited v. Republic of Kenya* (2006).

In *World Duty Free*, the claimant had entered into a contract with Kenya to obtain an interest in duty-free airport facilities. In procuring the said contract, the claimant's representative met with the then President of Kenya, Mr. Daniel arap Moi, and made a payment described as community fund. The claimant's only witness, Mr. Nassir Ibrahim Ali, testified that he was advised to make a "personal donation" of approximately US$2 million to President Moi. When the claimant allegedly refused to participate further in the President's fraudulent scheme, the President withdrew his support, and the company was subsequently barred from operating in Kenya. The claimant then initiated ICSID arbitration proceedings against Kenya, seeking compensation for the alleged expropriation of its investment.

The *World Duty Free* case is unique because the claimant openly admitted to bribing President Moi but sought to rely on that admission to prove that it had acted in good faith. As Mr. Nassir Ibrahim Ali testified: "Protocol in Kenya required that I should in addition make a 'personal donation' to HEDAM. I was given to believe, that this was payment for doing business with the Government of Kenya."

The awkwardness of *World Duty Free* lies in the fact that, despite the clear presence of corruption, the arbitral tribunal nonetheless proceeded to accept jurisdiction. In paragraph 187, the tribunal held:

> … the Tribunal notes that no evidence was adduced or argument submitted by either of the Parties to the effect that the bribe specifically procured Article 9 of the Agreement, containing the Parties' agreement to arbitration under the ICSID Convention. Accordingly, in accordance with well-established legal principles under English and Kenyan law, the Tribunal operates on the assumption that the Parties' arbitration agreement remains subsisting valid and effective for the purpose of this proceeding and Award.

In defence of the arbitral tribunal's approach, it may be argued that the decision was reasonable to the extent that the tribunal ultimately found in favour of Kenya and refused to uphold a contract procured through bribery. This position was reflected in paragraph 157 of the award:

> In light of domestic laws and international conventions relating to corruption, and in light of the decisions taken in this matter by courts and arbitral tribunals, this Tribunal is convinced that bribery is contrary to the international public policy of most, if not all, States or, to use another formula, to transnational public policy. Thus, claims based on contracts of corruption or on contracts obtained by corruption cannot be upheld by this Arbitral Tribunal.

Notwithstanding the tribunal's reasoning, it is important to note that the awkwardness of the *World Duty Free* decision is further exacerbated by the tribunal's decision to separate the actions of the President (in accepting the bribe) from those of the State of Kenya. In paragraph 185, the tribunal held:

> The President was here acting corruptly to the detriment of Kenya and in violation of Kenyan law (including the 1956 Act). There is no warrant at English or Kenyan law for attributing knowledge to the State (as the otherwise innocent principal) of a state officer engaged as its agent in bribery.

The arbitral tribunal's decision—that the President's actions could be viewed as separate from that of the State of Kenya—appears inconsistent with Article 7 of the International Law Commission's Articles on State Responsibility, which provides that:

> … conduct of an organ of a State or of a person or entity empowered to exercise elements of governmental authority shall be considered an act of the State under international law if the organ, person or entity acts in that capacity, even if it exceeds its authority or contravenes instructions.

The *World Duty Free* decision aptly illustrates the flaws in applying the principle of good faith in investor-state arbitration. In corruption-related cases, it is often said that "it takes two to tango." Acts of corruption—such as payment and acceptance of bribes—are not unilateral; they are *pari delicto* in nature, meaning both the investor and the host-state share responsibility for the corrupted conduct (Pereira, 2019). Therefore, by asserting yet ultimately deciding in favour of Kenya, the arbitral tribunal in *World Duty Free* inadvertently created a 'double standard' in applying the principle of good faith. The claimant was deprived of its claim on basis that it had engaged in corrupt acts (a violation of good faith), while Kenya effectively benefited from having accepted the same corrupt payment—also a violation of good faith.

Even in instances where arbitral tribunals have declined jurisdiction because of corruption (and thus a breach of the principle of good faith), the weakness in how the principle is applied remains evident. This is because host-states are, in effect, permitted to rely on their own misconduct—namely, accepting bribes—to shield themselves from investors' claims. As Diogo Pereira perceptively observes, "a cynical State could conclude that it should encourage an act of corruption at the inception of an investment to inoculate themselves against future investor claims" (Pereira, 2019).

This again reflects a 'double standard' in the application of the principle of good faith in corruption-related investor-state arbitrations. In such cases, investors are deprived of their claims, while host-states stand to benefit from the tribunal's lack of jurisdiction, even though both parties have violated the principle of good faith.

Treaty Shopping

Inconsistencies and uncertainties in the application of the principle of good faith are also evident in cases involving treaty shopping by foreign investors. Treaty shopping occurs when investor's structure or restructure their investments through a third State to 'shop' for a treaty that affords more advantageous procedural or substantive protection. Typically, this is achieved by altering their own nationality or by creating specific investment vehicles.

