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10  
17

# Reforming the International Investment Regime: An Action Menu

C H A P T E R I V

10  
17



## INTRODUCTION

Growing unease with the current functioning of the global international investment agreement (IIA) regime, together with today's sustainable development imperative, the greater role of governments in the economy and the evolution of the investment landscape, have triggered a move towards reforming international investment rule making to make it better suited for today's policy challenges. As a result, the IIA regime is going through a period of reflection, review and revision.

As evident from UNCTAD's October 2014 World Investment Forum (WIF), from the heated public debate taking place in many countries, and from various parliamentary hearing processes, including at the regional level, a shared view is emerging on the need for reform of the IIA regime to ensure that it works for all stakeholders. The question is not about *whether* to reform or not, but about the *what, how* and *extent* of such reform.

*WIR15* responds to this call by offering an action menu for IIA reform. It builds on UNCTAD's earlier work in this area, including UNCTAD's Investment Policy Framework (*WIR12*), UNCTAD's reform paths for investment dispute settlement (*WIR13*), and its reform paths for IIA reform (*WIR14*), as well as on contributions by others.

The chapter addresses *five main reform challenges* (safeguarding the right to regulate for pursuing sustainable development objectives, reforming investment dispute settlement, promoting and facilitating investment, ensuring responsible investment, and enhancing systemic consistency). It offers policy options for *key areas of IIA reform* (i.e. substantive IIA clauses, investment dispute settlement, and systemic issues) and for *different levels of reform-oriented policymaking* (national, bilateral, regional and multilateral).

The policy options provide reform-oriented formulations for standard IIA elements. They include mainstream IIA provisions as well as more idiosyncratic options that have so far been used by fewer countries or are only found in model agreements.

This *WIR* takes a *holistic approach*. It covers, in a single chapter, all the key aspects of IIA reform (i.e. substantive, procedural and systemic). It identifies reform *objectives, areas* and *solutions* in the form of an *action menu*, outlining a common *road map* for the reform process and inviting countries to use the action menu and to define their own, individual road maps for IIA reform.

This *WIR* takes an *approach that focuses on policy coherence*. It proposes that reform be guided by the need to harness IIAs for sustainable and inclusive growth. It suggests that the investment promotion and facilitation function of IIAs should go hand in hand with their function of protecting investment. And, it emphasizes that IIAs must be coherently embedded in countries' overall sustainable development strategies.

Finally, this *WIR* stresses the importance of a *multilateral approach* towards IIA reform. Given the large number of existing IIAs, the only way to make the IIA regime work for all is to collectively reform its components. In today's dynamic environment, where one change reverberates throughout the whole system, it is important to work towards a common vision and common rules of engagement. Only a common approach can ensure that reform does not lead to further fragmentation and incoherence, but is for the benefit of all, without leaving anyone behind. And only a common approach will deliver an IIA regime in which stability, clarity and predictability help achieve the objectives of all stakeholders, effectively harnessing international investment relations for the pursuit of sustainable development.

The chapter first takes stock of 60 years of international investment rule making, draws lessons learned and identifies today's reform needs and objectives. It then develops the design criteria and strategic choices, pinpoints the reform areas and tools, and advances detailed policy options for reform in the five identified reform objectives. The chapter closes with Guidelines for IIA Reform and suggested possible actions and outcomes at the national, bilateral, regional, and multilateral levels.

## A. SIX DECADES OF IIA RULE MAKING AND LESSONS LEARNED

### 1. Six decades of IIA rule making

International investment agreements (IIAs) – like most other treaties – are a product of the time when they are negotiated.

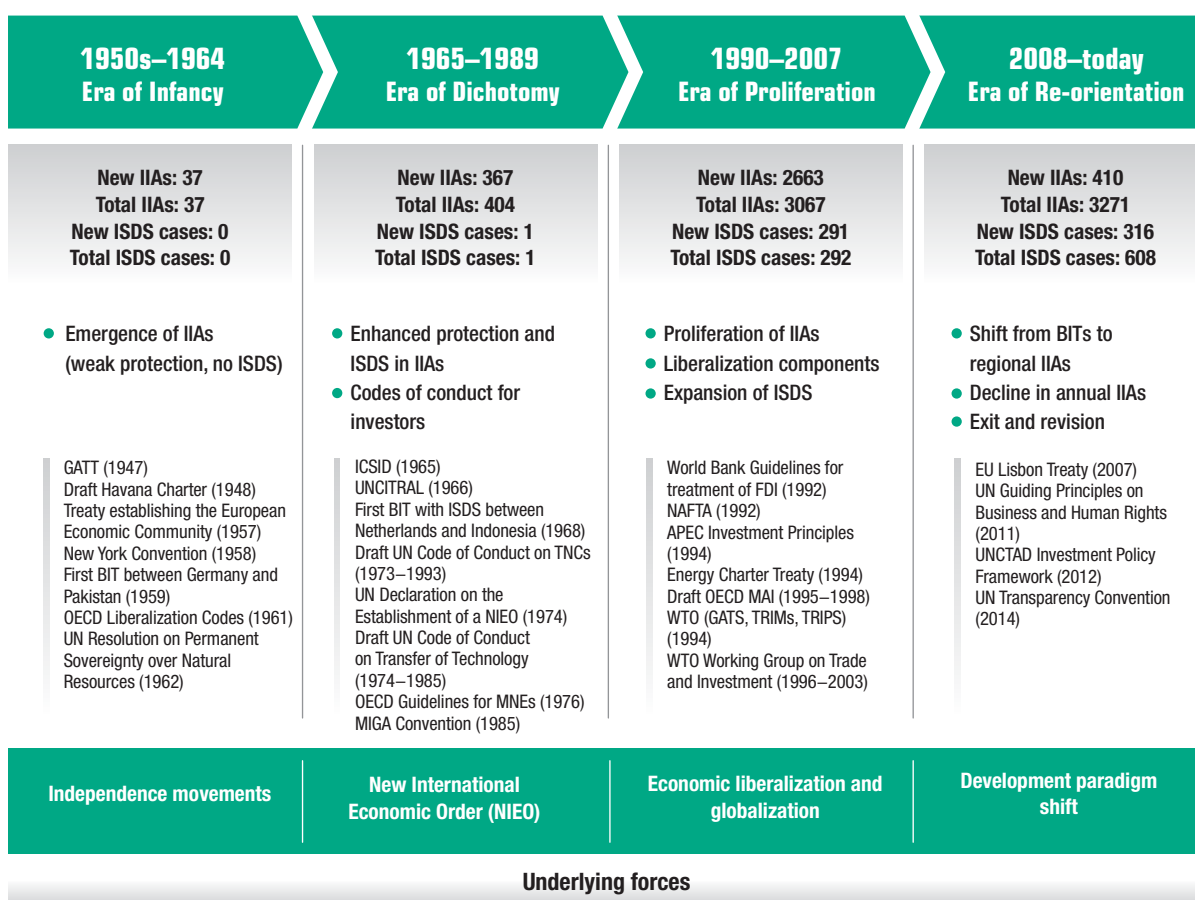
IIAs are concluded in a specific historic, economic and social context and respond to the then-existing needs and challenges. As more than half a century has passed since the first bilateral investment treaty (BIT) was concluded, it is no surprise that IIAs have gone through a significant evolutionary process during this period. Four main phases can be identified (figure IV.1).

#### a. Era of infancy (end of World War II until mid-1960s)

The BIT is born as a new type of instrument concluded between developed and developing countries, although with relatively few investment protections and without ISDS. The ICSID Convention is signed, later to become the main piece of ISDS infrastructure.

In the first half of the 20<sup>th</sup> century, customary international law (CIL) was the primary source of international legal rules governing foreign investment. The emergence of a number of major investment disputes

Figure IV.1. Evolution of the IIA regime



Source: UNCTAD.

Note: Years in parentheses relate to the adoption and/or signature of the instrument in question.

between foreign investors and their host countries after 1945<sup>1</sup> showed the significant limitations of protection afforded under CIL and through the system of home-State diplomatic protection, and triggered a move towards international investment treaty making.

A first attempt at multilateral investment rules was made in 1948 within the framework of the proposed Havana Charter, designed to establish an International Trade Organization. With respect to investment negotiations, developed, developing and socialist countries could not agree on the interpretation of customary international law and the content of an international minimum standard of treatment for foreign investors. The Charter never entered into force despite the fact that it was intended to supplement the other building stones of the post-war international economic order consisting of the Bretton Woods Institutions (1944) and the United Nations (1945) (UNCTAD, 2008). This earlier era of IIAs reflected the split between market economies (where private property was recognized) and countries under communist rule (where private property was not recognized).

Somewhat greater success was achieved through regional or plurilateral instruments that dealt with the establishment and treatment of foreign investment. The 1957 Treaty establishing the European Economic Community included the freedom of establishment and the free movement of capital as core pillars of European integration. Other early examples include the OECD Code of Liberalization of Capital Movements and Code on Current Invisible Operations of 1961.

In 1959, the first bilateral investment treaty (BIT), between Germany and Pakistan, was signed, following the example of existing bilateral treaties of “friendship, commerce and navigation” concluded by a number of countries in the inter-war years and following World War II. From that time on, BITs became the main instrument to govern investment relationships among countries of different levels of economic development. In terms of content, the BITs (or IIAs) had a focus on protection against expropriation and nationalization, as investors from developed countries perceived expropriation and nationalization as the main political risks when investing in developing countries. To a considerable extent, these first-generation BITs resembled the 1959 Abs-Shawcross Draft Convention on Investments Abroad, a private initiative, and the 1962 OECD Draft Convention on the Protection of Foreign Property

(revised and adopted in 1967 but never opened for signature) (Vandeveld, 2010).<sup>2</sup>

Another landmark development was the establishment of the International Centre for Settlement of Investment Disputes (ICSID) in 1965, providing a specialized facility for the resolution of investment disputes between investors and host States. In 1958, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards was concluded, facilitating the enforcement of international arbitral awards.

### **b. Era of dichotomy (mid-1960s until late 1980s)**

*Investment protections in BITs are enhanced, including by adding ISDS provisions. At the same time, multilateral attempts to establish rules on investor responsibilities fail.*

On the one hand, from the mid-1960s to the late 1980s, IIAs expanded in number and substance, although at a relatively slow pace and with the participation of a limited number of countries. The main signatories of IIAs during this period were developed countries from Europe and those developing countries – including in Africa, Asia and Latin America – that considered FDI an important contribution to their economic development strategies. Many countries, however – among them the Soviet Union, countries in Central and Eastern Europe, China, India and Brazil – stayed out of the IIA regime altogether or joined only at a relatively late stage. At the end of the 1980s, the global IIA regime consisted of fewer than 400 BITs.

In terms of substance, the main development in IIAs was the increasing inclusion of ISDS provisions. The earliest known example of ISDS is the BIT between Indonesia and the Netherlands of 1968. Several other countries followed in the 1970s and 1980s, until ISDS became a standard provision in BITs from the 1990s onward. Investment protection was also strengthened in other substantive provisions.

On the other hand, during this period, there were multilateral attempts towards strengthening States’ sovereign powers and towards emphasizing investor responsibilities. These policies were backed by two UN Resolutions, one on “Permanent Sovereignty over Natural Resources” in 1962 and one on “Establishment of a New Economic Order” in 1974.

In addition, in the early 1970s, a second attempt to establish multilateral investment rules was launched when the UN initiated negotiations on a Code of Conduct on Transnational Corporations and a Code of Conduct on the Transfer of Technology. However, no solution could be found for how to reconcile the interests of developed countries in establishing strong and unambiguous protection for international investment, and the interests of developing and socialist countries in preserving a maximum of their sovereign right to treat multinational enterprises (MNEs) according to their own laws and regulations. Although these negotiations proved unsuccessful, the “Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices” was adopted by the General Assembly in 1980.

### c. Era of proliferation (1990s until 2007)

*The global IIA regime expands at great speed. BITs signed are broadly similar, although some countries add the investment liberalization component. In the late 1990s, investors “discover” ISDS; the fast-growing number of claims reveal the true “power” of IIAs as well as some of their inherent problems.*

IIA rule making – and international economic cooperation in general – substantially gained momentum in the 1990s. The fall of the Berlin Wall in 1989 and the dissolution of the Soviet Union caused a tectonic shift in geopolitics, in which political confrontation and economic separation gave way to political cooperation and economic integration. The transformation of former communist States brought about their recognition of private property. A few years earlier, China had adopted its “Open Door” policy with the explicit aim of attracting foreign investment for its economic development. These events significantly contributed to economic globalization, with a large and growing number of developing countries opening up to and actively competing for foreign investment, and more and more investors from developed countries seeking production locations abroad to reduce costs and gain market access.

The universe of BITs expanded rapidly, with almost three new agreements signed per week on average. Although only 381 BITs existed at the end of the 1980s, their number multiplied by five throughout the next decade to reach 2,067 by end of 2000. Most countries, both developed and developing, considered participation in

the IIA regime as a “must” in the global competition for foreign investment, so that by the mid-2000s hardly any country did not have at least a few BITs. Countries such as China and India, with enormous potential as both recipients and source of FDI, rapidly expanded their treaty networks. Brazil signed several IIAs but never ratified them.

