

## How to Break the Arbitrator's Trust Dilemma?

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To Link this Article: <http://dx.doi.org/10.6007/IJARBSS/v13-i5/16998> DOI:10.6007/IJARBSS/v13-i5/16998

*Published Date:* 10 May 2023

### Abstract

In solving the trust-shaping problem of the investment dispute settlement mechanism, one must overcome the arbitrator's dilemma of trust. For a long time, the arbitrator's independence, representativeness and professionalism have suffered from being questioned, thus a series of international societies covering the code of conduct was gradually launched, and conflict of interest has ruled arbitrator, the selection and appointment mechanism. While the systemic reform to promote the judge's jurisdiction in harmony with the host country's regulation rights relationship issues have also appeared in a different reform path. At the bilateral level between China and the EU, the possibility exists for China to accept the EU investment tribunal model, while at the broader bilateral and multilateral levels, China should adopt a balanced stance, that is, to be wary of the risk of over-politicization that may arise from the transfer of the power to appoint arbitrators. Aside from that, China also has to prevent the abuse of regulatory power in the process of harmonizing adjudicative and regulatory powers and may consider adopting a mandatory roster system of arbitrators led by an independent third-party body and a system for the selection of members of the appellate body.

**Keywords:** ISDS Mechanism, Arbitrator, Regulatory Power of Host Country, China-EU Comprehensive Investment Agreement, Trust Dilemma, Legitimacy Crisis.

### Introduction

There are many factors that need to be considered to address the challenges of shaping trust in the investor-state dispute settlement mechanism (hereinafter referred to as the ISDS mechanism), including the neutrality presented by the organization form and governance structure of the dispute settlement body, the impartiality and independence of adjudicators, the equality and reasonableness of the dispute settlement process, and the enforceability of decisions. It is the trust of the parties in the arbitrator that constitutes the fundamental element of legitimacy and credibility of the ISDS mechanism, as well as a guarantee of its proper functioning. Nowadays, doubts regarding the impartiality, independence, and representativeness of arbitrators are important reasons for negative evaluations of international investment arbitration. The increasing prevalence of investment disputes and the complexity of investment arbitration cases make it imperative to solve the trust dilemma of arbitrators. Therefore, the research motivation of this paper is to investigate the trust

dilemma of arbitrators in international investment arbitration, and to explore, explain and respond to the following questions: What are the specific causes of these doubts and whether they are objective? Is there a negative impact on strengthening the trust base of investment arbitrators? What position should China take in shaping the trust of ISDS arbitrators?

Having analyzed and answered the questions mentioned above, this study expects to make several theoretical contributions to the field of international investment arbitration and to have a practical impact on international investment practice. On the theoretical side, firstly, it can provide insights into the ethical and professional responsibilities of arbitrators and their impact on the credibility of the arbitration process. Secondly, it can analyze the legal framework governing the conduct of arbitrators and its effectiveness in resolving trust dilemmas. Finally, the paper can examine the role of arbitral institutions and their rules and procedures in ensuring the independence and impartiality of arbitrators. In practical terms, firstly, it could provide guidance to arbitrators on how to deal with trust dilemmas and maintain their independence and impartiality. Secondly, it can inform the design and implementation of arbitration rules and procedures by providing best practices for resolving trust dilemmas. Finally, this study can contribute to the ongoing discussion on the reform of the investment arbitration system by highlighting the need for greater transparency, accountability and integrity in the process.

### **The Origin of Arbitrator's Trust Dilemma Under ISDS Mechanism**

The trust dilemma of arbitrators under the ISDS mechanism has a long history. Moreover, this dilemma accounts not only for the direct cause of the shift in ISDS mechanism from domestic justice to international investment arbitration, but also is one of the reasons for the legitimacy crisis of international investment arbitration. According to ISDS mechanism, there are four primary channels of operation: (1) Negotiation or mediation with the host country; (2) diplomatic protection in the home country of the investor; (3) judicial remedies in the home country of the investor or a third country, and (4) local judicial and administrative remedies in the host country. The first two channels lack the constraints of neutral referees and mandatory procedures; the third channel is subject to the principle of sovereign immunity of the state and the act of state principle, except for the exceptions to expropriation specified by some countries such as the United States, and it is difficult for investors' judicial claims against the host country to cross the limits of jurisdictional immunity and enforcement immunity. Furthermore, the courts of other countries are prohibited to adjudicate on the validity of foreign state acts. As for the fourth avenue, although the investor's right of complaint or right of action usually exists, it is difficult to dispel the investor's doubts about the ability of the host country's domestic judges or investment processing agencies and personnel to maintain impartiality and independence when dealing with proceedings against the home government. In practice, such doubts are exacerbated by the fact that investors have no recourse in the host country or that the proceedings are protracted.

To this end, the international community has constructed an international investment arbitration mechanism independent of the domestic relief system at the international level by referring to the international commercial arbitration mechanism to avoid the influence of the host country on judges and has established the arbitrator's appointment mechanism with the parties' autonomy as the core. In ICSID and UNCITRAL arbitrations, for example, in the general case of a three-arbitrator tribunal, the parties may not only each appoint an arbitrator and agree on the appointment of a third arbitrator, but the appointed arbitrator is also not limited by the roster of arbitrators. Arbitration mechanisms featuring international, commercialized

appointment of arbitrator processes facilitate investor's choice of arbitrators whom they trust and are therefore an important attraction of international investment arbitration. According to general consensus, international investment arbitration has 'allowed the depoliticization of international investment disputes, thereby significantly reducing the risk of disputes between investors and host governments escalating into interstate disputes' (Schreuer, 2010).