Treaty shopping does not, by itself, constitute a violation of the principle of good faith, as it may take both legitimate and illegitimate forms (Sipiorski, 2019, para. 3.127; Skinner et al., 2010). The determining factor is the timing of the investor's manoeuvre. Where investors engage in pre-dispute planning, such conduct is generally not viewed as acting in bad faith. On the contrary, it may "demonstrate foresight on the part of the investor," and arbitral tribunals have conventionally accepted jurisdiction in such cases (Sipiorski, 2019, para. 3.135). In contrast, when investors restructure their investments after a dispute has arisen—typically upon realising that their investment is not protected under an existing treaty—and attempts to establish jurisdiction through any available means, such conduct is usually deemed to contravene the principle of good faith. The challenge, however, lies in the fact that tribunals have not always applied this distinction consistently. In both pre-dispute and post-dispute treaty shopping scenarios, some tribunals have deviated from the conventional approach, resulting in further inconsistency and uncertainty in the application of the principle of good faith.

Pre-dispute Treaty Shopping

The general approach to pre-dispute treaty shopping is exemplified in *Rompetrol v. Romania* (*The Rompetrol Group N. V. v. Romania*, 2008). In this case, Rompetrol, a Dutch company controlled by Romanian nationals, initiated ICSID arbitration against Romania under the Netherlands-Romania Bilateral Investment Treaty or 'Dutch-Romanian BIT.' The claimant denied engaging in treaty shopping, arguing that its incorporation in the Netherlands was not intended to secure jurisdiction, as the corporation had been incorporated there six years prior to the dispute. The arbitral tribunal eventually accepted jurisdiction and agreed with the claimant's position.

Tribunals such as the one in *Rompetrol* have generally emphasised timing as the key factor in assessing whether treaty shopping violates the principle of good faith. However, in an inconsistent and somewhat peculiar departure from this approach, the arbitral tribunal in *TSA Spectrum de Argentina S. A. v. Argentine Republic* (2008) placed its focus instead on the nationality of the investors.

In *TSA Spectrum de Argentina S.A. v. Argentine Republic* (2008), the parent company, TSI Spectrum International N. V ('TSI') was incorporated in the Netherlands on 15 August 1996, while its subsidiary, Thomson Spectrum de Argentina S. A. ('TSA'), was established in Argentina only five days later, on 20 August 1996. In essence, the parent company TSI was created shortly before the formation of its subsidiary.

On 11 June 1997, TSA entered into a concession agreement with Argentina to provide radio spectrum administration, monitoring, and control services to the Argentine Telecommunications Commission. However, on 26 January 2004, Argentina terminated the concession agreement, prompting TSA to file a request for ICSID arbitration on 20 December 2004.

The arbitral tribunal, relying on Article 25(2)(b) of the ICSID Convention, ultimately declined jurisdiction on the basis that TSA lacked 'foreign control.' It found that TSA did not meet the requirements of an 'investor' because the ultimate owner of both TSI and TSA was an Argentine national, Mr. Jorge Justo Neuss. This conclusion was reached despite the fact that the foreign element of the investment had been structured prior to the dispute.

As explained in paragraph 147 of the award, the arbitral tribunal reached its decision on the basis that the second part of Article 25(2)(b) of the ICSID Convention obligated it to pierce the corporate veil in order to determine whether TSA was genuinely under foreign control. Upon doing so, the tribunal concluded that such foreign control could not be established.

In the context of pre-dispute treaty shopping, arbitral tribunals generally do not regard investors' corporate or structural manoeuvres as contrary to the principle of good faith—unless the dispute was already foreseeable at the time of restructuring.

However, the decision of *TSA* undermines the clarity of this principle's application in cases of pre-dispute treaty shopping. The tribunal's reasoning appears inconsistent with other decisions, as it focused primarily on the nationality of the ultimate owner rather than the timing of the restructuring, despite the fact that the 'foreign element' of the investment had been planned prior to the dispute. Had the arbitral tribunal adopted the conventional approach—emphasising whether the restructuring occurred before the dispute could be reasonably envisaged—it would likely have upheld jurisdiction, since both TSI and TSA were incorporated prior to any identifiable dispute.

A possible counterargument in support of the *TSA* decision is that by piercing the corporate veil and examining the nationality of the true owner, the tribunal in fact upheld the principle of good faith by preventing deceit and the abuse of the investor-state arbitration mechanism. However, if one accepts that the owners' nationality is the decisive factor, this would imply that the decision in *Rompetrol* was wrongly decided. In *Rompetrol*, the majority of the claimant's owners were Romanian nationals, yet the arbitral tribunal nonetheless accepted jurisdiction and allowed the claimant to rely on the Netherlands-Romania BIT to bring its claim against Romania.