In parallel, regional and plurilateral IIA rule making increased substantially. A landmark event was the establishment of the WTO in 1994, with several WTO agreements containing rules applicable to foreign investment (GATS, TRIMs, TRIPS). In the same year, the Energy Charter Treaty was concluded; today it comprises more than 50 contracting parties from Europe, Asia and Oceania, and contains detailed investment provisions as one of its pillars. At the regional level, countries concluded the North American Free Trade Agreement (NAFTA) (1992) and adopted the APEC Non-Binding Investment Principles (1994). Within the OECD, negotiations took place on the Multilateral Agreement on Investment (MAI) from 1995 to 1998. However, unexpected differences emerged on core principles of investment protection (e.g. investment definition, degree of investment liberalization, indirect expropriation, ISDS, cultural exception, labour and environmental issues) which resulted in the ultimate demise of the undertaking.

At the multilateral level, the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA), as a member of the World Bank Group, was concluded in 1985 and the World Bank Guidelines on the Treatment of Foreign Direct Investment were launched in 1992 (UNCTAD, 2004). Within the WTO, the 1996 Singapore Ministerial Conference initiated a work programme on the relationship between international trade and investment; due to diverging interests in investment negotiations and in other policy areas the programme was abandoned after the Fifth Ministerial Conference (held in 2003 in Cancún, Mexico).

While the vast majority of BITs concluded in this period covered only the post-establishment phase of investment, many free trade agreements (FTAs) went one step further and included in their investment (and/or services) chapters commitments on non-discriminatory treatment of establishment by foreign investors as a means to facilitate market access. The 1990s also witnessed the start of a move towards renegotiating first-generation BITs with the objective of

further enhancing investment protection by including protection elements hitherto missing. In 1990, the first award in a treaty-based case was issued.<sup>3</sup> This was followed by a number of new cases during the 1990s and a rapid increase in the 2000s (chapter III).

#### **d. Era of re-orientation (2008 until today)**

*The “IIA rush” of the 1990s gradually slows down. Many countries refine treaty content. States’ increased exposure to ISDS cases, the global financial crisis, a paradigm shift towards “sustainable development” and important changes at regional levels mark the beginnings of a concerted move towards IIA reform.*

By April 2015, the IIA regime had grown to close to 3,300 treaties. Several developments in the second half of the 2000s lead to a new era of IIA rule making, which can be characterized as a period of reorientation.

The experience of Canada and the United States as respondents in NAFTA investment arbitrations, prompted them to create, already in 2004, new Model BITs aimed at clarifying the scope and meaning of investment obligations, including the minimum standard of treatment and indirect expropriation. In addition, these new models included specific language aimed at making it clear that the investment protection and liberalization objectives of IIAs must not be pursued at the expense of the protection of health, safety, the environment and the promotion of internationally recognized labour rights. Canada and the United States also incorporated important innovations related to ISDS proceedings such as open hearings, publication of related legal documents and the possibility for non-disputing parties to submit amicus curiae briefs to arbitral tribunals. Also included, following on from NAFTA, were special regimes of substantive protection and dispute resolution for investments in the financial services industry, as well as specialized mechanisms for disputes by investors based on host-country tax measures. The United States Model BIT was slightly revised in 2012.

The global financial and economic crisis that broke out in September 2008 – following the Asian and Argentine financial crises a number of years before – emphasized the importance of solid regulatory frameworks for the economy, including for investment. Growing dissatisfaction with the existing IIA regime and its impact on contracting parties’ regulatory powers to pursue public interests and to enhance sustainable

development led countries to reflect on, review and reconsider their policies relative to IIAs.

The rise in ISDS cases, from 326 in 2008 to 608 known cases at the end of 2014, involving both developed and developing countries as defendants, contributed to this development (UNCTAD, 2015). In addition, investment disputes became more complex, raising difficult legal questions about the borderline between permitted regulatory activities of the State and illegal interference with investor rights for which compensation has to be paid. At the same time, as the number of ISDS cases began to rise sharply, so did the amount of compensation sought by investors in their claims and awarded by arbitral tribunals in a number of high-profile cases.

Accordingly, governments have entered into a phase of evaluating the costs and benefits of IIAs and reflecting on their future objectives and strategies as regards these treaties. Mounting criticism from civil society plays a role as well. As a result, several countries have embarked on a path of IIA reform by revising their BIT models with a view to concluding “new generation” IIAs and renegotiating their existing BITs. This move is based in part on UNCTAD’s Investment Policy Framework for Sustainable Development (IPFSD), which was developed to provide guidance to the reform of investment policies at the national and international levels and which is increasingly being used by developing and developed countries (box IV.1 and chapter III). Countries have started to clarify and “tighten” the meaning of individual IIA provisions and to improve ISDS procedures, with the objective of making the process more elaborated, predictable and transparent and of giving contracting parties a stronger role therein. Improved transparency is also the outcome of the recently adopted UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration and the UN Transparency Convention (see chapter III).

Other countries, by far a smaller group, have announced a moratorium on future IIA negotiations, while still others have chosen a more radical approach by starting to terminate existing IIAs. A few countries have also renounced their membership in ICSID (UNCTAD, 2010a).

Although bilateral treaty making lost much of its dynamism, regional IIA making accelerated (see chapter III). This is partially a reaction to the failure to establish

## Box IV.1

## UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD)

UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) (UNCTAD, 2012a), the special theme of *WIR12*, responds to the recognition that at a time of persistent crises and pressing social and environmental challenges, mobilizing investment and ensuring that it contributes to sustainable development objectives is a priority for all countries. In so doing, the UNCTAD Framework built on the emerging new generation of investment policies.

The Framework first details the drivers of change in the investment policy environment and the challenges that need to be addressed; it then proposes a set of Core Principles for investment policymaking which serve as “design criteria” for national and international investment policies. On this basis it presents guidelines for national investment policies and policy options for the formulation and negotiation of IIAs. UNCTAD's IPFSD has since served as a reference point for policymakers in formulating national investment policies and negotiating IIAs, as a basis for building capacity on investment policies, and as a point of convergence for international cooperation on investment issues.

Source: UNCTAD.

multilateral investment rules, leaving regional approaches as a “second best solution”. In addition, the entry into force of the Treaty of Lisbon in December 2009 triggered a trend towards intensifying and upscaling regional IIA treaty making. By transferring competence in FDI from the EU member States to the EU, with potential implications for almost half of the IIA universe, the Treaty of Lisbon enables the EU to negotiate IIAs with post-establishment provisions (earlier, EU treaties only covered pre-establishment). Examples are the Canada–EU Comprehensive Economic and Trade Agreement (CETA, draft 2014), the EU–Singapore Free Trade Agreement, and negotiations for the EU–United States Transatlantic Trade and Investment Partnership (TTIP). Outside the EU, megaregional negotiations are ongoing for the Trans-Pacific Partnership (TPP), the Regional Comprehensive Economic Partnership Agreement (RCEP), and negotiations for the COMESA-EAC-SADC Tripartite Agreement (chapter III). For IIA treaty making, regionals and, even more so, megaregionals offer opportunities to consolidate today's multifaceted and multilayered treaty network. However, without careful drafting, they can also create new inconsistencies resulting from overlaps with existing agreements (*WIR14*).

## 2. Lessons learned

*IIA reform can build on lessons learned from 60 years of IIA rule making.*

Sixty years of IIA rule making reveal a number of lessons on how IIAs work in practice and what can be learned for future IIA rule making.

The expected key function of IIAs is to contribute to predictability, stability and transparency in investment relations, and to help to move investment disputes

from the realm of State-to-State diplomatic action into the realm of law-based dispute settlement and adjudication. IIAs can help improve countries' regulatory and institutional frameworks, including by adding an international dimension to them and, by promoting the rule of law and enhancing good governance. IIAs can reduce risks for foreign investors (i.e. act as an insurance policy) and, more generally, contribute to improving the investment climate. Through all of this, IIAs can help facilitate cross-border investment and become part of broader economic integration agendas, which, if managed properly, can help achieve sustainable development objectives. At the same time, experience has shown that IIAs “bite” (i.e. their protection provisions can and have been enforced by arbitral tribunals at sometimes huge costs to the State), and that – like any other international treaty – they limit the regulatory space of the contracting parties. As a result, concerns have been raised that these limits on regulatory space go too far, were not properly understood at the point of entry into IIAs or are inadequately balanced by safeguards for governments or by obligations on MNEs.

### Lesson 1: IIAs bite and may have unforeseen risks – take safeguards

IIAs are legally binding instruments and not “harmless” political declarations. As shown by the surge in ISDS cases during the last 15 years, they “bite”. Broad and vague formulation of IIA provisions has allowed investors to challenge core domestic policy decisions, for instance in the area of environmental, energy and health policies. Whereas in the past, it was mostly developing countries that were exposed to investor claims, there are nowadays also more and more developed countries as defendants (chapter III).

The language used in IIAs has generated unanticipated (and at times inconsistent) interpretations by arbitral tribunals, and has resulted in a lack of predictability as to what IIAs actually require from States. As a result, there is today a broadly shared view that treaty provisions need to be clear and detailed, and drafted on the basis of a thorough legal analysis of their actual and potential implications.

Anticipating IIAs' effect on regulatory space is not straightforward. Although ISDS cases expose the constraints that IIAs can place on regulatory powers, there is no clear methodology for conducting regulatory impact assessments and for managing attendant risks. The IIA impact will depend on the actual drafting and design of the IIA and the capacity of national and subnational entities to effectively implement the treaty.

**Lesson 2: IIAs have limitations as an investment promotion and facilitation tool, but also underused potential**

IIA rule making needs to be informed by a proper cost-benefit analysis. However, determining the impact of IIAs on FDI flows is not a straightforward exercise. IIAs can help encourage cross-border investment flows by reducing political risks for foreign investors, liberalizing investment flows (depending upon the treaty's provisions) and, more generally, signalling a better investment climate to international investors, especially in countries with weak domestic investment frameworks and enforcement. However, IIAs are only one of many determinants of FDI decision-making, and their importance is contingent on other variables. IIAs cannot substitute for sound domestic policies and regulatory and institutional frameworks. IIAs alone cannot turn a weak domestic investment climate into a strong one, like other treaties, they cannot guarantee market outcomes in the form of inflows of foreign investment (UNCTAD, 2014a).

Yet, IIAs have underused potential as an instrument for sustainable development objectives. First, they can do more to promote and facilitate investment and channel it to sustainable development. Today, increasing the quantity of investment is not enough. What matters is its quality, i.e. the extent to which investment delivers concrete sustainable development benefits. In light of the financing gap for meeting the Sustainable Development Goals (SDGs) (developing countries face an annual gap of \$2.5 trillion), investment needs to be channelled to specific SDG sectors (*WIR14*).

Second, IIAs can do more to enhance responsible investment. Although (foreign) investment can create positive conditions for improving peoples' lives, it can also carry the risk of negatively impacting on the environment, peoples' health and the enjoyment of their human rights. These effects can be aggravated due to domestic regulatory lacunae. It is important, therefore, that while IIAs continue to provide a firm basis for investment protection, they should also begin to address more directly investor responsibilities.

**Lesson 3: IIAs have wider implications for policy and systemic coherence, and capacity-building**

IIA negotiations are not only about investment policies per se, but also have implications for numerous other policy areas at all levels of policymaking within countries (national, subnational, municipal). Given their broad scope of application and the wide range of foreign investment operations, IIA disciplines interact with policies on trade, labour and social issues, taxation, intellectual property, land rights, sector-specific policies, national security issues, cultural policies, health and environmental protection, and many others. The far-reaching scope of these agreements and the obligations they create calls for broad internal policy coordination – both at and within the national and subnational levels – when developing a country's IIA negotiation strategy and in the negotiation process itself. Care needs to be taken to ensure coherence between IIA obligations and domestic policies, and to achieve consistency between IIAs and other international obligations of the IIA contracting parties.

Ensuring this degree of coordination can be a daunting challenge. The complexity of IIA negotiations and their likely impact on domestic policies calls for more capacity-building in developing countries, in particular least developed countries (LDCs). Without an in-depth knowledge of international investment law and pertinent arbitral decisions, countries risk concluding IIAs that do not properly reflect their interests and objectives. Moreover, without such coordination, countries risk entering into commitments that they cannot implement at either the national or subnational levels or that inadvertently (and unnecessarily) limit the pursuit of government policies. In addition, lack of capacity and negotiation skills also negatively affect countries' bargaining power.



## B. STRATEGIC APPROACH AND POLICY OPTIONS

### 1. Reform needs and objectives

*IIA reform responds to a new context for investment policymaking and should address five main challenges.*

As recognized in UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD) (*WIR12*), the reorientation in IIA rule making responds to a new context for investment policymaking, nationally and internationally.

#### **A new sustainable development paradigm**

The conservation of natural resources, environmental protection and social well-being did not feature prominently on the international policy agenda some 50 years ago. Today, however, these objectives have become universally recognized guiding principles for all policymaking in developed and developing countries, including in investment policymaking (Hindelang et al., 2015). Accordingly, investment policies (and IIAs) can no longer be designed in isolation, but need to be harmonized with, and made conducive to, the broader goal of sustainable development. This is even more so, given the importance of international investment for achieving the SDGs as part of the post-2015 development agenda, and for living up to the commitments of the forthcoming third "Financing for Development" Conference in Addis Ababa.

As the global community's views on development have evolved, societies' expectations about the role of foreign investment have become more demanding. Today, it is no longer enough that investment creates jobs, contributes to economic growth or generates foreign exchange. Countries increasingly look for investment that is not harmful for the environment, which brings social benefits, promotes gender equality, and which helps them to move up the global value chain.