### **Disputes Concerning Arbitrators in International Investment Arbitration**

Referring to independence, when the mechanism for the appointment of international commercial arbitrators was directly transplanted to international investment arbitration, the existing controversy regarding the independence of arbitrators under that appointment mechanism was introduced together. First, the problem with the unilaterally appointed arbitrators easily becoming the representatives of the parties has been criticized as these arbitrators are motivated to get a favourable result by helping to select their parties and expect to be appointed again later. In reality, the parties always select arbitrators who share their views with the phenomenon of repeated appointment of arbitrators do exist objectively and is inconsistent with the fundamental assumption that 'both parties trust all arbitrators' (Paulsson, 2010).

Further, the unilateral appointment of arbitrators may accommodate the parties responsible for appointing them to the tribunal in the following ways: Firstly, by permeating the claims of the party who appointed him or her into the communications with the members of the arbitral tribunal and thus convincing them to adopt his or her views in the dispute extensively. Secondly, even if an adverse award is unavoidable, it can still influence the final outcome in order to make the outcome of the case as favourable as possible to the party appointing him or her. This is achieved, for example, by persuading the other members of the arbitral tribunal to reduce the amount of payment of the adverse award in return for a unanimous award (Smit, 2010). Thirdly, a dissenting opinion is issued in the award which expresses support for the party who appointed him or her. In practice, dissenting opinions almost exclusively originate from the unilateral arbitrator appointed by the losing party (Van Den Berg, 2011). Due to this basis, two groups of investment arbitrators have been formed in practice as a result of this, one group of arbitrators has been appointed many times by investors and the other group has been appointed many times by countries that are the hosts. According to the former, the arbitral tribunal has a jurisdiction over the matter, and the state should bear responsibility, whereas the latter believes the opposite (Chen, 2017). The second problem relates to the conflicting identities of the arbitrators as this stems from the ad hoc nature of the tribunal and the plurality of arbitrators—the arbitral tribunal is constituted on a case-by-case basis and the members may either be full-time or part-time arbitrators. Part-time arbitrators are often an attorney, scholar, government official, or expert witness. According to the 'green list' of situations in which disclosure will not be required, set out in Part II, Subsection 4 of the Guidelines on Conflicts of Interest in International Arbitration, an arbitrator's previous award can be cited as the basis when he or she acts as an acting lawyer in the future. It is clear that at this point, the significant risk of overlapping roles between the arbitrator and an acting lawyer in different cases lies in the overlapping roles of rule maker and rule user. At the same time, the experience of arbitrators and acting lawyers working together in different cases may also bring the risk of mutual favouring or backroom dealing.

As for 'representation', it is directly related to the final outcome of the case on the manner the arbitrator judges the facts of the case and applies the law. It is ideal for the arbitrator to have a full grasp of the social context in which the dispute arises and of the overall

legal context to avoid any potential unfairness to the parties due to cultural and legal differences. For international dispute settlement mechanisms, it is required that the adjudicator hearing the case to be geographically representative and able to truly understand the social, cultural, and legal context of the particular dispute. Therefore, in order to guarantee the legitimacy and smooth functioning of international dispute settlement mechanisms, it is necessary to include members from different countries, regions and legal systems, even if, between the qualifications of the adjudicators and their representativeness, qualifications need to give way to representativeness (Yang, 2018). In practice, however, a significantly higher proportion of Western arbitrators are appointed than non-Western arbitrators. While Western countries or their parties naturally appoint Western arbitrators, non-Western countries or their parties, because they lack the capacity and experience of their own arbitrators to participate in international arbitration, typically place more trust in experienced and highly regarded Western arbitrators in major cases, resulting in a lack of practice opportunities for non-Western arbitrators (Puig, 2015). Consequently, non-Western countries appear apprehensive, sceptical, and even alienated towards ISDS mechanism as their nationals cannot partake in the judging process, which further intensifies the distrust dilemma between the arbitrator and ISDS mechanism. In the same way, no law can be applied, enforced, or evaluated without taking into account its respective social context and the value system it possesses (Tao, 2020). The inability to bridge cultural and different legal philosophies gaps can pose a serious problem for arbitration (Chu, 2019).

In terms of expertise, the arbitrator's knowledge structure and work background may have a direct effect on the perspective, manner, and outcome of the case. International investment disputes usually involve disputes over national treatment of investors, most-favoured-nation treatment, fair and equitable treatment, expropriation compensation, etc., and are of a more public law nature, a feature not normally found in international commercial arbitration, so arbitrators have the necessary public law background to better understand the scenario in dispute and the original intent and spirit of the relevant law. In international investment arbitration, investors have the option of selecting arbitrators of their choice through the existing arbitrator appointment mechanism, and due to background screening, a large number of arbitrators aligned with investors' interests can enter international investment practice, maintaining the concept of 'private interest first' in international investment arbitration. According to statistics, the number of investment arbitrators with a working background in private law and academic fields, on the whole, is more than that of arbitrators who are government workers which is significantly different from the absolute majority of expert group members from the government sector under WTO dispute settlement mechanism (Fontoura Costa, 2011). On this basis, arbitrators were challenged for their inability to understand the rules applied against countries, which were very different from those applicable to transactions concluded between business veterans (Deng, 2019). This has, to some extent, contributed to the perception that international investment arbitration mechanisms are investor-friendly (Zhang, 2011).

### **The Specificity of the Arbitrator's Trust Dilemma Under the ISDS Mechanism**

It is necessary to first reflect on whether these trust dilemmas are objective and whether the attention caused by them may be overemphasized exaggerated. The fact is that, while doubts about arbitrators exist to varying degrees in the field of international commercial arbitration, they have never shaken the foundations of trust in the international commercial arbitration system. Although national arbitration legislation is constantly being improved, the

overall tendency remains to resolve the trust dilemma of referees through self-regulation of the arbitration mechanism. For instance, the elimination of arbitrators who lack independence and impartiality through the credibility mechanism of arbitrators as to achieve self-purification of the group of arbitrators. Therefore, similar doubts surfaced in the international commercial arbitration and international investment arbitration as to whether there is a difference between the basis and necessary ought to be delineated. This article argues that the investment dispute and the particularity of the trust framework of the ISDS mechanism has led to the construction of referee trust in this mechanism and thus, raising special challenges.