Post-dispute Treaty Shopping

As a matter of conventional practice, when investors engage in treaty shopping by initiating changes in the control or ownership structure of their investments after a dispute has arisen, such conduct is typically regarded as a violation of the principle of good faith (Sipiorski, 2019, para. 3.77). Within the context of post-dispute treaty shopping, a case that arguably creates a conundrum in the application of this principle is *Mobil v. Venezuela* (*Mobil Corporation, Venezuela Holdings, B. V. v. Venezuela,* 2010). The tribunal in this case held that corporate reorganisation undertaken by investors for planning purposes did not contravene the principle of good faith.

In *Mobil*, the dispute arose from the claimants' oil holdings in Venezuela, specifically following Venezuela's substantial increase in royalties' payable by the Claimants. Although the Claimants had received notices of investment disputes in February, May and June 2005, they nonetheless incorporated a new entity under Netherlands law in October 2005. Subsequently, the Claimants initiated ICSID arbitration proceedings against Venezuela under the Netherlands-Venezuela BIT.

Venezuela contended that the ICSID tribunal lacked jurisdiction, arguing that the jurisdictional basis invoked by the Claimants fail to comply with the principle of good faith. Specifically, Venezuela asserted the Dutch entity had been created solely to establish jurisdiction before the ICSID tribunal and thus constituted a mere "corporation of convenience," as it was established in anticipation of litigation against Venezuela.

Venezuela further maintained that the Claimants' incorporation constituted an "abuse of the corporate form" and that such "blatant treaty-shopping should not be condoned." Relying on the principle of good faith, Venezuela argued that the restructuring did not result in a protected investment under the good faith standards articulated in *Phoenix v. Czech Republic,* therefore constituted an abuse of rights.*"*

Nevertheless, the tribunal upheld its jurisdiction, finding at paragraph 204 that:

> As stated by the Claimants, the aim of the restructuring of their investments in Venezuela through a Dutch holding was to protect those investments against breaches of their rights by the Venezuelan authorities by gaining access to ICSID arbitration through the BIT. The Tribunal considers that this was a perfectly legitimate goal as far as it concerned future disputes.

However, the arbitral tribunal reaffirmed the significance of the *Phoenix* decision (*Phoenix Action, Ltd. v. The Czech Republic*, 2009) at paragraph 205:

> With respect to pre-existing disputes, the situation is different and the Tribunal considers that to restructure investments only in order to gain jurisdiction under a BIT for such disputes would constitute, to take the words of the Phoenix Tribunal, "an abusive manipulation of the system of international investment protection under the ICSID Convention and the BITs.

This demonstrates that the tribunal was cognizant of the conventional approach regarding post-dispute treaty shopping, as it sought to reconcile its reasoning with the *Phoenix* decision. Specifically, at paragraph 203, the tribunal held that the dispute in question could only have arisen after Venezuela implemented its nationalisation measures in January 2007. Accordingly, the Claimants' restructuring of their investments in October 2005 was considered legitimate and not an abuse of process.

The decision of *Mobil* further obscures the clarity surrounding the application of the principle of good faith in cases involving post-dispute treaty shopping. *Mobil* demonstrates that certain tribunals may deviate from the conventional approach and instead base their reasoning on the investors' motives or purposes in undertaking the disputed restructuring.

In the context of *Mobil*, it is arguably artificial to contend that, despite the Claimants having been notified of a potential investment dispute, they could not have foreseen the dispute simply because the specific governmental measures had yet to materialise. Evidently, the Claimants were already aware of the likelihood of an investment dispute from the outset, even though Venezuela's nationalisation measures were only implemented after the restructuring.

The core rationale behind the conventional approach to post-dispute treaty shopping is to discourage opportunistic or "cherry-picking" manoeuvres by investors seeking to manufacture jurisdiction. However, by departing from this approach, the *Mobil* tribunal effectively enabled such manoeuvres.

More broadly, the *Mobil* decision underscores a deeper issue: it conveys an impression of inconsistency in the application of the principle of good faith, suggesting that tribunals may exercise excessive discretion in determining whether investors could have reasonably foreseen a dispute.

Fair and Equitable Treatment

Fair and equitable treatment (FET) standard is also significant in illustrating the role of the principle of good faith in regulating the conduct of host-states in investor-state arbitration. Dolzer and Schreuer (2012) observe that within the field of investor-state arbitration, the FET standard often provides a means of redress in situations where the facts do not support a claim for expropriation.

A close and interdependent relationship exists between the principle of good faith and the FET standard, as reflected in the way arbitral tribunals often describe claims brought under FET provisions. This is because a host-state's failure to act consistently with the principle of good faith often constitutes a valid basis for an FET claim. The tribunal in *Sempra Energy International v. Argentine Republic* explicitly acknowledged this connection at paragraph 298, noting that the "… principle of good faith which is at the heart of the concept of fair and equitable treatment." (*Sempra Energy International v. The Argentine Republic,* 2007).