Moreover, concerns about the strength and conduct of individual foreign investors have brought foreign investment in general under closer domestic and international scrutiny. Investors are increasingly expected to do more than the minimum required by law. Increasingly, investment behaviour is assessed on whether it complies with international standards, such as the UN Guiding Principles on Business

and Human Rights, the revised OECD Guidelines on Multinational Enterprises, and the FAO/World Bank/UNCTAD/IFID Principles on Responsible Agricultural Investment (PRAI). In addition to standards developed by international organizations, investors are expected to develop their own corporate social responsibility (CSR) codes and to report on the actions they have taken in order to comply with them (*WIR11*).

#### **A new investor landscape**

Developing countries and economies in transition nowadays attract more than half of global FDI flows, and their importance as FDI recipients continues to increase. Emerging economies have not only become important hosts of FDI; they are increasingly large sources of investment themselves, with their share in world outflows exceeding one third. While these countries previously looked at IIAs mainly from a host-country perspective, they now also consider their interests as home countries to investment abroad.

#### **The greater role of governments in the economy**

Following the global financial crisis in 2008, governments have become less reticent about regulating and steering their economies. While private sector capital remains the chief engine of global economic growth and innovation, more and more governments are moving away from the deregulation approach to economic growth and development that has predominated since the 1990s. Industrial policies and industrial development strategies are proliferating in developing and developed countries alike (*WIR11*). These strategies often contain elements of targeted investment promotion or restriction, increasing the importance of integrated and coherent development and investment policies.

Similarly, a stronger role for State regulation manifests itself with regard to sustainable development. As the goals and requirements of sustainable development have come to be widely accepted, new social and environmental regulations are being introduced and existing rules reinforced – all of which have implications for investment policy. The trend for policymakers to intervene more in the economy, and to steer

investment activity, is visible in the overall increasing share of regulatory and restrictive policies in total investment policy measures over the last decade (see chapter III). This trend reflects, in part, a new realism about the economic and social costs of unregulated market forces but it has also given rise to concerns about investment protectionism.

When placing these lessons learned into the new context of today's investment for today's development paradigm, a number of concrete reform needs and objectives emerge.

### **(i) Safeguarding the right to regulate**

While IIAs contribute to a favourable investment climate, they inevitably place limits on contracting parties' sovereignty in domestic policymaking. Given the rising concerns that such limits go too far, especially if combined with effective enforcement, IIA reform needs to ensure that countries retain their right to regulate for pursuing public policy interests, including sustainable development objectives (e.g. for the protection of the environment, the furtherance of public health or other social objectives) (WIR12). Safeguarding the right to regulate may also be needed for implementing economic or financial policies (WIR11). At the same time, however, policymakers must be vigilant that providing the necessary policy space for governments to pursue bona fide public goods does not inadvertently provide legal cover for investment protectionism or unjustified discrimination.

### **(ii) Reforming investment dispute settlement**

Originally modelled on the system of ad hoc confidential commercial arbitration between private parties, today, the ISDS system suffers from a legitimacy crisis. There are concerns that the current mechanism exposes host States to additional legal and financial risks, often unforeseen at point of entering into the IIA and in circumstances beyond clear-cut infringements on private property, without necessarily bringing any benefits in terms of additional FDI flows; that it grants foreign investors more rights as regards dispute settlement than domestic investors; that it can create the risk of a "regulatory chill" on legitimate government policymaking; that it results in inconsistent arbitral awards; and that it is insufficient in terms of ensuring transparency, selecting independent arbitrators, and guaranteeing due process. IIA reform needs to address these concerns.

### **(iii) Promoting and facilitating investment**

As said above, promoting and facilitating investment is crucial for the post-2015 development agenda, with developing countries facing an annual SDG-financing gap of \$2.5 trillion (WIR14). Thus far, however, the majority of existing IIAs do not include efficient investment promotion and facilitation provisions, and reserve this issue for domestic policymaking. A third reform objective, therefore, is to expand the investment promotion and facilitation dimension of IIAs together with domestic policy tools, and to target them towards foreign investment capable of promoting sustainable development.

### **(iv) Ensuring responsible investment**

Foreign investment can make positive contributions for development, but it can also negatively impact the environment, health, labour rights, human rights or other public interests (WIR14). Typically, IIAs set out few, if any, responsibilities on the part of investors in return for the protection that they receive. One objective of IIA reform therefore is ensuring responsible investor behaviour. This includes two dimensions: maximizing the positive contribution that investors can bring to societies ("doing good") and avoiding negative impacts ("doing no harm").

### **(v) Enhancing systemic consistency**

In the absence of multilateral rules for investment, the atomised, multifaceted and multilayered nature of the IIA regime gives rise to gaps, overlaps and inconsistencies, between IIAs, between IIAs and other international law instruments, and between IIAs and domestic policies. IIA reform therefore should seek coherence in these various relationships.

## **2. Designing a future IIA regime**

*IIA reform needs to be guided by design criteria and strategic choices that will inform the areas, tools and best possible policy options for implementing reform.*

When designing a future IIA regime that meets the above-mentioned five reform challenges, countries can be guided by a number of design criteria for investment policymaking. They also need to make a number of strategic choices, with a view to identifying reform areas, reform tools and best possible policy options for implementing reform.

**Table IV.1. Core Principles for investment policymaking for sustainable development**

Area	Core Principles
<b>1. Investment for sustainable development</b>	<ul style="list-style-type: none"> <li>The overarching objective of investment policymaking is to promote investment for inclusive growth and sustainable development.</li> </ul>
<b>2. Policy coherence</b>	<ul style="list-style-type: none"> <li>Investment policies should be grounded in a country's overall development strategy. All policies that impact on investment should be coherent and synergetic at both the national and international levels.</li> </ul>
<b>3. Public governance and institutions</b>	<ul style="list-style-type: none"> <li>Investment policies should be developed involving all stakeholders and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensures predictable, efficient and transparent procedures for investors.</li> </ul>
<b>4. Dynamic policymaking</b>	<ul style="list-style-type: none"> <li>Investment policies should be regularly reviewed for effectiveness and relevance and adapted to changing development dynamics.</li> </ul>
<b>5. Balanced rights and obligations</b>	<ul style="list-style-type: none"> <li>Investment policies should be balanced in setting out rights and obligations of States and investors in the interest of development for all.</li> </ul>
<b>6. Right to regulate</b>	<ul style="list-style-type: none"> <li>Each country has the sovereign right to establish entry and operational conditions for foreign investment, subject to international commitments, in the interest of the public good and to minimize potential negative effects.</li> </ul>
<b>7. Openness to investment</b>	<ul style="list-style-type: none"> <li>In line with each country's development strategy, investment policy should establish open, stable and predictable entry conditions for investment.</li> </ul>
<b>8. Investment protection and treatment</b>	<ul style="list-style-type: none"> <li>Investment policies should provide adequate protection to established investors. The treatment of established investors should be non-discriminatory in nature.</li> </ul>
<b>9. Investment promotion and facilitation</b>	<ul style="list-style-type: none"> <li>Policies for investment promotion and facilitation should be aligned with sustainable development goals and designed to minimize the risk of harmful competition for investment.</li> </ul>
<b>10. Corporate governance and responsibility</b>	<ul style="list-style-type: none"> <li>Investment policies should promote and facilitate the adoption of and compliance with best international practices of corporate social responsibility and good corporate governance.</li> </ul>
<b>11. International cooperation</b>	<ul style="list-style-type: none"> <li>The international community should cooperate to address shared investment-for-development policy challenges, particularly in least developed countries. Collective efforts should also be made to avoid investment protectionism.</li> </ul>

Source: UNCTAD.

### a. Design criteria and strategic choices

UNCTAD's Investment Policy Framework sets out 11 Core Principles for investment policymaking, which aim to guide policymaking at both the national and international levels. To this end, they translate the challenges of investment policymaking into a set of "design criteria" for investment policies (table IV.1). As such, the Framework's principles are also a useful guide for IIA reform.

Before embarking on IIA reform, countries need to make a number of strategic choices:

#### (1) Whether or not to have IIAs

The first strategic choice is about whether "to have or not to have" an IIA. This requires a careful assessment of the pros and cons of such agreements (summarized in table IV.2). Countries may come to different conclusions, depending on their individual development strategies, their domestic investment policies, their role

as a home or host country of investment, their prior experience with IIAs/ISDS and the way they conduct their international investment relations.

#### (2) Whether to disengage from IIAs

Since most countries are – to various degrees – already members of the global IIA regime, the question of having or not having IIAs is not only about concluding new treaties, but also about whether to maintain or terminate existing agreements. For some States, disengaging from existing IIAs may be appealing where IIA-related concerns feature particularly high in the domestic policy debate and where policymakers no longer consider IIAs to be an important element of their investment promotion strategies, both inward and outward. Also, this option becomes more and more available since many BITs have reached an "age" where contracting parties have the right to denounce them.

Countries considering this path need to keep in mind that treaty termination through denunciation is

**Table IV.2. Summary of arguments put forward in favour and against IIAs**

Main arguments made in favour of IIAs	Main arguments made against IIAs
<p>IIAs:</p> <ul style="list-style-type: none"> <li>• Contribute to a favourable investment climate.</li> <li>• Contribute to fostering and expanding economic and political cooperation between contracting parties.</li> <li>• Contribute to the stability and predictability of the policy framework, foster good governance and the rule of law.</li> <li>• Provide protection rights that are independent from host countries' domestic legislation (superiority of international law over national law).</li> <li>• Compared with customary international law, improve legal certainty as protection rights are specified by treaty.</li> <li>• Reduce political risks of investing abroad.</li> <li>• May facilitate the granting of investment guarantees by the home country.</li> <li>• Help to avoid politicization of investment disputes.</li> </ul>	<p>IIAs:</p> <ul style="list-style-type: none"> <li>• Do not guarantee additional investment inflows.</li> <li>• May negatively affect host countries' sovereign right to regulate in the public interest.</li> <li>• Expose host States to ISDS and associated financial risks.</li> <li>• Privilege foreign investors over domestic investors.</li> <li>• Only provide for investor rights, not obligations.</li> <li>• Reflect a negotiated outcome that is influenced by the bargaining power of the negotiating parties.</li> <li>• May result in overlapping and inconsistent IIA obligations of contracting parties.</li> <li>• Are difficult to amend in case of changing circumstances.</li> </ul>

Source: UNCTAD.

not permitted before the IIA has reached a certain "age", set by the duration provision of the treaty. In addition, denunciation does not immediately liberate contracting parties from their treaty obligations, since IIAs usually contain a "survival clause", protecting existing investment in the host country for a certain additional period, typically between 10 and 20 years. Finally, treaty denunciation done without consulting the other contracting party risks negatively affecting foreign relations.

### (3) Whether to engage in IIA reform

The next strategic choice is whether or not to engage in IIA reform. Refraining from substantive changes to international investment policymaking sends an image of continuity and investor friendliness. It may be particularly attractive for countries with a strong outward investment perspective and with no – or little – ISDS experiences. Not engaging in reform, however, comes with serious drawbacks in that it does not address any of the challenges arising from today's global IIA regime and keeps the country exposed to risks created by IIAs in their traditional form. Moreover, mounting pressure for reform from existing treaty partners and other constituencies in many countries will make it increasingly difficult to maintain the status quo.

### (4) How to reform IIAs

Should a country decide to embark on IIA reform, further strategic considerations come into play, relating to both substantive and procedural aspects.

### What extent and depth should the reform agenda have?

Pursuing IIA reform requires decisions on the sequencing of individual reform steps. Gradual, incremental reform steps may be easier to realize than a holistic approach. It may be advantageous to prioritize those areas for reform (e.g. certain IIA clauses or ISDS reform elements) where consensus among the respective actors is most likely to emerge.

Limited, i.e. selective, adjustments that address specific concerns may be particularly attractive for those countries that wish to respond to the challenges posed by IIAs but, at the same time, wish to demonstrate their continued engagement with the investment regime. Selective modifications, while leaving the treaty core untouched, permit countries to address both changes which seem most readily achievable (i.e. "low-hanging fruit") and addressing concerns that appear most relevant and pressing. It also allows the tailoring of the modification to a particular negotiating counterpart so as to suit a particular economic relationship. Indeed, introducing selective adjustments may appear as an appealing option for reducing the mounting pressure on IIAs.

At the same time, however, selective adjustments cannot comprehensively address the challenges posed by the existing stock of treaties. It cannot fully deal with the interaction of treaties with each other, unless the selective adjustments address the most-favoured-nation (MFN) clause. Without addressing MFN application, selective adjustments may lead to

“treaty shopping” and “cherry-picking” and thereby undermine improved formulations of treaty provisions. And, throughout all of this, selective adjustments may lay the groundwork for further change, thus creating uncertainty instead of stability.

By contrast, pursuing systematic and comprehensive reform means overhauling international commitments in a way that ensures the promotion of sustainable development. It implies addressing the key challenges to the IIA regime in all dimensions, with regard to substantive and procedural issues, treaty network issues and ISDS, as well as resolving incoherence, filling systemic gaps, and eliminating loopholes. Taking reform steps in respect of all five reform objectives and addressing future and existing treaties is the most comprehensive approach to reforming the current IIA regime.