First, while international commercial arbitration usually involves only private conflicts of interest between parties on an equal footing and uses public policy as a safety valve for the defence of domestic interests in the judicial review of awards (He, 2014), however, under the ISDS mechanism, the tension between adjudicators and their adjudicative activities, the foreign investment regulatory powers of host countries and the public interest in investment governance is more pronounced due to the special mix of the nature of public and private law regarding investment disputes, and therefore disputes over adjudicators are also more sensitive and intense. Specifically, the investor-state investment disputes being dealt with under the ISDS mechanism have a distinctly mixed public-private character. From a private law perspective, an investor's claim for compensation or damages is based on the protection of his private interests; the method adopted in examining whether the host country violates the investment contract or investment commitment and calculating the corresponding loss is similar to how disputes regarding commercial investments are generally handled. From a public law perspective, an investor's claim is usually directed against public law of the host country, Disputes are often politically sensitive in areas such as energy supply, natural resource allocation, environmental regulation, sewage treatment, taxation, financial regulation, the impartiality of local courts, medicine and tobacco control and others. Some host countries' government behaviours such as political changes, policy mutations and economic or social upheavals will also cause international investment disputes (Brower, 2017). As a private subject, investors intend to avoid the possibility that the host country government may exert undue influence over arbitrators. In the case of the host government as a public subject, the arbitrator may be able to review policy, regulatory, legislative, and even judicial measures in the field of investment during the adjudication process, thereby restricting its power. That is to say, the 'chilling effect' of giving up or being scared to regulate investors for fear of being sued by investors and being subject to adverse rulings constitutes a realistic weakening of the host country's right to regulate foreign capital. Therefore, the shaping of trust by arbitrators requires a balance between three pairs of relationships, namely the contracting states relationship between the host country and the home country, the party relationship between the host country and the investor, and the stakeholder relationship between the investor and society at large (Wang, 2018).

Second, at the level of the establishment of the ISDS mechanism, the contracting states trust and authorize international investment arbitrators or judges of domestic courts or other arbitrators to hear disputes; at the level of the hearing of specific cases, the trust of the host government and investors, who possess the power to appoint arbitrators in individual cases, is a prerequisite for the appointment of arbitrators. This two-tier trust structure creates a complex issue of trust for arbitrators under the ISDS mechanism. In particular, even if parties refuse to trust the arbitrators in the international commercial arbitration, their first reaction is to request that they recuse the arbitrators or to seek a judicial annulment. In applying to the court to set aside or not to recognize or enforce the award, and the parties lack motivation

and sufficient influence to discuss or thoroughly resolve the trust issue at the level of rules and institutions. In other words, even if the trust dilemma of arbitrators under the international commercial arbitration exists, the parties' power to seek institutional change is diffuse and thus, there is room for it to be allowed to cleanse itself. This is not the case for parties under the ISDS mechanism, as the ISDS mechanism depends first and foremost on the treaty negotiations of the contracting states. Further, the agreement on rules concerning adjudicators is first and foremost an agreement between the contracting states, which means that the host country, as a party, can directly shape the issue of trust in referees and incorporate its claims into the bilateral treaty negotiations or multilateral reform process of the ISDS mechanism. Indeed, the shaping of new global rules through domestic law, bilateral agreements and regional arrangements, in the context of dissatisfaction with certain current institutional arrangements, has been a distinctive feature of the international law practice of some states in recent times (Che, 2019).

### **Review on the Path of Arbitrator's Trust-shaping Under the ISDS Mechanism**

#### **Plural Paths of Trust-shaping for Arbitrators**

The ISDS mechanism is comprised of the ISDS provisions in investment agreements, the specific applicable procedural rules and other accompanying links (such as a code of conduct for arbitrators), whereas the existing international investment system is a fragmented system made up of many bilateral investment agreements (BITs) and some regional investment agreements. Hence, the shaping of trust in the ISDS mechanism is also multifaceted and characterized by a diversity of practices. The current stances of countries in reforming the ISDS mechanism can be broadly divided into three categories; the United States, Chile, Japan, Russia, and Japan holding incremental reform positions favour partial reforms of the existing investment arbitration system in order to improve it; the EU, Canada and Mauritius are advocating for the establishment of international investment tribunals in order to replace the international investment arbitration mechanism; while Brazil and South Africa deny that investors can sue host countries directly at the international investment court. Instead, they contend that the focus should be on establishing mechanisms that prevent investment disputes (Roberts, 2018). Linked to this, reforms relating to the shaping of trust in referees can also be grouped into three paths.

The first path refers to improving the rules under the arbitration framework. To strengthen the trust in the arbitrators, while maintaining the broad framework of the international investment arbitration regime, it is proposed that measures must be taken to fill in the gaps in terms of a code of conduct for arbitrators, conflict of interest rules, and improving the selection and appointment procedures. ICSID Centre does not only require arbitrators to sign a declaration of independence and impartiality when taking appointed cases but has worked with the UNCITRAL secretariat to promote the publication of the draft Code of Conduct for Investor-State Dispute Settlement Adjudicators (UNCITRAL, 2021). Numerous BITs and FTAs with investment chapters tend to specify relevant content or cite mature practical experience. For example, Article 9(22) of the Investment Chapter (Chapter 9) of the Comprehensive and Progressive Trans-Pacific Partnership Agreement (CPTPP) specifies that the contracting parties shall, prior to the entry into force of the agreement, establish a code of conduct to be followed by arbitrators and guidelines on other rules or guidelines on conflicts of interest. Article 14.D.6 (5) of the Investment Chapter (Chapter 14) of the US-Mexico-Canada Agreement (USMCA) incorporates the provisions of the International Bar Association Guiding Principles on Conflicts of Interest in International Arbitration by applying the rules on direct or