Despite the FET standard's importance in safeguarding investors' rights, it remains, much like the principle of good faith itself, inherently ambiguous. This ambiguity exacerbates the challenge of determining the precise role that the principle of good faith plays within FET-based claims. As demonstrated by the divergent interpretations among arbitral tribunals, there is little consensus on the extent to which the principle should influence or define the content of the FET standard.

Certain arbitral tribunals have interpreted the FET standard as an imposing express obligation upon host-states to act in accordance with the principle of good faith. In *Waste Management v. United Mexican States,* for instance, the tribunal held at paragraph 138 that: "A basic obligation of the State under Article 1105(1) [NAFTA] is to act in good faith and form, and not deliberately to set out to destroy or frustrate the investment by improper means." (*Waste Management, Inc. v. United Mexican States*, 2004). Likewise, in *Indian Metals & Ferro Alloys Ltd v. Republic of Indonesia*, the tribunal held at paragraph 226 that "the host state is obliged to act in good faith" (*Indian Metals & Ferro Alloys Ltd v. Republic of Indonesia, 2019).*

On the other hand, other tribunals have taken the view that the principle of good faith serves only as a guiding norm in the interpretation of the FET standard rather than as a substantive obligation in itself. In *Sempra Energy International v. The Argentine Republic,* the tribunal stated at paragraph 297 that: "The principle of good faith is thus relied on as the common guiding beacon that will orient the understanding and interpretation of obligations, just as happens under civil codes."

The 'counterpart' of the principle of good faith — bad faith — has also been subject to inconsistent treatment by arbitral tribunals in the context of FET-based claims. In *Técnicas Medioambientales Tecmed, S. A. v. The United Mexican States,* 2003, the tribunal held paragraph 153 that bad faith is not a necessary element to establish a violation of the FET standard (*Techmed v. Mexico*, 2003). Conversely, in *Alex Genin, Eastern Credit Limited, Inc. and A. S. Baltoil v. The Republic of Estonia,* the tribunal held at paragraph 367 that a breach of the FET standard may indeed include demonstrating subjective bad faith (*Alex Genin, Eastern Credit Limited, Inc. & A. S. Baltoil v. The Republic of Estonia*, 2001).

Criticism of the reliance on the principle of good faith in FET-based claims and standards centres on the uncertainty it introduces into the field of investor-state arbitration. Paparinskis (2015) aptly observes that:

> … *good faith is injecting looseness back into principles, standards, and rules that have been particularised* from it at both domestic and international levels; *eroding the precision and predictability of rule-making* both domestically and internationally; and perhaps even tinkering with some basic underpinnings of the structure of the international legal order.

In a similar vein, UNCTAD has cautioned that "an expansive approach to interpretation of the FET standard," particularly where it relies on the principle of good faith, carries the risk of unpredictability within the investor-state dispute settlement system (UNCTAD, 2012).

Costs

Apart from substantive protection, the inconsistencies and uncertainty associated with the principle of good faith are also evident in the allocation and award of costs in investor-state arbitration. In this context, arbitral tribunals have often invoked the principle of good faith either to justify their allocation and award of costs or as grounds to penalise or sanction parties through cost orders.

Despite its perceived importance in determining costs, the principle has not resolved the inherent inconsistencies in arbitral practice concerning costs. For instance, reference to the principle of good faith has paradoxically been used by tribunals to justify both the "50:50 rule" and the "costs follow the event" approach — two allocation methods that rest on fundamentally different rationales.

50:50 Rule

The "50:50 rule" of cost allocation — whereby each party bears its own costs — remains the most common approach adopted by investor-state arbitration tribunals. This allocation method is frequently applied even in cases where the foreign investor prevails in its claim against the host-state. A prime example is *Metalclad Corporation v. The United Mexican States* (2000).

Metalclad concerned the investor's claim that Mexico had violated the minimum standard of treatment under Articles 1105 and 1110 of NAFTA by expropriating its investment through interference with the development and operation of a hazardous waste landfill. Although *Metalclad* succeeded in its claims, the tribunal nevertheless allocated costs in accordance with the 50:50 rule, requiring each party to bear its own legal expenses.

Despite being the conventional default cost allocation method, the 50:50 rule nonetheless revealed the lack of uniformity in tribunals' approaches to cost allocation, as it may be applied even in cases where the host state prevails. This is illustrated in *Tradex Hellas S. A. v. Republic of Albania* (1999).

In *Tradex*, a Greece-incorporated company initiated ICSID arbitration proceedings against Albania, alleging expropriation of an agricultural joint venture. The tribunal ultimately ruled in favour of Albania, finding that Tradex had failed to prove expropriation and that Albania had, to some extent, acted in good faith, Nevertheless, the arbitral tribunal applied the 50:50 rule, ordering each party to bear its own costs.