Systematic and comprehensive reform presents a number of challenges. It may be time- and resource-intensive. Its result may be perceived as reducing the protective value of the agreements and offering a less attractive investment climate. It requires dealing with the stock of existing IIAs. And amendments or renegotiation may require the cooperation of a potentially large number of treaty counterparts. At the same time, however, this course of action is the only one that can bring about comprehensive and coherent IIA reform. It is also the one best suited for fostering a common response from the international community to today’s shared challenge of promoting investment for the SDGs.

**How to balance investment protection and the need to safeguard the right to regulate?**

IIA reform steps can be moderate or far-reaching. Care needs to be taken that individual reform steps or the cumulative effects of a whole reform package do not deprive the IIA of its investment protection function, but rather achieve a balance between the foreign investors’ adequate protection and the host countries’ need to preserve sufficient regulatory space. How to strike this balance is a strategic choice and depends on individual country preferences and policies.

In addition, there is a risk that individual reform steps only create an illusion of retaining regulatory space (e.g. emphasising the right to regulate while noting that any measure must be otherwise consistent with the IIA). Accordingly, the pursuit of comprehensive reform requires a careful choice of options, bearing in mind the interaction between them.

**How to reflect home and host countries’ strategic interests?**

The strategic position of countries towards IIA reform will depend on whether they approach reform from the perspective of a host or also as a home country of foreign investment. While as host countries, they may wish to focus on ensuring regulatory space and reducing exposure to ISDS, as home countries they will be interested in providing adequate protection for their own investors abroad. They may also be interested in establishing entry rights for foreign investors in IIAs. As more and more countries become both host and home bases of foreign investment, they need to reconcile these strategic interests in the IIA reform debate.

**How to synchronize IIA reform with domestic investment policies?**

IIA reform needs to take into account the interaction and “division of labour” between IIAs and domestic investment policies (noting a key difference between the two, namely that domestic law can be unilaterally amended, while this is not possible for IIAs). One strategic choice therefore is how much protection to grant under domestic law and how much under IIAs. Similar considerations apply with regard to the issue of whether to reform at the domestic or the international level, or both. In an optimal architecture, both policy levels will complement each other (e.g. with regard to investment protection, promotion and investor responsibility). In other areas (in particular dispute settlement), decisions may need to be made about whether domestic and international dispute settlement procedures should be complementary or mutually exclusive.

**Whether to consolidate the IIA network instead of continuing fragmentation?**

As countries reform and replace individual IIAs, there will be more cases where “old” and “new” IIAs coexist. IIA reform therefore risks bringing about – at least initially – a further fragmentation of the IIA regime. At the same time, IIA reform offers an opportunity for consolidating the IIA network, provided that a sufficient number of countries participate in the process. Regional IIA reform efforts – both at the intraregional and at the interregional level – offer particular opportunities for treaty consolidation. Such regional IIAs can replace existing BITs between the participating States, unless the latter wish that the “old” agreements continue to exist. Allowing old bilateral agreements to coexist with new regional agreements heightens the risk of

fragmentation and systemic incoherence and this may be further exacerbated where MFN clauses remain unreformed.

Overall, the response to these strategic considerations will depend on country-specific circumstances and preferences. Relevant factors include the kind of treaties that make up a country's IIA network, its individual experience with ISDS, the role it allocates to IIAs as part of its overall development strategy and the extent of IIA reform desired, including by its domestic stakeholders.

### b. Reform areas

The starting point for IIA reform is the lessons learned from the past, which translate into the five reform objectives identified above. These reform objectives can be pursued by addressing a number of “reform areas”, which largely correspond to key IIA clauses. For each of these, there are a number of sustainable-development-oriented policy options. Together, the reform objectives, the corresponding reform areas and the policy options for pursuing them offer an action menu for IIA reform.

#### Approach to designing reform elements

By and large, the policy options address the standard elements included in an IIA. The options discussed below include both mainstream IIA provisions (e.g. clarification of indirect expropriation) as well as more idiosyncratic options that have so far been used by fewer countries or that are found only in model agreements or policy statements and concept notes (e.g. an international investment court). Many of the options had already been set out in UNCTAD's Investment Policy Framework in 2012.

Another possibility would be to develop new approaches to international investment law and policymaking from “scratch”. Such an exercise could be based on a review of existing standards of protection (and respective gaps) in domestic laws and policies, and analysis of their pros and cons and suitability for use at the international level. Similarly, new IIA elements could be designed based on inputs from outward investors regarding the type of protections and support initiatives they would consider beneficial for them. Such an approach was partly undertaken by

Brazil, when devising its Cooperation and Facilitation Investment Agreements (CFIAs) (chapter III).

#### Approach to choosing a combination of reform elements

Today's efforts towards comprehensive IIA reform face the specific challenge of properly harnessing IIAs, including their investment protection elements, for promoting sustainable and inclusive development. Finding the right balance between investor protection, on the one hand, and safeguarding the right to regulate, on the other, is of particular importance. Some combinations of policy options may result in a treaty that is largely deprived of its basic investment protection *raison d'être*, wherein the cumulative compound effect of all modifications renders the treaty's commitments meaningless. Ultimately, it is the blend of policy options that determine where on this spectrum a particular IIA is located. Accordingly, the pursuit of comprehensive reform requires a careful choice of options, bearing in mind the interactions between them.

This need for balance is already reflected in the UNCTAD Policy Framework's principles, which include the principles of openness to investment, investment protection and treatment, as well as principles such as the right to regulate and balanced rights and obligations.

There are many ways to pursue the five reform objectives identified. Table IV.3 offers a menu for doing so. Countries can use this menu with a view to identifying the most suitable combination of reform objectives and reform areas for them.

### c. Reform tools

When pursuing IIA reform and designing new-generation agreements, countries have a number of reform tools at hand. Table IV.4 provides an overview of these tools and the various entry points to which they can be applied. These tools can be grouped into eight partially overlapping categories of actions. Several tools can be used jointly with respect to one particular IIA entry point or clause.

- **Adding new provisions.** The impact of this tool on the pursuit of reform objectives varies, depending on the content of the new provision. For example, adding a clause can help safeguard the right to regulate (e.g. if it is a “safety valve” such as a general or national security exception).

Table IV.3. Objectives and areas for IIA reform

Reform objectives	Reform areas
<b>1. Safeguarding the right to regulate</b>	<p>Circumscribed (clearly defined) IIA standards of protection</p> <ul style="list-style-type: none"> <li>• Fair and equitable treatment</li> <li>• Indirect expropriation</li> <li>• MFN</li> </ul> <p>“Safety valves”; e.g. exceptions for</p> <ul style="list-style-type: none"> <li>• Public policies</li> <li>• National security</li> <li>• Balance-of-payments crises</li> </ul>
<b>2. Reforming investment dispute settlement</b>	<p>Clauses that</p> <ul style="list-style-type: none"> <li>• Fix the existing ISDS mechanism by improving transparency, limiting investors’ access, enhancing the contracting parties’ control and introducing local litigation requirements</li> <li>• Add new elements to the existing ISDS mechanism (e.g. building in effective alternative methods of dispute resolution, introducing an appeals facility)</li> <li>• Replace the existing ISDS mechanism (e.g. by creating a standing international investment court, reliance on State-State dispute settlement and/or reliance on domestic dispute resolution)</li> </ul>
<b>3. Promoting and facilitating investment</b>	<p>Clauses that</p> <ul style="list-style-type: none"> <li>• Strengthen promotion measures (inward and outward)</li> <li>• Target promotion measures to sustainable development</li> <li>• Foster cooperation in this regard</li> </ul>
<b>4. Ensuring responsible investment</b>	<p>Clauses that</p> <ul style="list-style-type: none"> <li>• Prevent the lowering of environmental or social standards</li> <li>• Ensure compliance with domestic laws</li> <li>• Strengthen corporate social responsibility (CSR) and foster cooperation in this regard</li> </ul>
<b>5. Enhancing systemic consistency</b>	<p>Clauses and mechanisms that manage interaction between</p> <ul style="list-style-type: none"> <li>• IIAs and other bodies of international law</li> <li>• IIAs and domestic investment and other policies</li> <li>• Different IIAs within a country’s network</li> </ul>

Source: UNCTAD.

Adding a clause can promote responsible investor behaviour (e.g. if it is a not lowering of standards or CSR clause) or foster investment promotion (e.g. if the addition relates to home-country measures or a joint committee charged with pursuing promotion-related activities).

- **Omitting existing provisions.** Again, the impact of this tool depends on the content of the respective clause. For example, refraining from including certain types of clauses that have proven controversial or that are susceptible to receiving contradictory interpretations by arbitral tribunals can increase legal certainty (e.g. omitting the umbrella clause), help safeguard the right to regulate and improve investment dispute settlement.
- **Reformulating existing provisions.** Reformulations usually clarify or circumscribe the scope of provisions. *Clarifying* clauses supports both investors and host countries, as ultimately both benefit from enhanced legal clarity and predictability.
- **Carving out aspects.** Carve-outs can circumscribe the treaty’s scope of application (e.g. limiting the scope of protected investments) or the reach of specific clauses (e.g. limiting the situations to which ISDS applies). Carve-outs can also relate to specific sectors, industries or policies. Generally, carve-outs can help safeguard the right to regulate.
- **Linking provisions.** Linking provisions usually results in a situation where protections offered are conditioned on certain circumstances. An example would be to make IIA protections or ISDS subject to investor compliance with domestic laws or to require tribunals to take into account States’ different level of development when interpreting protection standards (e.g. fair and equitable treatment). Conditioning protections usually weakens the protective dimension of an IIA. At the same time, linking can also strengthen the treaty’s impact in inducing responsible investor behaviour.

Table IV.4. Reform tools	
Reform tools	Examples
<b>1. Adding new provisions</b>	<ul style="list-style-type: none"> <li>Public policy exceptions</li> <li>Clause on compliance with domestic laws</li> <li>Clause on not lowering of standards</li> <li>Clause on CSR</li> </ul>
<b>2. Eliminating (omitting) existing provisions</b>	<ul style="list-style-type: none"> <li>FET, MFN, umbrella clause, ISDS</li> </ul>
<b>3. Reformulating existing provisions</b>	Clarifying the content of <ul style="list-style-type: none"> <li>FET</li> <li>Indirect expropriation</li> </ul>
<b>4. Carving-out aspects</b>	Circumscribing (in IIA clauses or reservations) the <ul style="list-style-type: none"> <li>Scope of the treaty</li> <li>Scope of protected investments/investors</li> <li>Scope of application of key clauses (e.g. MFN, national treatment)</li> <li>Scope of access to ISDS</li> </ul>
<b>5. Linking provisions</b>	Conditioning protections on <ul style="list-style-type: none"> <li>Investor behaviour</li> </ul>
<b>6. Calibrating the normative intensity of provisions</b>	<ul style="list-style-type: none"> <li>Hortatory language</li> <li>Transition phases/phase-ins</li> <li>Differentiated obligations</li> </ul>
<b>7. Creating/strengthening institutional mechanisms</b>	Within the IIA, a joint committee, council or working group, coordinating and facilitating dialogue and cooperation on <ul style="list-style-type: none"> <li>Investment promotion, the prevention of disputes, the interpretation of provisions, the review of the agreement</li> </ul> Beyond the IIA, <ul style="list-style-type: none"> <li>An appeals facility, an international investment court</li> </ul>
<b>8. Referring to other bodies of law</b>	Managing the interaction between IIAs and other bodies of law with a view to avoiding inconsistencies and seeking synergies, e.g. <ul style="list-style-type: none"> <li>Preamble</li> <li>References to CSR instruments</li> <li>Reaffirmations of contracting parties' commitments under other international law instruments</li> <li>References to the Vienna Convention on the Law of Treaties</li> <li>ISDS rules</li> </ul>

Source: UNCTAD.

- Calibrating provisions.** Calibrating provisions implies managing the normative intensity of provisions. Examples include the use of hortatory language (e.g. for CSR issues), the establishment of differentiated responsibilities (e.g. less stringent obligations for the less developed treaty partner) or the delayed implementation of treaty obligations (e.g. phase-in periods for the less developed treaty partner). The former (e.g. hortatory language for CSR) have typically been used for strengthening the sustainability/responsibility dimension of IIAs; the latter (phase-ins) have traditionally been used in the context of special and differential treatment. It has to be noted, though, that such treatment, while being a regular feature in the WTO legal system, is not yet integrated in international investment law.
- Creating mechanisms.** This can include changes to existing committees or councils, or the creation of new mechanisms (e.g. an appeals facility, an international investment court). Given that most first-generation BITs do not have institutional structures or follow-up mechanisms, this tool will usually imply the addition of new provisions or elements, and so it is likely to overlap with the first tool. In terms of impact on reform objectives, this tool can address ISDS-related challenges (e.g. when creating an appeals facility or an international investment court), strengthen the promotion dimension of the IIA (e.g. when establishing a body charged with cooperating on promotion-related issues), increase the IIA's impact on inducing responsible investor behaviour



(e.g. when establishing a mechanism charged with reviewing CSR-related issues) and strengthen the role of countries as masters of their treaties (e.g. when establishing a body charged with reviewing the IIA or with submitting interpretative guidance to arbitral tribunals).

- **Referring to other bodies of law.** This can include references to other bodies of law, with a view to fostering coherence between IIAs and such other bodies of law (e.g. human rights, environment, public health); to CSR rules, as part of an effort to foster responsible investor behaviour; to the Vienna Convention on the Law of Treaties, with a view to ensuring consistent interpretation (in case of conflict); or to international conventions or rules regarding investment dispute settlement.