indirect conflicts of interest directly to the ISDS mechanism under the USMCA, applies the rules on direct or indirect conflicts of interest straight to the ISDS mechanism under the USMCA, and explicitly prohibits arbitrators from receiving dispute-related instructions from any organization or government. Further, he or she shall not act as an agent of, or as an expert or witness appointed by a party to an ongoing arbitration case under this agreement during the arbitration proceedings. Certainly, the provisions relating to the parties' disclosure obligations should also be refined. As an example, a third-party funding has attracted considerable attention. However, whether a third-party funding would affect arbitrators' independence is similarly depending on what parties disclose. It is only when the existence of a third-party funding is known that the tribunal can gain the initiative to regulate third-party funding and thus, may examine whether a potential conflict of interest exists in a timely manner (Xu & Chen, 2020). The relevant measures and proposals to reform the procedure for the selection and appointment of arbitrators are more varied and include: refining the expertise requirements for arbitrators.

For example, Article 9.21(5) of the CPTPP requires that arbitrators are equipped with the expertise or relevant experience in the applicable law of the dispute; a compulsory list of arbitrators shall be adopted, that is, the states' parties shall negotiate a list of arbitrator candidates, and the parties to the dispute can only select members from the arbitrator candidates (Shan & Wang, 2019); establish an independent review committee of international investment arbitrators, similar to the Advisory Committee on the Appointment of Judges to the International Criminal Court, to review arbitrator candidates (Devaney, 2019); abolish the unilateral party appointment mechanism and appoint arbitrators by a neutral third party institution (Paulsson, 2020).

The next path relates to the radical changes on the mechanism for appointing arbitrators. Historically, European countries have been the beneficiaries and advocates of the international investment arbitration mechanism; however, evidently more European countries are now becoming the respondents to investment arbitration cases, and they are becoming increasingly dissatisfied with the possible disadvantages and limitations of the international investment arbitration mechanism. In September 2015, the EU systematically proposed to establish an international investment court with a court of the first instance and an appeals court in its draft of TTIP investment chapter. This idea was subsequently included in the FTAs signed by the EU. Specifically, regarding the rules on referees, the EU has borrowed a practice similar to the appointment mechanism of the members of the WTO Appellate Body and radically changed the appointment mechanism of arbitrators. This is conducted by transferring the right to appoint referees and removing the right of investors to choose referees. Under the current bilateral model, the members of the tribunal are appointed jointly by the contracting states, with an equal number of nationals of both contracting states and nationals of third countries, while the composition of the tribunal for a specific case is randomly assigned, with the chairman assigning cases in rotation among different groups. The EU has made it clear in its new FTAs with Canada, Vietnam and Singapore that upon the appointment of an individual to the investment court, during his or her term of office, he or she shall no longer act as an attorney or as a designated expert or witness of a party in an ongoing or future international investment case brought under this Agreement or any other international investment agreement. At the same time, these FTAs contain a provision for a future resolution to convert the monthly advance commissions and daily fees paid at this stage into a fixed salary, and once this conversion is made, the member becomes full-time and cannot hold any other position whether the other position is remunerated. The code of conduct section of these agreements

specifies the obligations attached to members after the expiration of their term of office. It is spelled out that no member of a tribunal or appellate tribunal before which he or she is a member may take part in investment arbitrations or disputes, which are pending before or directly or indirectly relating to arbitrations or disputes heard during the term of office by those members. Within three years of the expiration of their term of office, they are also prohibited from acting as an agent in a tribunal or appellate division case. By implementing these institutional arrangements, the EU seeks to prevent conflicts of interest that may arise from arbitrators holding multiple identifying identities and to minimize the likelihood of such conflicts impairing impartiality and independence.

Further, easing the relationship between adjudicative and regulatory powers. Recent years have seen a variety of ISDS mechanisms established to resolve the conflict between the arbitrator's jurisdiction and the host country's regulatory powers by restricting the use of ISDS in sensitive cases and giving contracting states a right to intervene in ISDS proceedings. Broad general exceptions are generally excluded from the scope of application of the ISDS mechanism measures relating to public safety, public morals, public order or the protection of human, animal and plant life and health. Security exception clause aims to clarify that the application of the ISDS mechanism shall not require parties to disclose its thought to be against the interests of the basic safety information, shall not prevent parties to implement which is considered to be fulfilled to maintain or restore international peace and security obligations, and finally, it shall not prevent parties to take necessary measures in protecting its own fundamental interests. Matter-specific exceptions are usually directed at areas that countries consider to be the most sensitive, such as taxation and finance. Limiting the scope of application of ISDS has been established to prevent the exercise of referees' powers of adjudication touching on areas of governance where the Contracting States are reluctant to be subject to review by international legal processes.

The contracting states intervene in ISDS primarily through the contracting states consultation procedure and interpretation mechanism. For example, the consultation mechanism between the tax authorities of the contracting parties set forth by Article 19 of the China-Singapore FTA investment chapter provides that a dispute will only formally enter the ISDS procedure if the investor submits a written request for consultation to the tax authorities of both contracting states. This written request pertains a disputed tax measure that violates the obligation to levy and compensate; the tax authorities of both contracting states do not agree to consider the issue within 180 days, or if they agree to consider the issue but fail to agree on whether the tax measure involves a levy. As for the mechanism of interpretation by the contracting states, it is covered by the 2004 US Model BIT, Article 31 of which provides that in respect of questions relating to the international customary laws, expropriation and related issues of service, the tribunal shall, at the request of the claimant, request the contracting parties to provide an interpretation of the dispute over the non-conforming measure submitted by the claimant. Following that, the contracting parties shall issue a written decision within sixty days. As a continuation, Article 14.D.10 of the USMCA provides that in cases involving service and public debt, the FTC shall, at the request of the arbitral tribunal, provide a joint interpretation of the non-conformity clauses submitted by the parties within ninety days, which shall be binding on the arbitral tribunal. The discretion of the arbitral tribunal is thus limited, and the balance between investor protection and state sovereignty, and between the arbitral tribunal and the right of interpretation of the contracting parties, is expected to be sought again (He, 2020).