Adding further confusion, the 50:50 rule has also been applied in cases where the host-state was found to have acted in bad faith. In *World Duty Free Company Limited v. Republic of Kenya* (2006), for example, despite the tribunal's findings that Kenya had engaged in corrupt behaviour and acted in bad faith, it nevertheless adopted the 50:50 rule for cost allocation.

Costs Follow the Event

Similarly, in the context of the *costs follow the event* method (where the allocation of costs depends on the outcome of the dispute), inconsistencies have also arisen from tribunals' reliance on the principle of good faith.

On one hand, certain tribunals have invoked the principle of good faith and bad faith to justify penalising parties through this method. For instance, in *Renée Rose Levy and Gremcitel S. A. v. Republic of Peru* (2015), the tribunal found that the claimants had abused the arbitral process, and accordingly applied the costs follow the event approach to penalise them.

On the other hand, some tribunals have applied the *costs follow the event* method without reference to the principle of good or bad faith considerations. A prime example is *EDF (Services) Limited v. Romania* (2009), where the tribunal adopted cost allocation method but refrained from invoking the principle of good faith in determining the award of costs.

The *EDF* case concerned an alleged violation by Romania, which had invited the claimant to develop commercial spaces at Otopeni Airport. Subsequently, the Claimant was deprived of its investments and argued that Romania had breached its obligations under the BIT. Ultimately, the tribunal ruled in favour of Romania, concluding that no BIT violations had been committed. Significantly, although the tribunal acknowledged that the claimant had initiated the proceedings in good faith and had not abused the arbitral process, it nonetheless applied the *costs follow the event* method and ordered the claimant to pay Romania USD 6 million in legal costs.

This decision prompted one of the arbitrators, Mr. Arthur W. Rovine, to issue a "Dissent regarding costs." In paragraphs 10 to 11 of his dissent, he expressed disagreement with the majority decision, arguing that the tribunal had failed to provide adequate justification for adopting the costs follow the event allocation method (*EDF (Services) Limited v. Romania (Dissent Regarding Costs)*, 2009).

Stakeholders in the field of investor-state arbitration are cognizant of the widespread recognition that inconsistencies and uncertainties persist in the application of the principle of good faith to the allocation, assessment, and award of costs (Sipiorski, 2019, para. 12.02; Franck, 2011). These inconsistencies have had adverse effects on the system, as Professor Emily Sipiorski aptly observes:

> *Without uniformity*, however, there is *a clear lack of legitimate expectations for the investors and the states as to how such awards may ultimately end … lack of firm results in how and when they are allocated may allow for sufficient uncertainty* to lead to a potentially drawn-out arbitration process where a party may have been more willing to settle had it known the amount of costs to be awarded against it. This *lack of uniformity and expectations even undermines the system of investment arbitration*, drawing states as well as investors to question its effectiveness and their participation in it.

This article likewise concurs with these views and concerns. Unless the issue of inconsistency is addressed and uniformity and clarity are established in the application of the principle of good faith to costs allocation, assessment, and award, the credibility of the entire investor-state arbitration system will continue to erode. The *EDF* case serves as a prudent illustration of the challenges and concerns arising from this lack of uniformity.

In *EDF*, the tribunal adopted the costs allocation method of *costs follow the event*, which effectively penalised the Claimant despite its express acknowledgement that the Claimant had brought the claim in good faith. This article contends that such an approach evokes disappointment toward the investor-state arbitration system. If the very purpose of investor-state arbitration is to provide foreign investors with a means of amicably resolving investment disputes with sovereign states, there appears to be no cogent justification for penalising investors in costs for initiating claims grounded in the principle of good faith.

From a theoretical standpoint, it may even be argued that decisions such as *EDF* suggests that the broad discretion and prerogative afforded to tribunals in deciding costs allocation, assessment, and award inadvertently extend to disregarding considerations of good faith and bad faith whenever deemed appropriate. This, in turn, arguably fuels criticism that arbitral tribunals in investor-state arbitration possess excessive latitude to decide upon sovereign and financially significant issues according to their preferences.

REFORMS TO REGULATE THE PRINCIPLE OF GOOD FAITH IN INVESTOR-STATE ARBITRATION

Building upon the preceding discussions, the inconsistencies and uncertainties surrounding the application of the principle of good faith in investor-state arbitration underscore the urgent need for regulatory reform. This article contends that targeted reforms are necessary to introduce clarity, predictability, and uniformity in how the principle is understood and applied across arbitral proceedings. The proposed reforms and resolutions can be broadly classified into two categories:

(1) Reforms to the principle of good faith itself; and
(2) Reforms to the system of investor-state arbitration, which would indirectly stabilise the definition and application of the principle of good faith within the field.