The tools discussed above not only differ in their nature and impact, but also in the ease with which they can be used. *Additions*, particularly when they concern “enforceable” provisions, can raise questions about their potential implications and their unanticipated side effects. When additions also include new concepts, such as investor obligations, they can give rise to the argument that such novel concepts do not belong in an IIA (particularly, when the IIA is considered as an agreement aimed in essence at protecting investors). *Omissions*, particularly when they concern key protection standards, may raise concerns that they weaken the IIA and its potential investment-promotion effect.

*Additions* and *omissions* are the tools that go furthest in terms of departing from the model of a “typical IIA”. They come closest to an approach of conceptualizing IIA reform, as overhauling instead of improving the current system. All of these considerations will impact policymakers’ selection of elements for their country’s individual road map for IIA reform.

### 3. Policy options for reform

*UNCTAD presents policy options for meeting the five IIA reform challenges.*

This section offers numerous policy options for the key IIA clauses and entry points. It discusses how the options contribute to reaching the reform objectives outlined above and their respective pros and cons. The discussion of reform options in this section is further supported by tables (available online, at [http://](http://investmentpolicyhub.org)

[investmentpolicyhub.org](http://investmentpolicyhub.org)) listing the particular reform option, offering selected treaty examples and providing information on the prevalence of the reform option in current State practice. Actual drafting language, as found in actual treaties, can be found in the APEC-UNCTAD Handbook for IIA Negotiators (APEC and UNCTAD, 2012).

To a large extent, the reform options reflect the respective policy options for IIAs contained in UNCTAD’s Investment Policy Framework (IPFSD). This Report takes a different approach and includes only those options that contribute to IIA reform by addressing the above-mentioned five challenges. It focuses on the most pressing issues (e.g. MFN, FET, indirect expropriation, ISDS) in more detail.

Some of the options for individual IIA clauses are alternatives, others can be used together.

#### a. Safeguarding the right to regulate

*Options include clarifying or circumscribing provisions such as most-favoured-nation (MFN) treatment, fair and equitable treatment (FET) and indirect expropriation, as well as including exceptions, e.g. for public policies or national security.*

The right to regulate in the public interest is addressed in IIAs mainly through provisions related to the standard of treatment that the treaty affords to foreign investors. Among the provisions particularly implicated in delineating the balance between investment protection and the right to regulation in the public interest are MFN clauses, the FET standard, expropriation provisions, and provisions on safeguards and exceptions, which may be either built into particular substantive standards of protection or drafted as generally applicable clauses. These issues are at the heart of the IIA reform debate and will be dealt with in detail in this section. Other IIA provisions (ranging from the preamble, to the scope and definition clauses, national treatment, the umbrella clause, and provisions related to remedies and compensation) also have a bearing on the right to regulate; they are equally important for States to consider, but they figure less prominently in the reform discussion. They are therefore covered in a more abbreviated manner in the second part of this section. A number of other IIA provisions that can have an impact on the right to regulate (e.g. performance requirements or pre-establishment treatment) are not covered in this report.

### Standards of treatment

#### • MFN

The MFN clause is a crucial provision for IIA reform. Failure to take appropriate action with respect to the MFN clause can undermine improved formulations of treaty provisions.

MFN clauses, routinely included in traditional IIAs, aim to prevent less favourable treatment of investors from the signatory State vis-à-vis comparable investors from any third country (i.e. nationality-based discrimination). The MFN principle thereby aims to ensure a level playing field between investors of different foreign nationalities (UNCTAD, 2010b).

In actual ISDS practice, investors have relatively infrequently alleged that they have been discriminated against by virtue of the host States' more favourable application of domestic measures to investors of third states. Instead, investors have most often invoked the MFN clause to access more "investor-friendly" provisions in IIAs concluded by the host State with third countries.

In particular, investors have relied on the MFN clause to avoid dispute resolution requirements imposed by the applicable IIA (e.g. a set period of time for which they must pursue local remedies before turning to international arbitration). Several tribunals have deemed this circumvention possible in cases involving broadly drafted MFN clauses in which the claimant has been able to point to an IIA signed by the host State in which such pre-arbitration requirements were absent. In other cases, investors have invoked the MFN clause to benefit from higher protection standards

than the ones found in the base treaty ("base treaty" is the treaty pursuant to which the claim is brought). For example, in situations in which an IIA with a third country has contained additional investor protections or more favourable formulations, as compared to the base treaty, a number of tribunals have decided that it is possible for the investor to take advantage of these more favourable provisions to "replace" or "add to" the provisions in the base treaty.

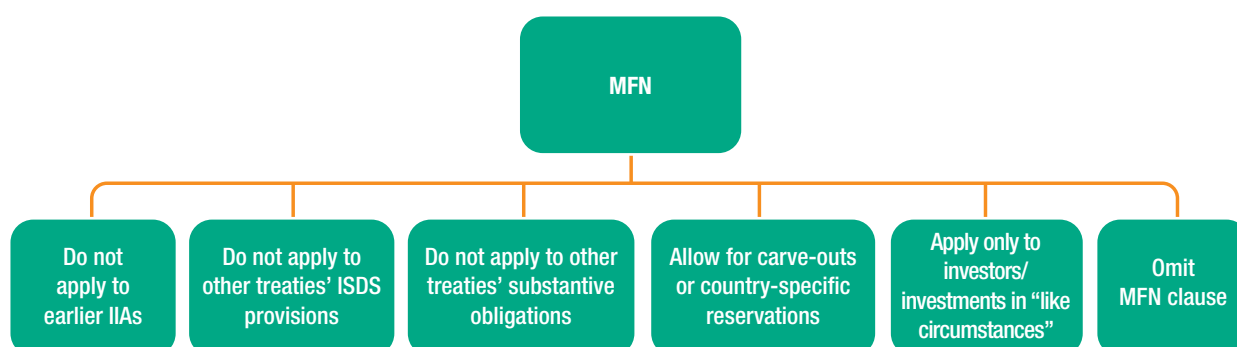
Application of MFN clauses in this way can result in investors "cherry picking" the most advantageous clauses from different treaties concluded by the host State, thereby potentially undermining individual treaty bargains and sidelining the base treaty. For example, treaty commitments may clash, or hard-won concessions in a negotiation (e.g. on flexibility in performance requirements) may be undone through the application of a broadly worded MFN clause, as interpreted by arbitral tribunals. This concern is particularly heightened given countries' current efforts to reform their IIA regimes, which implies a refinement and rebalancing of treaty standards. Clearly, States will need and want to be careful that the desired effects of newly crafted treaty provisions are not obviated by the application of a broadly worded MFN clause.

There are a number of options to address these challenges (figure IV.2).

A first option is to specify that the MFN clause does not allow for the importation of substantive or ISDS-related elements contained in older treaties. This option ensures that a country's IIA reform efforts are not compromised by provisions contained in its stock of older treaties.

Figure IV.2.

#### Options for IIA reform: MFN



Source: UNCTAD.

A second option is to specify that MFN treatment does not apply to ISDS provisions found in other IIAs, existing or future.

A third option is to specify that the MFN clause does not apply to substantive obligations undertaken in (existing or future) IIAs. Similarly, a treaty can clarify that substantive obligations in other IIAs do not in themselves constitute “treatment”, absent measures adopted by a State pursuant to such obligations (e.g. see Canada–EU CETA, draft 2014).

All of these approaches support IIA reform and avoid the undoing of modernization efforts – however they can raise concerns as to the diminution of the protective value of the agreement.

A fourth option is carving out from the MFN obligation certain sectors or industries or certain policy measures through a general carve-out (applicable to both parties) or through country-specific reservations. This option is particularly relevant for IIAs with a pre-establishment dimension.

A fifth option, frequently undertaken in recent agreements, clarifies that the MFN obligation requires comparison of investors/investments that are “in like circumstances”. Such a provision can go some way in safeguarding the right to regulate, but it can also raise questions about the specific criteria for comparison. Some recent treaties and models attempted to set out criteria for determining whether investors/investments are in “like circumstances” (Azerbaijan–Croatia BIT (2007)) (see also national treatment).

A final option, followed by some countries, is to omit the MFN clause altogether. The FTA between the EU and Singapore (2014), the FTA between India and Malaysia (2011), the ASEAN–Australia–New Zealand FTA (2009), the Japan–Singapore FTA (2002) and the SADC Model BIT (2012) are examples in point. Such an approach preserves a maximum of flexibility and can facilitate IIA reform. At the same time, omitting a standard that many consider to be one of the cornerstones of international economic law may raise concerns. In response, some have argued that in an IIA, the investment-enhancing effect of the MFN clause is less important as compared with other clauses and as compared with its presence in other international economic agreements (e.g. preferential trade agreements).

- **FET**

The FET standard is one of the IIA clauses that is at the core of today’s debate on IIA reform. The standard is designed to protect foreign investors from government misconduct not captured by other standards of protection. It is also sometimes said that the FET standard may serve to foster good governance in host States. In actual practice, owing to its open-ended and largely undefined nature, the FET standard, especially as it has been drafted in traditional IIAs, has turned into an all-encompassing provision that investors have used to challenge any type of governmental conduct that they deem unfair. In fact, almost all ISDS cases to date have included an allegation of a FET breach.

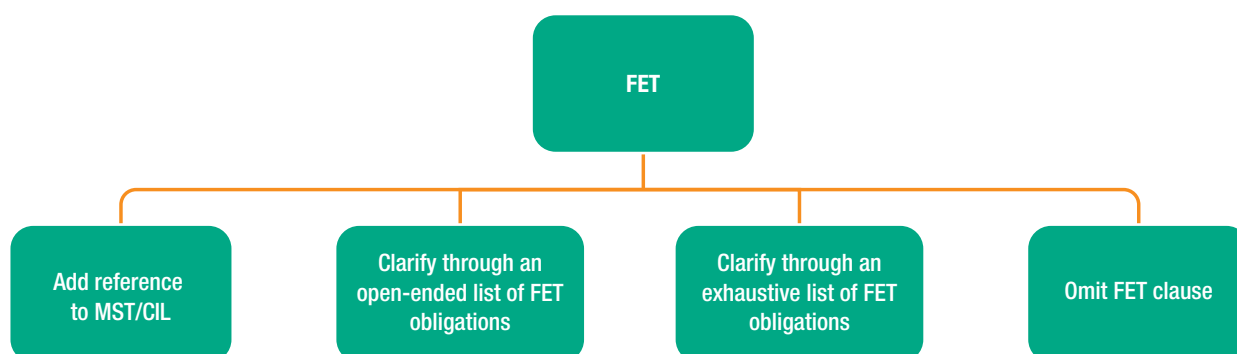
There is a great deal of uncertainty concerning the precise meaning of the concept of FET, because the notions of “fairness” and “equity” do not connote a clear set of legal prescriptions and are open to subjective interpretations. Moreover, the relationship between FET and principles of customary international law, such as the international minimum standard of treatment, has raised significant issues of interpretation, especially where the IIA text contains no express link between FET and customary international law. As a result, the task of determining the meaning of the FET standard has been effectively left to ad hoc arbitral tribunals (UNCTAD, 2012b).

A particularly challenging issue that has arisen through arbitral practice relates to the use of the FET standard to protect investors’ “legitimate expectations”. Given the potentially far-reaching application of the concept of “legitimate expectations”, there is a concern that the FET clause can restrict countries’ ability to change investment-related policies or introduce new policies – including those for the public good – if they have a negative impact on individual foreign investors.

Traditional first-generation IIAs typically included an unqualified FET standard, which has given rise to some of the problems identified above. New-generation IIAs contain a number of more precise drafting options to choose from (see figure IV.3 on the next page).

A first option is to qualify the FET standard by reference to the minimum standard of treatment of aliens under customary international law (MST/CIL). Depending on a particular tribunal’s reading of MST/CIL, this approach may raise the threshold of State liability

Figure IV.3. Options for IIA reform: FET



Source: UNCTAD.

(e.g. the challenged conduct will need to be found to amount to egregious or outrageous mistreatment of foreign investors) and help to preserve States' ability to adapt their policies in light of changing objectives. However, the contours of MST/CIL are far from clear, and a reference to this concept could engender a new, significant uncertainty, for both States and investors. Moreover, in light of the arguments about the nature and development of CIL, not all countries may feel comfortable in referring to this concept.

A second option is to clarify the FET standard with an open-ended list of State obligations. The formulation may be "positive", specifying what the standard includes (e.g. the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings), or "negative", explaining what the standard does not include (e.g. establishing that the FET standard does not include a stabilization obligation that would prevent the host State from changing its legislation), or a combination thereof. This option has the advantage of clarifying the meaning of FET by indicating examples of what it covers and what it does not cover. One of its disadvantages is that the open-ended, indicative list of obligations, by its nature, leaves open the potential for expansion of the meaning of FET through subsequent arbitral interpretation.

A third option is to clarify or replace the general FET clause with an exhaustive, i.e. "closed" list of more specific obligations (e.g. a prohibition to deny justice or flagrantly violate due process, engage in manifestly abusive or arbitrary treatment). Although agreeing on such a list may be a challenging endeavour, its

exhaustive nature would help minimize unanticipated and far-reaching interpretations by tribunals. As a further option, the contracting parties may wish to include a requirement for a periodic review of the list or the content of the FET obligation.