**The Holistic Orientation Behind Multiple Paths**

In essence, the arbitrator's trust dilemma results from an inadequate response to his or her two-tier trust structure. In terms of the level of trust between investors and the host country, both domestic judges and international investment arbitrators are considered biased towards one of them. At the level of trust, the contracting states are not able to address the common problems that they are concerned with, namely maintaining foreign capital regulation rights and creating an investment environment that is conducive in attracting investors. Likewise, investors tend to focus on the legal validity of a case outcome, while states are more concerned about how it is handled and how it impacts the management of investments. In this setting, arbitrators under the ISDS mechanism ought to consider the possible legal and political implications of the outcome when making decisions. Therefore, for the arbitrator disputes under the current international investment arbitration, the trust shaping of arbitrators is very clear in terms of overall goals and trends, that is, to improve the political effect of arbitrators' adjudication activities in existing international investment arbitration, rebuild the confidence of states parties in ISDS mechanism, coordinate investors' independent litigation right at the international level, host country's regulation right and arbitrator's discretion, and seek a new balance between legal effect and political effect of adjudication.

The aforementioned rebalancing and shaping of the trust of arbitrators are also in line with the current overall shift from neoliberalism to balanced liberalism in the international investment rule of law. Being internationalized, commercialized international investment arbitration is one of the most important manifestations of neoliberalism at the rule of law in international investment level. Host countries and investors have equal procedural status whereby investors have the right to initiate arbitration independently and to appoint arbitrators in the same way as host countries and enjoy a high degree of autonomy in the advancement of investment dispute settlement, among other things, and international claims against sovereign states are thus 'personalized' (Van Harten, 2008). The replication of the international commercial arbitrator appointment mechanism, underpinned by the theory of autonomy, is at the heart of the neo-liberal paradigm of the international investment arbitration regime, which has greatly increased investors' confidence that they will be adequately protected in the ISDS mechanism and has weakened the host country's ability to control the ISDS mechanism. However, the discrepancy between the actual role played by adjudicators in the governance of international investment disputes and the expectations of the system have made the mechanism for appointing arbitrators under this neo-liberal paradigm controversial. On the one hand, countries with developed legal teams have the right to speak in the practice of international investment arbitration, so that the practice of investment arbitration cannot represent and reflect the universal interests of the international investment community. On the other hand, arbitrators have been given too much room for interpretation, especially at an early stage when the rules of international investment law are still underdeveloped. Against this backdrop, arbitrators have been given more discretion in the interpretation of international investment agreements, including the domestic laws of contracting states, than expected by the contracting states. Furthermore, their creative interpretation of relevant issues beyond the factual findings of individual cases and the choice of applicable law has had a *de facto* law-making effect. It does not only restrict the regulatory space of the host country but also affect the legislative power of the contracting states. With the shift in the status of developed countries in the international investment arena and the increasing number of cases in which they are the respondents to arbitration, a consensus is

emerging between developed and developing countries on the basic requirement to safeguard the public interest of the host country and to preserve the necessary regulatory powers. Moreover, international investment law is shifting towards embedded or balanced liberalism that promotes investment protection, investment liberalization and the strengthening of the regulatory powers of the host country. Naturally, the challenge of arbitrators is part of this macro shift.

### **The Fear of Overcorrection**

Though it is clear that the objectives to maintain the necessary regulatory powers of the contracting states and to enhance the political impact of the ISDS mechanism are noteworthy trend and goals, but caution needs to be exercised regarding two possible overcorrections.

The first possibility is the risk of a return to politicization. This risk is manifested in two ways. First, the risk of a return to politicization by depriving investors of the right to appoint adjudicators. In the case of the investment tribunal model that has been put into practice in the EU, for example, the mechanism for appointing members of the tribunal draws on many elements of the mechanism for appointing members to the WTO Appellate Body. Hence, considering that contracting states control the right to appoint members, the process itself could become politicized, as is the case with the dilemma being faced by the WTO Appellate Body (Puig & Shaffer, 2018). In particular, under the current model of investment tribunals at the bilateral level, the lack of a well-developed system for the joint appointment of third-country members could lead to a crisis of institutional paralysis in the subsequent operation since the tribunal hearing for each specific case would need to be composed of members from both contracting states (one from each) as well as a third-country member. Alternatively, contracting states may screen candidates with a 'pro-state' bias based on whether they have a background in public law or government experience. Furthermore, the positions of different members in a particular case are likely to differ significantly depending on their nationality, and the problem of proxies of the arbitrator may still exist. It is likely that members with the nationality of the host country will be most inclined to defend the public interest or national security of that country, and members with the same nationality as the investor will be more inclined to defend the interests of their own country on behalf of the investor (Dong, 2018).

Second, it is possible that a broad interpretational power granted to the contracting states in the exceptions clause may also be overly politicized and undercut the legal character of the ISDS mechanism. The general exception, the security exception and the matter-specific exception are usually broadly worded and, combined with the vagueness of the criteria for judging fundamental security interests, national interests and public order in international investment law, give the contracting states great scope for interpretation and discretion, and therefore risk the politicization of rights being abused. As scholars have questioned, how can the fairness of the ISDS mechanism be guaranteed by interpreting ad hoc changes to the rules of the game when the host country is both a rule maker and a participant (Lin, 2021)? Although politicized dispute resolution can result in ideal results in some cases, international investment arbitration itself serves as a substitute when a politicized dispute settlement mechanism is not effective or ineffective. If politicized factors return for too much, their existence value will be greatly diminished. Arbitration should be innovative, but the innovation must be upright (Zhang & Kuang, 2019). The most extreme scenario of the return of politicized factors is the abandonment of the ISDS mechanism and the reintroduction of local remedies and diplomatic protection instruments of the investor's home country to settle international investment

disputes, which is undoubtedly a heavy blow to the development of the ISDS mechanism and international investment law.