Reforms to the Principle of Good Faith Itself

Adopt an Appropriate Definition of the Principle of Good Faith

With respect to defining the principle of good faith, this article argues for the adoption of a definition that is both comprehensive and consistently applied by arbitral tribunals. Such a definition should be sufficiently narrow to establish a clear benchmark standard, yet broad enough to enable the principle to respond to evolving factual circumstances. Additionally, consistent application of this definition across tribunals is essential to ensure certainty and predictability in its interpretation and enforcement.

It is not necessary to create a wholly ‘new’ definition, as an appropriate formulation already exists within the field of investor-state arbitration. This article posits that the ideal definition is that provided by the tribunal in *Inceysa Vallisoletana S. L. v. Republic of El Salvador* (2006). At paragraph 231 of its award, the tribunal defined good faith as:

> … good faith means absence of deceit and artifice during the negotiation and execution of instruments that gave rise to the investment, as well as loyalty, truth and intent to maintain the equilibrium between the reciprocal performance of the parties.

Although the tribunal in *Inceysa* provided this definition in a contractual context, this article submits that it represents the most appropriate definition of the principle of good faith for investor-state arbitration for two reasons.

The first reason is that defining good faith as the "absence of deceit and artifice," coupled with "loyalty, truth and intent to maintain the equilibrium between the reciprocal performance of the parties," imbues the principle with both breadth and flexibility. Terms and phrases such as "deceit," "artifice," and "intent to maintain the equilibrium between the reciprocal performance of the parties" provide tribunals with the necessary interpretive scope to adapt the definition to differing factual circumstances.

The second reason is that the definition provides certainty by clearly specifying the temporal framework with which conduct should be assessed. By referring to the period "during the negotiation and execution of instruments …" and the aim "to maintain the equilibrium between the reciprocal performance of the parties," the tribunal narrows the focus of assessment to relevant actions, thereby ensuring that the benchmark standard is applied predictably and consistently.

In sum, the definition of the principle of good faith articulated by the tribunal in *Inceysa* is recommended for adoption because it simultaneously ensures flexibility and certainty, thereby promoting both adaptability and predictability in its application.

Incorporation of the Principle of Good Faith in BITs

As a subset of public international law, investor-state arbitration is fundamentally dependent on the consent of host-states, which is most often expressed through bilateral investment treaties (BITs) (Boisson De Chazournes, 2023). Accordingly, the legitimacy of investor-state arbitration and the prerogatives of arbitral tribunals are largely derived from the provisions of BITs (Dolzer & Schreuer, 2012).

Given that BITs constitute the primary source of tribunals' jurisdiction and authority, this article proposes that the principle of good faith should be explicitly incorporated within BITs or other relevant investment instruments. Explicit incorporation would serve a dual purpose: provide a clear legal basis for tribunals to reference and apply the principle, and it would mitigate criticisms or perceptions that tribunals are exceeding their jurisdiction by invoking good faith in the absence of express treaty provisions.

Reforms and Resolutions Regarding the System of Investor-State Arbitration

Doctrine of Precedent

A key factor contributing to inconsistency in defining and applying the principle of good faith in investor-state arbitration is the absence of a formal doctrine of precedent within the field. Without such a practice, certainty and uniformity in the application of legal principles—including the principle of good faith—are significantly compromised.

In the absence of binding precedent, counsels often present a wide range of interpretations of legal principles to tribunals, regardless of whether those interpretations have been previously adopted or rejected by other tribunals. This practice increases the complexity, costs, duration of entire investor-state arbitration proceedings. This challenge is acknowledged by the United Nations Commission on International Trade Law (UNCITRAL) Working Group III, which observed:

> … lack of a rule of binding precedent and a consequent lack of predictability may place parties and their legal counsel under a duty to submit all available arguments, whether or not those arguments had been accepted or rejected by earlier tribunals … The fact that many legal issues remain unsettled leads parties to invest extensive resources to develop a legal position by studying numerous previous arbitral awards (United Nations Commission on International Trade Law Working Group III, 2018).

To tackle the conundrum mentioned, this article proposes the adoption of the practice of a doctrine of precedent within investor-state arbitration. Although there is currently no formal system of precedent—and certain tribunals have expressly held that the practice is not followed—some tribunals have nonetheless emphasised the relevance of prior awards, recognising their value in promoting consistency and predictability within the field. For example, *ADC Affiliate Limited & ADC & ADMC Management Limited v. The Republic of Hungary* (2006), the tribunal observed at paragraph 293:

> It is true that arbitral awards do not constitute binding precedent. It is also true that a number of cases are fact-driven and that the findings in those cases cannot be transposed in and of themselves to other cases. It is further true that a number of cases are based on treaties that differ from the present BIT in certain respects. However, cautious reliance on certain principles developed in a number of those cases, as persuasive authority, may advance the body of law, which in turn may serve predictability in the interest of both investors and host States.