A final option that some countries have implemented in some of their IIAs is omitting the FET clause altogether (e.g. Bangladesh–Uzbekistan BIT (2000), Australia–Singapore FTA (2003)) or reducing it to a softer commitment; for example, by referring to FET in the preamble but not in the main treaty text (e.g. Turkey–United Arab Emirates BIT (2005) or Azerbaijan–Estonia BIT (2010)).<sup>4</sup> This approach reduces States' exposure to investor claims, but also reduces the protective value of the agreement.

- **Indirect expropriation**

The expropriation provision is a key IIA element that mitigates an important risk faced by investors. Expropriation clauses do not take away States' right to expropriate property, but make the exercise of this right subject to certain conditions (UNCTAD, 2011a).<sup>5</sup> Expropriation provisions usually cover both "direct" and "indirect" forms of expropriation. "Indirect expropriation" covers acts, or series of acts, whose effects are "tantamount to" or "equivalent to" a direct, formal taking. These are acts that generally involve total or near-total deprivation of an investment or destruction of its value but without a formal transfer of title to the State or outright seizure.

Investors have used provisions on indirect expropriation to challenge general non-discriminatory

regulations that have had a negative effect on their investments (e.g. a ban or the imposition of restrictions on a certain economic activity on environmental or public health grounds). This raises the question of the proper borderline between expropriation (for which compensation must be paid) and legitimate public policymaking (for which no compensation is due).

Historically, IIAs have not contained any criteria for distinguishing between State action amounting to an indirect expropriation and State action of a general regulatory nature for which no compensation is due. More recent IIAs, however, typically set out a number of criteria and a few recent agreements go so far as to omit an explicit reference to indirect expropriation (e.g. Serbia–Morocco BIT (2013)). While the omission of a reference to indirect expropriation may serve to limit (or even eliminate) State exposure to liability for non-direct takings, it may also increase investors’ perception of country risk and susceptibility to opportunistic regulatory behaviour.

There are a number of policy options in this regard (figure IV.4).

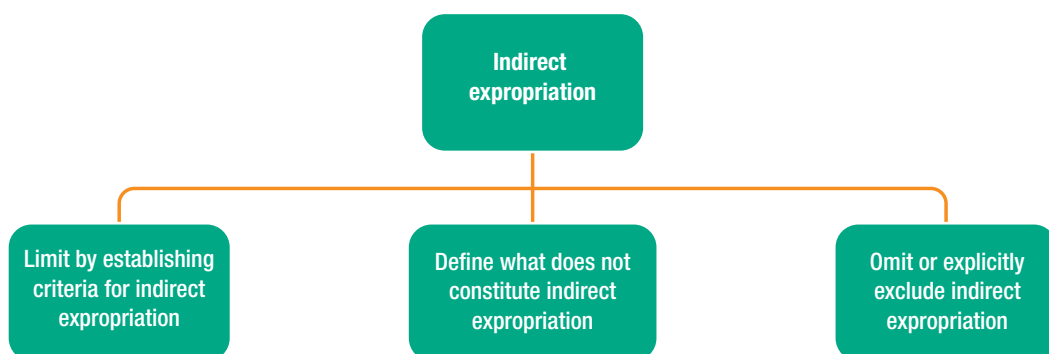
A first option is to limit the protection in case of indirect expropriation by establishing criteria that need to be met in order for an indirect expropriation to be found. This can include reference to (i) the economic impact of the government action; (ii) the extent of government interference with distinct, reasonable investment backed expectations; or (iii) the character of the government action (e.g. whether it is discriminatory or disproportionate to the purpose of the measure under challenge). Another possible criterion is

whether the measure(s) alleged to constitute an expropriation have produced a direct economic benefit for the State.

A second option is to define, in general terms, which measures do not constitute indirect expropriation. For example, it can be specified that “normal regulatory activities” (e.g. non-discriminatory, good faith regulations relating to public policy objectives) do not constitute indirect expropriation. Similarly, it can be clarified that a measure’s adverse effect on the economic value of the investment is not enough to establish an indirect expropriation. A variant of this option is to clarify that certain specific measures (e.g. compulsory licensing in accordance with WTO rules) do not constitute indirect expropriation.

A third option is to omit a reference to indirect expropriation from the IIA or even explicitly exclude it from the treaty coverage. Depending upon drafting, the simple omission of a specific reference to “indirect” expropriation may not eliminate the possibility of liability for indirect expropriations: a bare reference to “expropriation” in an IIA may be interpreted as subsuming both direct and indirect expropriation in subsequent arbitral proceedings. In contrast, expressly excluding indirect expropriation from the coverage of an IIA may be perceived as considerably reducing the protective value of the IIA as it would leave investors unprotected from the types of indirect expropriation that are unrelated to States’ regulatory conduct, such as “creeping” (through a series of damaging measures) or disguised (under a guise of lawful measures, e.g. tax enforcement) expropriation.

**Figure IV.4.** Options for IIA reform: Indirect expropriation



Source: UNCTAD.

All of the above variations give guidance to arbitral tribunals that is presently lacking in most IIAs. None of these options exclude the risk of liability altogether (except perhaps for the express exclusion of protection for indirect expropriations), but rather allow for a better and clearer balancing of investor and State interests. In so doing, these options can help safeguard the right to regulate non-discriminatorily in the general public interest, while simultaneously providing greater legal certainty to investors with respect to the scope of IIA rights. Although explicit exclusion of protection for indirect expropriation is also an option that States can consider, such an option must be viewed as a rarity in contemporary State practice and may be perceived by investors as significantly lowering the protective value of the IIA. From the investors' perspective, such protection is particularly desirable in governance-weak economies where protection from measures of this nature under the domestic laws of the relevant host State may not be seen as reliable. In the absence of IIA protection for indirect expropriation, investors may seek investment insurance from private or public providers.

### Safeguards

For the IIA elements below, the policy options are structured around a number of aspects, each requiring a choice between different options.

- **Public policy exceptions**

Investors may bring claims against public interest measures that have a negative effect on an investment's profitability. Whereas traditional IIAs typically do not contain express public policy exceptions, an increasing number of new treaties do include them. The formulation of such exceptions is often similar to the language found in the WTO's GATT Article XX and GATS Article XIV. These provisions aim at balancing investment protection with other public policy objectives and at reducing States' exposure to investor challenges of such measures. Public policy exceptions can also have an important signalling effect towards the general public, indicating an agreement's compatibility with sustainable development and public policy considerations.

At the same time, the absence of express public policy exceptions does not mean that States cannot take public policy measures at all. Instead, such measures either may not be in conflict with IIA obligations in the

first place or may be justified based on other principles of international law that inform the interpretation of IIA obligations. Nevertheless, including public policy exceptions expressly in an IIA increases legal certainty for host States: public policy exceptions explicitly allow for measures – which might otherwise be challengeable under the agreement – to be taken under specified circumstances. In so doing, they can have an important effect of increasing certainty and predictability about the scope of the IIA's obligations.

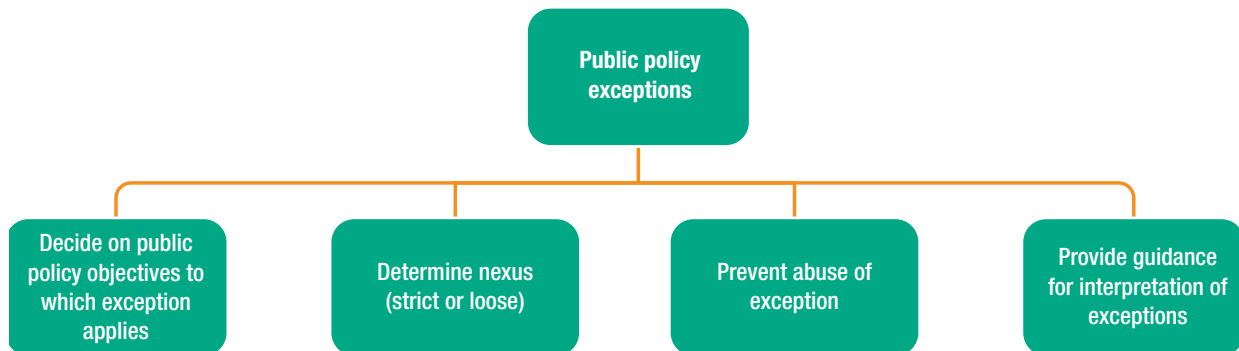
It should be noted that adding exceptions provisions raises questions about their relationship with some traditional investor protections, e.g. the provision on direct expropriation (if a direct expropriation corresponds to one of the objectives included in the exception clause, does this relieve the State of the duty to pay compensation?) or the FET standard (e.g. does the State's creation of protected legitimate expectations foreclose its later reliance on an exceptions clause?). Hence the relationship between an exceptions clause and each IIA obligation needs to be considered carefully. The Energy Charter Treaty's Article 24 on "Exceptions" for example, does not apply to the article on expropriation.

Assuming countries wish to include such exceptions into IIAs, they have a number of options at hand (figure IV.5), all with their pros and cons.

The first set of options relates to the type of situations that are covered. Countries can specifically list the public policy objectives to which they want the exception to apply (e.g. the protection of public health, public order and morals, the preservation of the environment). This list can be inspired from the relevant WTO (GATT and GATS) clauses but can also include other objectives, such as the provision of essential social services (e.g. health, education, water supply); the prevention of tax evasion; the protection of national treasures of artistic, historic or archaeological value (or "cultural heritage"); cultural diversity; and media diversity, or allow for the pursuit of broader objectives, such as the host countries' trade, financial and developmental needs. The exact content of such a list would depend on the negotiating partners' policy preferences.<sup>6</sup>

A second set of options relates to defining the required relationship (i.e. the "nexus") between a measure and the policy objective it pursues. This determines how easy or difficult it is for a State to use an exception. For example, the IIA can provide that the measure

Figure IV.5. Options for IIA reform: Public policy exceptions



Source: UNCTAD.

must be “necessary” to achieve the policy objective (strict test) or that it must simply be “related to” (“aimed at”, “directed to” or “designed to achieve”) the policy objective (less strict test): the stricter the relationship, the stronger the protective character of the agreement.

A third set of options aims at preventing potential abuse of exceptions. For example, an IIA can clarify that “exceptional” measures must be applied in a non-arbitrary manner and not be used as disguised investment protectionism. Again, these options can be inspired by the respective WTO (GATT and GATS) clauses.

A fourth option establishes guidance for tribunals in the interpretation of exceptions clauses. For example, IIAs can establish a mandatory mechanism whereby cases in which a respondent State invokes a public policy exception are referred to a joint committee of the contracting parties. The committee could guide the interpretation or, alternatively, issue a binding determination of whether or not a measure falls within the scope of the public policy exception. This allows States to retain a certain degree of control over the application of an exceptions clause.

- **National security exception**

A number of policy developments raise concerns about the constraints that IIAs potentially impose on host States’ measures that are designed to protect their national security interests.

In traditional IIAs, national security exceptions were included only sporadically. Their inclusion has been much more frequent in recent treaties (UNCTAD,

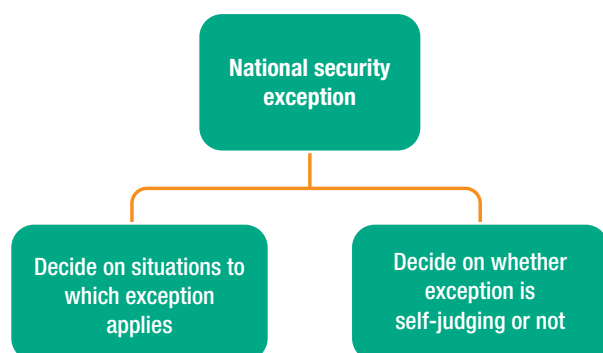
2009). At the domestic level, recent years have witnessed an expansion of the role of domestic screening and monitoring mechanisms for inward FDI (WIR13). In some cases, countries justify the imposition of investment restrictions or regulations on grounds of national security. Internationally, countries have invoked national security arguments in ISDS cases (e.g. in several cases brought against Argentina concerning measures taken to address the country’s economic and financial crisis). National security issues figure prominently in a number of negotiations, particularly those in which pre-establishment commitments are under consideration (e.g. States may wish to retain their right to refuse the admission of foreign investors/ investments where doing so would pose a risk to the State’s security interests).

A national security exception enables a State to introduce emergency measures when its essential security interests are threatened or for the maintenance of international peace and security, even if these measures contradict substantive IIA obligations. Such measures may include the freezing of assets, other types of sanctions, or discriminatory treatment of investors of certain nationalities (or of foreign investors in general). In the pre-establishment context, such measures may include refusal of access to specific projects or transactions in industries considered as strategically important (such as manufacturing of arms, telecommunications, transportation, energy or water supply).

Assuming countries wish to include a national security exception into IIAs, they have a number of options at hand, all with their pros and cons (figure IV.6).

Figure IV.6.

### Options for IIA reform: National security exception



Source: UNCTAD.

The first set of options relates to the types of situations that are covered and the degree of specificity that is applied to this policy choice. Countries can use a broadly formulated national security exception, e.g. for measures necessary for the protection of (or, with a looser nexus requirement, “directed to” or “designed to” protect) the State’s “essential security interests”. A related option is to define national security more specifically, e.g., as including measures taken to address a serious economic crisis situation or to maintain international peace and security.