The other possible overcorrection is a generalized arbitrators' code of conduct risks impeding the building of referees' trust and the operation of arbitration proceedings. According to the earlier discussion, developing a comprehensive code of conduct for arbitrators is one of the most important initiatives to address the trust dilemma of arbitrators currently underway. Recently published Guidelines for Adjudicators Under the Investor-State Dispute Settlement Mechanism by the ICSID Centre and UNCITRAL Secretariat include not only general requirements and prohibitions but also a list of conflict-of-interest risks and matters requiring disclosure. Of particular interest is the inclusion of a list of all publications (and their associated public speeches) by adjudicators or candidates as part of the arbitrator's disclosure. This is undoubtedly a very stringent requirement for an arbitrator who is an academician or a government official, as 'all' and 'public' are inherently ambiguous and not easy to be enforced. Moreover, there is a misunderstanding that the disclosure obligation of arbitrators is directly linked to the standards of challenging arbitrators. The broader the disclosure obligation is, the more times the judges will be challenged (requiring arbitrators to abide by the avoidance system). Even though challenges appear to be increasing in frequency and in most cases do not diminish the arbitrator's independence and impartiality, the challenges themselves can easily disrupt the arbitration process unduly and become a tool for the party seeking to hold it up. Moreover, the increased frequency of challenges tends to create the impression that the referee cannot be trusted, which undermines the construction of the arbitrator's credibility and even creates the illusion of a legitimacy crisis. Therefore, the purpose of developing standards and rules of conduct for arbitrators is not to increase the suspicion of parties and arbitrators; rather, the parties' expectations of disclosure by arbitrators should be clearly balanced with the standard of review for challenging arbitrators, and there is a need to clarify not only the clear standard of review for each of the duty to disclose, but also the challenge to arbitrators (Brodlija, 2021).

### **The Chinese Response to Arbitrator's Trust-shaping**

#### **A Balances Stance**

China should be given high priority on the issue of trusting arbitrators under the ISDS mechanism, and its suggestions concerning referee selection conditions, codes of conduct, appointment mechanisms, power limitations, etc., are awaiting a response from China at the bilateral and multilateral levels. This is crucial to China's ability to hold on to the mechanism discourse power in the long term. The ISDS mechanism in the China-EU Investment Agreement still needs supplementary negotiation after the signing of the agreement, and the reform of rules related to the appointment of arbitrators is one of the core content of the investment court model promoted by the EU. Whether China accepts the relevant scheme deserves special attention.

As both a home country of investors and a host country for foreign investment, China cannot take a unilateral position on the ISDS mechanism. According to the Chinese Government's Proposal on Reforming the Investor-State Dispute Settlement Mechanism submitted in September 2019, the reform proposal should safeguard both the legitimate regulatory rights of the host country and protect the rights and interests of investors. As far as the rules relating to arbitrators are concerned, China proposes to retain the right of parties to appoint arbitrators in the first instance of investment arbitration and to take a proactive approach regarding the expertise of the arbitrators concerned, the avoidance of conflicts of

interest, and the improvement of the rules on recusal. This does not only respond to the concerns of the host country but are also taking into account the interests of investors. The connection between the arbitrator and the host state that may affect their independence and the risk of the award being set aside or not enforced due to the arbitrator's deficiencies in these respects are also real concerns for investors. The balanced position is also reflected in China's treaty practice in recent years. For example, in the investment chapter of the China-Australia FTA, Article 15 sets forth specific provisions concerning the selection of arbitrators, their independence, as well as a code of conduct for arbitrators (to include procedural responsibilities, disclosure obligations, the performance of duties, independence and impartiality, etc.) in Attachment 1. Of course, the disclosure obligations of arbitrators should be reasonably limited in scope and distinguished from the criteria of challenging arbitrators, especially given the fact that most Chinese arbitrators in the ISDS field are part-time arbitrators with academic background, and that the views expressed in published writings should not be forcibly linked to the impartiality of arbitrators and the right to challenge them.

As for the right to appoint arbitrators, China's position on this is relatively conservative. This prudent choice of position is reasonable: Firstly, Chinese investors are not yet experienced in investing abroad and may face a greater risk of investment disputes in the event of a global outbreak of COVID-19 epidemic and a return to populism, unilateralism, and conservatism. Further, providing adequate protection for investors is a relatively more pressing demand for China at present. Nonetheless, the ISDS mechanism, which is a combination of public law values and being overly politicized, does not meet China's current international investment needs. Secondly, given the current predominance of BITs in international investment law, the plurality and flexibility of ad hoc arbitrators are better suited to the diversity of BITs (Akhavan, 2017). By introducing a permanent appellate mechanism, one can balance the possible shortcomings of the existing arbitration appointment mechanisms, with non-permanent arbitral tribunals and permanent appellate bodies each having their respective strengths and weaknesses to draw on to create an effective, balanced mix (Xiao, 2017).