Likewise, in *AES Corporation v. The Argentine Republic* (2005), the tribunal held at paragraph 27 of its decision on jurisdiction that:

> … Tribunal would nevertheless reject the excessive assertion which would consist in pretending that, due to the specificity of each case and the identity of each decision on jurisdiction or award, absolutely no consideration might be given to other decisions on jurisdiction or awards delivered by other tribunals in similar cases.

This article concedes that each investor-state arbitration ultimately depends on its specific facts. However, as posited by the arbitral tribunal in *AES*, the adaptation of a putative 'precedent' system—whereby prior arbitral awards are cited and followed as persuasive authority—can help establish a broad consensus on a wide range of legal issues, including the definition and application of the principle of good faith. As reflected in both *ADC* and *AES*, such an approach would enhance consistency and predictability, thereby strengthening the legitimacy and credibility of investor-state arbitration as a whole.

Appellate Mechanism

In tandem with the proposal to adopt a doctrine of precedent, this article proposes considering the establishment of an appellate mechanism within investor-state arbitration.

Currently, investor-state arbitration awards are generally final, binding, and not subject to appeal. For instance, Article 53(1) ICSID Convention stipulates: "The award shall be binding on the parties and shall not be subject to any appeal" The only limited recourse available to a losing party post-award is annulment proceedings, which challenge the arbitral award on limited procedural grounds (Article 52(1) ICSID Convention; *CDC Group plc v. Republic of Seychelles*, *CDC Group plc v. Republic of Seychelles*, ICSID Case No. ARB/02/14, Decision on Annulment (29 June 2005).

It is important to note that annulment proceedings do not constitute an appeal on the merits of the dispute. As ad hoc committee on the annulment request in *CDC Group plc v. Republic of Seychelles* explained:

> … [Annulment proceedings are] concerned with determining whether the underlying proceeding was fundamentally fair: Article 52(1) looks not to the merits of the underlying dispute as such, but rather is concerned with the fundamental integrity of the tribunal, whether basic procedural guarantees were largely observed, whether the tribunal exceeded the bounds of the parties' consent, and whether the tribunal's reasoning is both coherent and displayed … annulment is concerned with the 'legitimacy' of the process of decision' rather than with the 'substantive correctness of decision.'

Unlike appeals in most domestic courts, annulment proceedings do not review the substantive merits of an investment dispute. As Professor Gabrielle Kaufmann-Kohler explains "according to Article 53 ICSID Convention, the annulment process is not an appeal. It entails no review of the merits, whether facts or law, and is limited to the grounds listed in Article 52(1) of the ICSID Convention" (Kaufmann-Kohler, 2004).

At present, the absence of an appellate mechanism means that investor-state arbitration awards lack authoritative interpretations that could be definitively followed in subsequent cases. This article posits that establishing an appellate mechanism would allow consistency and certainty to be maintained through a "body of legally authoritative general principles and interpretations." (UNCITRAL Working Group III, 2019). This view is supported by stakeholders in the field, including UNCITRAL Working Group III which notes:

> … an appellate mechanism would serve to improve consistency, coherence and predictability in ISDS decisions. The objective would be … the dispute settlement process would be more accountable, and a body of legally authoritative general principles and interpretations could be developed so as to increase the coherence and predictability of the investment regime … The creation of an appellate mechanism is … a means to enhance the legitimacy of ISDS and as an important factor in promoting application of the rule of law to the settlement of disputes between investors and States. This would bring the ISDS regime more in line with adjudicatory mechanisms which usually provide for judicial review of first instance decisions in order to control judicial errors and ensure consistency and coherence in adjudication (UNCITRAL Working Group III, 2019).

At the time of writing, the UNCITRAL Working Group III is still in the process of drafting its recommendation on establishing an appellant mechanism for investor-state arbitration. The most recent document addressing this proposal is titled '*Possible Reform of Investor-State Dispute Settlement (ISDS) Appellate Mechanism: Note by the Secretariat,'* published on 17 November 2022.

It is important to note, however, that this proposed reform is not without potential drawbacks. Establishing an appellate mechanism may increase both the costs incurred by parties and the time required to reach finality in disputes when appeals are pursued (Paulsson, 2020). Nonetheless, this article submits that such negative implications can be mitigated or even largely avoided through arbitration rules or institutional procedures. For instance, Rule 41: Manifest Lack of Legal Merit of the ICSID Arbitration Rules provides an expedited procedure to dispose of claims that are unmeritorious at the preliminary stage of investor-state arbitration proceedings.