Countries may take other steps to fine-tune, i.e. circumscribe, the coverage of treaty exceptions; for example, by including a reference to actions taken in pursuance of States’ obligations under the UN Charter or by specifying that the exception covers only certain types of measures such as those relating to trafficking in arms or nuclear non-proliferation, applied in times of war or armed conflict, etc. Finally, a national security exception can also refer to “public order” or to the protection of “public security”, with or without a clarification that this applies only to situations in which a genuine and sufficiently serious threat is posed to one of the fundamental interests of society.

Although national security exceptions are sometimes seen as reducing or limiting the protective strength of a treaty, clarifying and fine-tuning exceptions can help to increase predictability in the application of the clause and the circumscription of its application. A reference to the UN Charter can also help foster coherence between different bodies of law.

A second set of options relates to the standard of review which ISDS tribunals should apply to measures invoked for national security reasons. Here, the important parameter of a national security clause is whether it is formulated as “self-judging”. If this is the case, the appropriateness of the measure in given circumstances is judged only by the invoking State itself (e.g. “measures which it considers to be in its essential security interests”). A “self-judging” exception gives host States a wide margin of discretion in its application and may trigger the perception that the treaty’s protective value is somewhat reduced. It should be noted, however, that depending on the formulation chosen, a tribunal may still be able to review whether the exception is being relied upon in good faith and without manifest abuse.

In addition to these provisions, other IIA clauses have a bearing on safeguarding the right to regulate in the public interest. Although they figure less prominently in the reform discussion, they are equally important for States to consider. These clauses include the preamble, provisions related to other substantive standards of treatment and provisions that delineate the scope and operative definitions of the treaty.

- **Preamble**

The preamble is a clause with a cross-cutting impact. It plays a role in interpreting all other IIA obligations and can help address all of the five reform objectives identified. Thus, by identifying and clarifying the treaty objectives in the preamble, contracting parties provide important guidance for tribunals in investment disputes.

As regards the specification of treaty objectives, contracting parties can clarify that the IIA is not only about investment protection and promotion, but also is intended to serve other public policy interests, such as sustainable development, job creation, technology and know-how transfer. Another option is to state that the treaty is not intended to override national development objectives and that the parties preserve the right to regulate for legitimate policy objectives (e.g. public health, safety, environment, public morals, cultural diversity). The preamble can also clarify that the treaty is meant to be in line with the parties’ other international obligations (e.g. treaties on human rights,



environment, cultural heritage), and that the parties should not derogate from such obligations in order to promote and protect investment.

- **Scope of the treaty**

Typically, IIAs are broadly formulated, covering all sectors of economic activities and all domestic measures that affect foreign investment. Nevertheless, countries may have an interest in carving out specific sectors or policy areas from the treaty scope (UNCTAD, 2010c).

Sensitive industries may include social sectors (e.g. education, health, the provision of water), cultural industries, or defence. Exclusion can be full (from all treaty obligations) or partial (from some obligations only). As regards the carving out of policy areas, a potential candidate is taxation or issues related to the restructuring of sovereign debt (UNCTAD, 2011b). Again, this can be a full or partial exclusion. For example, taxation measures – while often excluded from the treaty scope – are sometimes kept subject to the expropriation and certain other IIA provisions (Japan–Mozambique BIT (2013)). Broad exclusions can help preserve the right to regulate, but they can also raise concerns that the treaty does not offer sufficient protections.

- **Definition of covered investment**

A traditional, open-ended definition of investment grants protection to all types of assets. Although such an approach may be aimed at promoting an investment-attraction effect, it can also cover economic transactions not contemplated by the parties or expose States to unexpected liabilities – hence, the importance of clarifying the scope of covered investments (UNCTAD, 2010c).

One possibility is to require investments to fulfil specific characteristics. Treaty practice has converged on a number of such characteristics, notably, the commitment of capital, the expectation of profit and the assumption of risk. Some IIAs include further criteria, e.g. “a certain duration” (Canada–EU CETA (draft, 2014)) or “establishing lasting economic relations” (Nigeria–Turkey BIT (2011)). A policy debate is under way as to whether an investment’s positive contribution to (sustainable) development should constitute an additional criterion, and what indicators to use in this regard (draft Indian model BIT (2015)). Although some tribunals have looked at the investment’s contribution to “economic development”, such an additional criterion may be difficult to apply

in practice and reduce predictability. The practice of some political risk insurers can, however, offer useful insights in this regard (OPIC, 2012).

IIAs could also compile an exhaustive list of covered investments or expressly exclude specific types of assets. Examples of assets that could be considered for exclusion are short-term, speculative or portfolio investments; sovereign debt obligations; claims to money arising from commercial contracts; or intellectual property rights that are not protected under the host State’s law. There is also the possibility of adopting a narrow, enterprise-based definition of investment (e.g. the draft Indian model BIT (2015)). A final option, complementary to any of the above, is to include a legality requirement; i.e. to specify that investment must be made in accordance with the laws and regulations of the host State.

- **Definition of covered investors**

An IIA’s definition of “investor” determines which investors are protected and able to bring claims against host States. Increasing policy attention has been given to “treaty shopping” (i.e. the channelling of investment through a “mailbox” company established in the territory of a Party in order to obtain treaty protection) and investment “round-tripping” (i.e., when domestic investors expatriate investment capital for reinvestment in their home State through a foreign corporate vehicle in order to take advantage of IIA protections not otherwise available to domestic investors) (UNCTAD, 2010c).

There are several policy options to focus or narrow the range of protected investors. A first option is to include additional criteria in the definition of “investor”. For instance, it could be clarified that the investor (legal entity) must not only be incorporated but also engaged in “real/substantial business activities” in the home country.

A second option is to include a “denial of benefits” (DoB) clause to allow States to deny treaty benefits to “mailbox” companies (which are identified using the criteria of “substantial business activity” and the nationality of the company’s ultimate controller) as well as to investors from countries with no diplomatic relations with the host State and/or investors from countries under economic embargo. When designing a DoB clause, attention needs to be given to the time when the clause can be invoked. Several tribunals have held that the DoB clause may not be invoked against

an investor after it initiates a formal arbitration claim, severely limiting the effective scope of these clauses.

With respect to natural persons, there may be a need to decide whether individuals with dual nationality should be protected under the treaty or not.

- **National treatment**

The national treatment clause protects covered investors against nationality-based discrimination and guarantees them a level playing field with comparable domestic investors. For a number of reasons, countries – in particular developing countries – may have an interest in limiting the scope of the national treatment principle. For example, States may wish to accord more favourable treatment to socially or economically disadvantaged minorities or ethnic groups.

A number of options exist to address these policy challenges. One option, included in a number of IIAs, is to clarify that the principle of non-discrimination applies only to investors “in like circumstances” and to establish criteria for making this assessment (e.g. COMESA Investment Agreement (2007, not in force), draft Indian model BIT (2015)).

A second option is to exclude sensitive policy areas (e.g. support programs for local start-ups or economic support for specific ethnic groups) from the national treatment obligation. A third option, rarely used, would be to make national treatment “subject to domestic laws and regulations”. Finally, some IIAs omit the national treatment clause altogether (e.g. United Arab Emirates–Viet Nam BIT (2003)).

- **Umbrella clause**

An “umbrella” clause, frequently included in traditional IIAs, requires a host State to respect any obligation that it has assumed with regard to a specific investment (e.g. obligations undertaken in an investment contract or concession agreement). The clause thus brings these contractual obligations under the “umbrella” of the IIA, meaning that their breach becomes a violation of the IIA.

Umbrella clauses have proven problematic in application, both with respect to the scope of the obligation undertaken and with respect to the potential for parallel dispute settlement proceedings (e.g. one proceeding to address the breach of contract claim and a parallel proceeding to address the alleged breach of the umbrella clause). Countries wishing to

avoid the potentially far-reaching legal consequences of an umbrella clause can clarify and reduce its scope. For instance, States can clarify that the clause covers only “written obligations” and that the obligations must be “entered into” with respect to specific investments. They can also indicate that the umbrella clause applies only to conduct that constitutes an exercise of sovereign powers by a government, i.e. not an ordinary breach of contract by the State. Another option is to exclude the applicability of the IIA dispute settlement mechanism to claims arising out of the umbrella clause. Finally, an increasing number of treaties omit the umbrella clause (chapter III).

- **Remedies and compensation**

Traditional IIAs do not specify the type of legal remedies a tribunal can order against a State. Furthermore, these IIAs contain no provisions as to the appropriate measure of compensation in the event of a breach of the treaty, with the notable exception of provisions on expropriation which have long included language regarding compensation. Several concerns have emerged in this connection. First, some arbitral tribunals have affirmed their power to grant any remedy they consider appropriate, including non-pecuniary remedies (e.g. an order to a State to revoke, amend or abstain from applying certain legislative, administrative or judicial acts). There are concerns that this type of remedy unduly interferes with States’ sovereignty, especially if ordered by an ad hoc tribunal; others argue that there would be benefits in leaving the State the freedom to choose between pecuniary and non-pecuniary remedies. Second, some arbitral tribunals have granted monetary awards perceived as exorbitant in light of the State’s public finances and compared with what the investor could conceivably obtain under the domestic rules.

There are several policy options – which can be used in a complementary manner – to deal with these concerns.

A first option is to set express limits on the remedial powers of tribunals. The growing trend has been to limit the available remedies to two forms: monetary damages and restitution of property, excluding the order to withdraw or amend a measure.

A second option concerns the standard of compensation for expropriation. The majority of IIAs set out a standard of prompt, adequate and effective compensation (the so-called “Hull formula”), rigidly

connected to the investment's fair market value. This standard may result in high amounts of compensation, especially if the expropriated investment is valued using certain valuation methods such as the discounted cash flow analysis. Countries concerned about this possibility could consider terms such as "appropriate", "fair" or "equitable" compensation and "relax" the link between the standard of compensation and the market value of investment (SADC model BIT (2012), draft Indian model BIT (2015)). Another approach would be to provide that – in case of lawful expropriation – arbitrators should rely on asset-based valuation methods (as opposed to methods based on future cash flows) and that, in any case, the award may not exceed the amount of capital invested plus interest at a commercially reasonable rate.

A third option is to include provisions that address the calculation of damages for treaty breaches that do not involve expropriation, with a view to limiting the extent of States' financial liabilities (BMW, 2015).

- **Exceptions to free transfer of funds obligation**

Most IIAs contain a clause granting investors the right to transfer funds, profits, capital and other payments freely and without delay. In times of economic or financial crises, this guarantee may be in conflict with the regulatory needs of host countries to impose capital controls or to put in place prudential measures aimed at ensuring the integrity and soundness of the financial system. Accordingly, the IMF has issued an official "institutional view" that encourages nations to regulate capital flows under certain circumstances and has begun recommending such measures to member countries (IMF, 2012). The WTO similarly includes safeguards that allow nations to regulate the inflow and outflow of capital. Specifically, the GATS includes a "prudential carve-out" (Article 2, Annex on Financial Services) and a balance-of-payments exception (Article XII).

There are a number of options for addressing these challenges in IIAs. A first, increasingly used option is to include an exception for situations when a country experiences (or there is a threat of) serious balance-of-payments difficulties or other serious financial and economic crises (e.g. serious difficulties for macroeconomic management, in particular, monetary and exchange rate policies). A second option is to provide an exhaustive list of the types of funds that are freely transferable. A third, more general option is to make the free-transfer obligation subject to

investors' compliance with certain key laws that aim at the protection of third parties (e.g. creditors) and prevention of illegal activities. The Austria–Nigeria BIT (2013) and Canada–Colombia FTA (2008) provide examples of this approach.

### **b. Reforming investment dispute settlement**

*Options include reforming the existing mechanism of ad hoc arbitration for ISDS while keeping its basic structure, and replacing existing ISDS arbitration systems.*

Investor-State dispute settlement through international arbitration (ISDS) is at the heart of the IIA reform debate. The increase in the number of ISDS cases (box IV.2) in recent years, together with sometimes expansive, unexpected and inconsistent interpretations of IIA provisions by arbitral tribunals, has resulted in mounting criticism of the existing ISDS system (UNCTAD, 2015, 2014b, 2014c, 2013a). This situation has triggered a worldwide debate about the pros and cons and about whether "to have or not to have" ISDS (table IV.5). Responding to these developments, a number of countries have been reassessing their positions on ISDS and have already adopted certain reform measures.

Two broad alternatives exist: to keep and reform ISDS, as some countries have done (e.g. in the Canada–EU CETA (draft 2014)) or to abandon and/or replace ISDS (table IV.6). Maintaining the status quo is hardly an option, given today's criticism of the existing system.

This section offers a number of concrete policy options in this regard. Countries can pick and choose, and adapt and adopt the various options. They can use them in isolation or in combination, taking a hybrid approach. Whatever option countries prefer, they need to bear in mind three challenges: (i) what is needed is comprehensive reform, applying not only to ISDS but also to the substantive IIA provisions, since these are the root cause of many problems; (ii) reform steps ideally should not only apply to future treaties, but also address the stock of existing IIAs – the IIA "survival clause" poses challenges in this regard; and (iii) IIA reform is not enough – domestic capacity-building is needed for improving developing countries' administrative and judicial capacities, a prerequisite for some of the reform options suggested below.