Moreover, in line with Article 6 of the Foreign Investment Law, which stipulates that foreign investment activities shall not endanger national security or harm the public interest, China has increasingly focused on harmonizing the host country's foreign investment regulatory power with the adjudicator's power to adjudicate in the investment agreements it has signed in recent years. By introducing general exceptions, security exceptions, and financial prudence clauses, the investment agreements further narrow down the scope of application of the ISDS mechanism, along with a detailed listing of areas and kinds of disputes to which it applies. For instance, the China-Canada BIT's clarification on the limitations of the application of the ISDS mechanism to tax collection disputes is not only spelled out in its Article 14 (provisions in the BIT other than those in this article is not applicable to tax measures) but also provided in Article 20 (investors' claims that disputes relating to tax measures brought under Article 14(4) disputes may be referred to the investment tribunal). It is worth mentioning in particular that Article 20 of the China-Canada BIT also embeds an interstate arbitration mechanism in the consultation process: If the respondent party defends the investor claim on the grounds that the measure at issue is a financial prudential measure, the ISDS tribunal shall seek a written report on the issue from both contracting parties and the arbitration proceedings shall be suspended; or if the financial authorities of both contracting parties are unable to reach agreement within sixty days, either party shall refer the issue to the inter-state arbitral tribunal within thirty days and the decision of the inter-state arbitral tribunal shall be binding on the ISDS tribunal.

Of course, China needs to be alert to the risk of abuse of regulatory power by host countries. Regarding the China-led 'Belt and Road' investment, some countries and regions may abuse the exception clause due to political unrest or other factors; and a country's regulatory powers may be subject to ideological manipulation and may be used to discourage Chinese investors' overseas investment activities, such as how some countries treat Chinese investors differently via their foreign investment security review mechanisms. Therefore, to protect investors, the positive value of the ISDS mechanism in preventing the host country from exercising its regulation right arbitrarily cannot be completely abandoned. Moreover, it is not appropriate to set all the exception clauses as self-adjudicative in nature, and in accordance with the importance of different parties in different agreements to different exception items. The preconditions for taking measures under the exceptions, avoidance of arbitrary and discriminatory conduct for instance, as well as the requirement of relevance ought to be developed in accordance with the importance that parties in different agreements are attached to. Thereafter, allowing the ISDS mechanism to review the consistencies of the application of the exceptions with the preconditions, satisfies the relevance requirement and is in goodwill.

### **Mandatory Arbitrator Roster and Attempts to Introduce Independent Third-party Institutions**

The question of whether the power to appoint arbitrators should be transferred is the most controversial in the arbitrators' current trust shaping under the ISDS mechanism. When China expresses its position on the reform of the arbitrator appointment mechanism, it assumes the establishment of a permanent appellate mechanism. The following questions arise: First of all, given that it may not be possible to establish a permanent appeal mechanism at the multilateral level in the near future, how will China respond to recent bilateral and regional investment treaty negotiations? Second, if a permanent appellate mechanism is established, how will referees (members) of the appellate body be selected?

According to this article, the adoption of a mandatory arbitrator roster is a balanced approach to the reform of the arbitrator appointment mechanism in the lack of a multilateral permanent appeals mechanism. While reserving the investor's right to appoint arbitrators, it shall be expressly informed that arbitrators can only be appointed in a fixed roster prepared in advance. At the same time, the scope of application of the mandatory arbitrator roster system is somewhat flexible, requiring, for example, that all appointed arbitrators choose from the roster, or that party-appointed arbitrators may not choose from the roster, but that a third arbitrator appointed by mutual consent or appointed by the institution must choose from the roster.

The development of a mandatory roster of arbitrators deserves further exploration. According to a survey of investors on the ISDS mechanism, where a compulsory roster of arbitrators is developed by a contracting state, 64% of respondents believe that this would undermine investors' trust in the ISDS mechanism while 48% felt that a mandatory roster of arbitrators developed by an independent body would be more helpful in breaking the trust dilemma of arbitrators (Queen Mary, 2020). It is therefore important to balance the interests of both the investor and the host country in developing a mandatory roster of arbitrators while avoiding an overly politicized option. This paper suggests that the contracting states may be allowed to specify the requirements for the selection of arbitrators and the composition of the members of the arbitral tribunal through investment agreements, but the contracting states are no longer given the dominant power to establish the mandatory roster of arbitrators. This authority is vested in an independent third-party body, which formulates it after a

comprehensive assessment of the contracting states' proposal, the arbitrators' application, and the recommendation of the relevant arbitration body or organization of arbitrators. In addition, independent third-party institutions can also carry out mechanism construction on the disclosure obligation of arbitrators and set up a column to collect and regularly update the information required to be disclosed by arbitrators according to the code of conduct, so that parties who need to inquire about conflicts of interest can obtain relevant information in a timely manner. The International Commercial Dispute Prevention and Settlement Organization (ICDPASO), initiated by the China Council for the Promotion of International Trade (CCPIT) and the China Chamber of International Commerce (ICC) and co-sponsored by business and legal service providers from more than 40 countries and regions, is one of the appropriate options. This organization offers new options for international commercial dispute prevention and resolution based on the concept of 'discuss, build and share'.

Similarly, if a future appeals mechanism at the multilateral level takes shape, it would not be reasonable to deprive investors of the right to appoint arbitrators altogether, with the contracting states completely dominating the process of appointing arbitrators. Further, the process of selecting arbitrators should also be handed over to an independent third-party body, as mentioned earlier, to dilute the risk of politicization and enhance investors' trust in the appeals mechanism. At the same time, the process of selecting the members of the appellate body should follow the principles necessary for the operation of international dispute settlement bodies and ensure that the members who hear cases adequately reflect the representation of geographical, national, cultural and legal systems.