Ban on Double-Hatting

Currently, akin to the practice in commercial arbitration, legal practitioners in investor-state arbitration are permitted to engage in 'double-hatting.' The term double-hatting refers to a situation where: "…those active in investment arbitration often take up multiple roles … Most commonly … participation as arbitrator in one case and as counsel in another." (Brown & Koumadoraki, 2020).

This practice has drawn widespread criticism from various quarters including prominent public international law practitioner, Professor Philippe Sands KC (Sands, 2015; Mackenzie & Sands, 2003). In 2015, Professor Sands strongly denounced the practice, stating:

> We also need to address the deplorable practice of the same individual sitting as arbitrator in one case and acting as counsel in another, giving rise to situations in which you might find yourself deliberating with your fellow arbitrators in the knowledge that one or more of them is actually litigating the very point that you are seeking to write an award on. That is unacceptable.

In response to the growing criticisms of double-hatting, it appears that reforms in this area will soon materialise. UNCITRAL Working Group III has taken actives steps by proposing a draft titled 'Draft Code of Conduct for Arbitrators in International Investment Dispute Resolution and Commentary' (dated 28 April 2023), which explicitly seeks to prohibit double-hatting. Specifically, Article 4 of the draft provides as follows:

> Article 4 – Limit on Multiple Roles
>
> 1. Unless the disputing parties agree otherwise, an arbitrator shall not act concurrently as a legal representative or expert witness in any other proceeding involving:
>
>   (a) the same measure(s);
>   (b) the same or related party (parties); or
>   (c) the same provision(s) of the same instrument of consent.
>
> 2. For a period of three years, a former arbitrator shall not act as a legal representative or expert witness in any other IID or related proceeding involving the same measure(s), unless the disputing parties agree otherwise.
>
> 3. For a period of three years, a former arbitrator shall not act as a legal representative or expert witness in any other IID or related proceeding involving the same or related party (parties), unless the disputing parties agree otherwise.

4. For a period of one year, a former arbitrator shall not act as a legal representative or expert witness in any other IID or related proceeding involving the same provision(s) of the same instrument of consent unless the disputing parties agree otherwise.

This article posits that, if the draft Code of Conduct is successfully implemented, it would rectify certain structural deficiencies in investor-state arbitration and, consequently, address issues arising from the inconsistent application of the principle of good faith. By prohibiting legal practitioners from engaging in double-hatting, those who choose to serve exclusively as arbitrators will become more readily identifiable, thereby fostering greater transparency and accountability. Moreover, these dedicated would be better positioned to contribute consistently to the development of jurisprudence—particularly in relation to the interpretations and application of the principle of good faith—thus enhancing both consistency and predictability in the field of investor-state arbitration.

Costs

As previously discussed, the inconsistencies and uncertainties surrounding the application of the principle of good faith are also reflected in the allocation of costs in investor-state arbitration, where differing tribunals have inconsistently adopted differing methods of cost allocation (UNCITRAL Working Group III, 2018).

Importantly, the UNCITRAL Working Group III has recognised the need for reform in this regard, recommending the establishment of "clear and definitive rules on allocation of costs."

This article concurs with that recommendation and submits that the adoption of clear and definitive cost allocation rules would enhance clarity in the application of the principle of good faith, while simultaneously mitigating the prevailing inconsistencies and uncertainties surrounding cost allocation in investor-state arbitration.

CONCLUSION

The primary challenge surrounding the application of the principle of good faith in investor-state arbitration lies in the inconsistency and uncertainty generated by its interpretation and implementation. These difficulties stem from the principle's inherent susceptibility to divergent interpretations, further compounded by structural deficiencies within the investor-state arbitration system. To address this conundrum, this article has proposed both substantive reforms to the principle itself and structural changes to the arbitral framework.

Admittedly, the proposed reforms are not a panacea for all the problems arising from the application of the principle of good faith, nor for the legitimacy crisis faced by the investor-state arbitration system. Implementing the proposed reforms may even give rise to new challenges; for example, the establishment of an appellate mechanism could increase both the cost and duration of arbitral proceedings.

This naturally raises the question; is there any real value in pursuing these reforms, or would doing so merely be akin to rearranging deckchairs on the Titanic? The straightforward answer is that reform remains necessary. These reforms would not be futile gestures but would instead cultivate *constrained flexibility*—that is, flexibility underpinned by certainty—in the application of the principle of good faith within investor-state arbitration.

Such constrained flexibility is crucial because, unlike international commercial arbitration, investor-state arbitration must balance the protection of foreign investors' rights with the preservation of host-states' sovereignty authority. Investor-state arbitral tribunals often adjudicate complex disputes involving significant public interests, including but not limited to, human rights and constitutional considerations. Accordingly, ensuring constrained flexibility—particularly through the principled application of good faith as reinforced by the proposed reforms—is not merely desirable but is indispensable to sustaining the legitimacy and viability of the investor-state arbitration system.

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