### **Special Focus on China-EU ISDS Mechanism Negotiations**

First of all, the existing ISDS mechanism between China and the EU is not unified, and the ISDS clauses in the BIT between China and EU member states do not involve the improvement of the ISDS mechanism (Deng, 2017). Therefore, the supplementary negotiation on the ISDS mechanism in the China-EU investment agreement negotiation is of self-evident value for the unification and optimization of the existing ISDS mechanism between China and the EU. Secondly, after the CJEU found in the Case of *Slovak v. Achmea* that ISDS clauses in BITs between EU member states were incompatible with EU law, whether the judgment of this case can be used as a reference for subsequent investment arbitration cases filed according to BITs between EU member states and non-EU member states have aroused discussion. These discussions further raised concerns that the ISDS mechanism in the relevant BITs would not be implemented (Lenk, 2017). The negotiation of the ISDS mechanism in the China-EU Investment Agreement responds to these concerns. In conclusion, although the EU's practice of establishing international investment tribunals has gained some institutional experience and consensus among partners at the bilateral level, the EU's advocacy of systemic reform through the establishment of international investment tribunals has not been well received at the multilateral level. In this context, it is clear that the negotiations on a complementary ISDS mechanism to the China-EU investment agreement will be a strong focus for the EU. If it succeeds in bringing in China at the bilateral level, it will provide a strong backing for the promotion of its ideas on a broader scale.

Two aspects of the EU model of international investment tribunals are worth discussing. One is the introduction of an appeal mechanism in responding to the current lack of consistency and predictability of awards under international investment arbitration, and the other is the reform of the appointment mechanism of adjudicators in responding to the current controversy regarding arbitrators. For the former, the bilateral path which is not being the

international investment arbitration appeal mechanism is the best route because the bilateral path means that every introduction of the appeal mechanism investment agreement will set up an independent appeal mechanism. This does not only give a party a significant cost pressure, but can cause the appeal mechanism of fragmentation, ruling the consistency between the appellate body which is also difficult to guarantee. In fact, the construction of a permanent appeal mechanism on the basis of maintaining the existing ISDS mechanism has been effective in responding to the demand for consistency in adjudication. In comparison, a separate permanent appeal mechanism is less costly, less economically and financially burdensome for the States and more acceptable to them as it does not require the establishment of a court mechanism at first instance (Qin, 2021). In the case of the latter, the risk of politicization in the EU investment tribunal model regarding the reform of the appointment mechanism for adjudicators does not fit perfectly with China's overall aspirations and position on the protection of investment interests. China will not accept overly aggressive proposals regarding the appointment of arbitrators and the ISDS system that are contrary to its overall approach to international investment as a major two-way investment country. Surely, given the strong determination that the EU has expressed at both bilateral and multilateral levels to move forward with the international investment tribunal model, and the strategic value of a complete conclusion of China-EU investment negotiations at the international political and economic level, it remains to be assessed whether there is room for concessions and adjustments to the aforementioned overall position in the bilateral context and whether there is a mutually acceptable compromise.

This article argues that, at the bilateral level only, the reform of the arbitrator appointment mechanism in the EU investment tribunal model is not entirely unacceptable for the following reasons. Firstly, in terms of the scale of bilateral investment between China and the EU in recent years, China and the EU are in a more or less equal position, with a relatively balanced status between the home and host countries of investors, and therefore the reform of the arbitrator appointment power is less negative at the bilateral level than in other bilateral investment relationships where the home country status of Chinese investors is more prominent. Secondly, as far as the practice of international investment arbitration is concerned, there is currently only one investment arbitration case registered in ICSID Centre by EU investors against China, and only one investment arbitration case filed by Chinese investors against EU member states.<sup>1</sup> Therefore, there has not been a great deal of experience in an investment arbitration under BITs between China and EU Member States. Aside from that, issues regarding the ISDS mechanism have also not been the focus of investment practice on either side, at least thus far. Furthermore, due to language, cultural and legal traditions, there is a very low participation level of Chinese arbitrators in the existing international investment arbitration mechanism. Nonetheless, the composition and appointment of arbitrators in the EU investment tribunal model may provide valuable insight in increasing the participation and influence of Chinese arbitrators. Therefore, at the bilateral level, there is room for China to make concessions to the EU investment tribunal model which can be considered as a small-scale experiment. Of course, China's concessions to the EU investment

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<sup>1</sup> The two cases are *Helleciase GmbH v. China* (Case No. ARB/17/19) and *Ping An Bank v. Kingdom of Belgium* (Case No. ARB/12/29). Furthermore, Swiss investors notified the Chinese government in November 2020 of their intention to negotiate investment disputes under the China-Switzerland BIT.

tribunal model at the bilateral level do not mean that the investment tribunal model is the only ISDS mechanism to be used in the China-EU Investment Agreement.

An acceptable compromise is to include the investment tribunal as an option for the China-EU ISDS mechanism, while also including other mutually acceptable dispute settlement bodies and mechanisms to provide investors with some choice. China might demand that multilateral dispute settlement bodies established under its auspices such as ICDPASO to participate in the China-EU ISDS mechanism as a condition for accepting the EU investment tribunal model. At the same time, even if China introduces an international investment tribunal model in the follow-up negotiations to the China-EU investment agreement based on political considerations to complete the negotiations, China should not change its overall position at the broader bilateral level. Accordingly, China should maintain its established position in the UNCITRAL-led reform of the multilateral ISDS mechanism.

### Conclusion

In the field of international investment, the transfer of state jurisdiction over investment disputes and the abandonment of sovereign immunity are the prerequisite for the vigorous development of international investment arbitration mechanisms. However, the restriction of the transfer of sovereignty on the host country's right to regulate foreign investment and the negative impact on local governance also arouse the vigilance of sovereign states, while the questioning of the independence, professionalism and representativeness of arbitrators is the externalization of such vigilance. The basic objective of these reform plans is to limit the power of the arbitrator regarding judgment and interpretation as well as to incorporate the will of the contracting states into the process of establishing codes of conduct, appointments, interpretations and discretion of arbitrators. It is important nonetheless to maintain a balance between the political and legal effects of the ISDS mechanism, and any reform of it should avoid going from one extreme to the other, namely from full commercialization to excessive politicization. It is advisable for China to take a balanced stance towards the reform of the ISDS mechanism and the building of arbitrators' trust carefully.

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