Building on its past work on ISDS (e.g. the 2012 Policy Framework, *WIR13* and the Pink Series Sequel on ISDS (UNCTAD, 2014b)), UNCTAD identifies three sets

**Box IV.2.****Facts and figures (as of end 2014)****The number of cases and countries involved**

- 608 known treaty-based ISDS cases brought
- 99 governments have been respondents
- 70 per cent of all known cases brought against developing and transition economies
- 80 per cent of all known claims brought by investors from developed countries

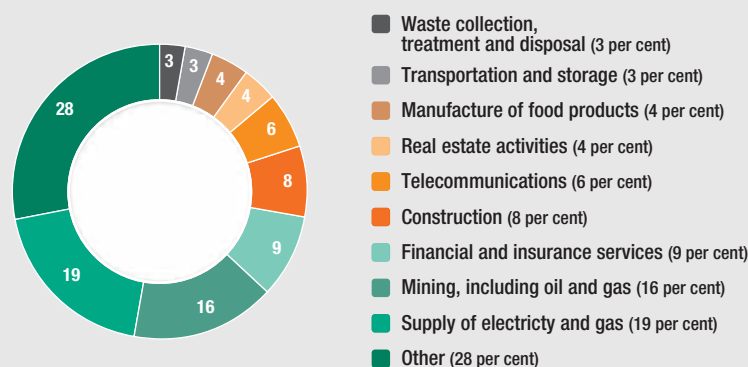
**Results of 405 concluded ISDS cases (see chapter III)**

- 36 per cent in favour of the State
- 27 per cent in favour of the investor
- 26 per cent settled

**Amounts claimed and awarded**

- \$1.1 billion in damages claimed in a case, on average (based on 447 cases for which this information is available)
- 65 known cases with claims exceeding \$1 billion
- 37 cases with claims between \$500 million and \$999 million
- \$575 million in damages awarded, on average (based on 106 cases for which this information is available; amounts do not include interest)
- \$40 billion – largest amount ever awarded by an investment tribunal (UNCTAD, 2015)

**Figure box IV.2. | ISDS cases by economic sector**  
(Per cent)

**State conduct most commonly challenged by investors**

(preliminary data based on cases where information is available)

- Cancellations or breaches of investment contracts (29 per cent of cases)
- Legislative changes (25 per cent)
- Direct expropriation or seizure of investment (15 per cent)
- Tax-related measures (11 per cent)
- Refusal to grant or revocation of licenses (8 per cent)
- Abusive treatment or failure to protect investment (7 per cent)

Other challenged measures relate to judicial acts or omissions, withdrawal of incentives, freezing of bank accounts, sovereign debt restructuring, damage from armed conflict, interference with management of an investment, and measures to combat the 2001 financial crisis in Argentina.

**The FDI background to ISDS (economic context)**

- \$27 trillion in global FDI stock
- 100,000 multinational companies
- 890,000 foreign affiliates worldwide

Source: UNCTAD.

of options for improving investment dispute settlement (table IV.6), along the two prongs of actions: reforming the existing ISDS system or replacing it. Some of these reform options can be combined and tailored to meet several reform objectives.

**Fixing the existing ISDS mechanisms**

This set of reform options aims at reforming existing ISDS mechanisms *while keeping their basic structure*, namely that investors can bring claims against host States to ad hoc arbitral tribunals. Reform elements could be the inclusion in IIAs of new provisions

designed to (1) improve the arbitral process; (2) refine investors’ access to investment arbitration; (3) establish filters for channelling sensitive cases to State-State dispute settlement; and (4) introduce local litigation requirements. These reform options could be implemented by contracting States in existing and future individual IIAs and would not require coordinated actions by a large number of countries.

**1. Improving the arbitral process**

This option focuses on reforming the way arbitration proceedings are conducted while preserving the main features of the ISDS system. The goals of such

**Table IV.5. Summary of arguments put forward in favour and against ISDS**

Main arguments made in favour of ISDS	Main arguments made against ISDS
<p>ISDS:</p> <ul style="list-style-type: none"> <li>• Provides an additional avenue of legal redress to covered foreign investors and enforces the substantive treaty obligations.</li> <li>• Allows foreign investors to avoid national courts of the host State if they have little trust in their independence, efficiency or competence.</li> <li>• Avoids recourse to diplomatic protection (investors do not need to convince their home State to bring claims or to exercise diplomatic protection).</li> <li>• Ensures adjudication of claims by a qualified and neutral tribunal.</li> <li>• Removes any State immunity obstacles that may complicate domestic legal claims in some States.</li> <li>• May be faster than domestic court procedures in some countries.</li> <li>• Allows recognition and enforcement of arbitral awards in many jurisdictions (under the ICSID Convention or the New York Convention).</li> </ul>	<p>ISDS:</p> <ul style="list-style-type: none"> <li>• Grants foreign investors greater rights than those of domestic investors, creating unequal competitive conditions.</li> <li>• Exposes host States to legal and financial risks, without bringing any additional benefits, and can lead to “regulatory chill”.</li> <li>• Lacks sufficient legitimacy (is modelled on private commercial arbitration, lacks transparency, raises concerns about arbitrators’ independence and impartiality).</li> <li>• Fails to ensure consistency between decisions adopted by different tribunals on identical or similar issues.</li> <li>• Does not allow for correcting erroneous decisions.</li> <li>• Creates incentives for “nationality planning” by investors from third countries (or from the host State itself) in order to gain access to ISDS.</li> <li>• Is very expensive for users.</li> <li>• Holds little additional value in the presence of well-established and well-functioning domestic legal systems.</li> </ul>

Source: UNCTAD.

**Table IV.6. Sets of options for reforming investment dispute settlement**

Reforming existing investor-State arbitration		Replacing existing investor-State arbitration
Fixing existing ISDS mechanisms	Adding new elements to existing ISDS mechanisms	
<p><b>1. Improving the arbitral process</b>, e.g. by making it more transparent and streamlined, discouraging submission of unfounded claims, addressing ongoing concerns about arbitrator appointments and potential conflicts.</p> <p><b>2. Limiting investors’ access</b>, e.g. by reducing the subject-matter scope, circumscribing the range of arbitrable claims, setting time limits, and preventing abuse by “mailbox” companies</p> <p><b>3. Using filters for channelling sensitive cases</b> to State-State dispute settlement</p> <p><b>4. Introducing local litigation requirements</b> as a precondition for ISDS</p>	<p><b>1. Building in effective alternative dispute resolution</b></p> <p><b>2. Introducing an appeals facility</b> (whether bilateral, regional or multilateral)</p>	<p><b>1. Creating a standing international investment court</b></p> <p><b>2. Replacing ISDS by State-State dispute settlement</b></p> <p><b>3. Replacing ISDS by domestic dispute resolution</b></p>

Source: UNCTAD.

modifications are to (i) enhance the legitimacy of the ISDS system, (ii) enhance the contracting parties' control over the interpretation of their treaties and/or to (iii) streamline the process and make it more efficient.

Specific reform steps may include the following:

- *Providing for more transparency*, for example, by granting public access to arbitration documents (including settlement agreements) and arbitral hearings and allowing the participation of interested non-disputing parties such as civil society organizations (UNCTAD, 2012c).
- Ensuring that *persons adjudicating disputes possess the requisite skills and are fully independent, impartial, free from conflicts of interest and "affordable"* to the parties, for example by creating rules on qualifications, conduct and/or remuneration of arbitrators (e.g. through a code of conduct).
- *"Breaking the link" between the parties to the dispute and the arbitrators*, for example, by establishing a roster of qualified arbitrators agreed upon by the contracting parties and determining by lot the arbitrators who sit on a specific case.
- *Enhancing the contracting parties' role in interpreting the treaty*, for example, by establishing mechanisms for the provision of binding joint party interpretations and facilitating interventions by the non-disputing contracting parties (UNCTAD, 2011c).
- *Strengthening the contracting parties' control over adjudication of certain sensitive issues*, for example, by requiring tribunals to refer certain matters (e.g. taxation, financial services (prudential carve-out), scheduled reservations) for joint determination in the first instance by the treaty parties, i.e. as a "filter" mechanism (see also (3) below) (Canada–EU CETA (draft, 2014), NAFTA (1992)).
- *Avoid wasting resources on full-length proceedings in case of manifestly unmeritorious claims*, for example, by including a mechanism for early discharge of frivolous claims.<sup>24</sup>
- *Providing for a more equitable distribution of costs and discouraging submission of unfounded claims*, through appropriate allocation of legal costs (fees paid by each party to arbitrators, lawyers, experts and other costs); for example, by expressly adopting the "loser pays" or the "cost follows the event" principles.

- *Preventing investors from seeking relief for the same violation in multiple forums*, for example, by including a "waiver" ("no-U-turn") clause (in contrast to the "fork-in-the-road" clause, often included in traditional BITs, "waiver" clauses do not discourage investors from first trying to obtain redress in the domestic courts of the host State).

## 2. Limiting investors' access to ISDS

This approach aims to narrow the range of situations in which foreign investors may resort to international arbitration, thereby reducing States' exposure to legal and financial risks posed by ISDS.

There are several possibilities to achieve this objective:

- *Excluding certain types of claims from the scope of ISDS*. This could apply, for instance, to certain sectors considered particularly sensitive (e.g. for claims relating to financial institutions and real estate), specific treaty provisions (e.g. pre-establishment obligations) or sensitive policy areas (e.g. measures adopted on national-security grounds). Exclusions can be party-specific or apply to all contracting States.
- *Circumscribing admissible claims to treaty breaches only*. This approach would exclude all non-treaty-based claims (e.g. alleged violations of domestic law, customary international law or investment contracts), but still provide investors with means to enforce the substantive protections found in the IIA. It can be combined with an applicable-law clause that allows application of the treaty and international law only (but not domestic law).
- *Prohibiting recourse to ISDS after a certain time period* has passed from the events giving rise to the claim ("limitations period"), e.g. three years. This introduces a time factor that fosters certainty and predictability with regard to the assumed treaty obligations. Without it, claims could be filed any time, exposing States to uncertainty. It may be useful to clarify whether the limitation period includes the time that the investor spends pursuing its claims in domestic courts.
- *Preventing "abuse" of the treaty by denying ISDS access to investors who engage in "treaty shopping" or "nationality planning" through "mailbox" companies* that channel investments but do not engage in any real business operations in the home State.
- *Providing for State consent to international investment arbitration on a case-by-case basis*.

### 3. Using filters for channelling sensitive cases to State-State dispute settlement

This reform option provides for State-State dispute settlement if a joint committee fails to resolve a case. While maintaining the overall structure of today's ISDS mechanism, this constitutes a *“renvoi” of disputes on sensitive issues to State-State dispute settlement*; e.g. whether a measure is a “prudential” measure aimed at safeguarding the integrity and stability of the financial system or whether a taxation measure constitutes an expropriation. In this case, the ISDS proceeding is suspended until the State-to-State tribunal renders its decision. The latter is binding on the ISDS tribunal. This approach has been adopted in the BIT concluded between Canada and China in 2012 and in NAFTA (for investment disputes in financial services). The “filter” was evoked by the European Commission in its Public Consultation on the TTIP.

State-State dispute settlement (be it in the form of arbitration, judicial or other procedures) may be better suited for sensitive issues of systemic importance, such as those relating to the integrity and stability of the financial system, the global system of international tax relations, or public health. For example, States are likely to use only those legal arguments with which they would feel comfortable in cases directed against them.

### 4. Introducing local litigation requirements as a precondition for ISDS (including exhaustion of local remedies)

This reform option aims to promote recourse by foreign investors to domestic courts while retaining the option for investor-State arbitration, as a remedy of last resort. In so doing, it would respond to some of the concerns arising from the steep rise in ISDS cases over the last decade. Domestic resolution of investment disputes is available in virtually every jurisdiction.

Two options could be considered to foster the use of domestic courts, without foreclosing investors' resort to ISDS:

- The IIA could require investors to exhaust local remedies before accessing international arbitration.
- The IIA could set out a “local litigation requirement”, i.e. specify that the recourse to international investment arbitration becomes possible only after a certain period of time (e.g. 18 months) of litigating the dispute in domestic courts.

Requiring dispute resolution before the domestic courts of the host country puts foreign investors on an equal footing with domestic investors (as well as with foreign investors from States which do not have an IIA with the host country). It would also help establish a level playing field among foreign investors, as the financial costs associated with international investment arbitration may preclude small and medium-sized enterprises from using it. In addition, national jurisdictions usually also include a right to appeal first-instance decisions and are well-suited to interpret and apply the domestic laws of the host State. Also, the argument has been made that reliance on ISDS is less important in countries with a sound legal systems, good governance and local courts' expertise. Finally, the argument is gaining ground that rather than focusing exclusively on ISDS, domestic reforms aimed at fostering sound and well-working legal and judicial institutions in host States are important. This may ultimately help remedy some of the host-State institutional deficiencies which IIAs and the ISDS mechanism were designed to address.

At the same time, however, there are concerns that some host States cannot guarantee an efficient and well-functioning domestic court system. Local courts may lack independence and be subject to political control and abuse by the State, including delaying tactics. Also, this approach would be particularly challenging in governance weak countries, where local court decisions could be difficult to enforce. In other jurisdictions, owing to the high workload of local tribunals, the exhaustion of local remedies may span a long period of time and thereby reduce the value of the investment arbitration option. Furthermore, if the investor switches to ISDS after local litigation as an “appeal” to a domestic court ruling, this would potentially increase the legitimacy concerns with ISDS. Finally, local courts may not have the legal competence to apply international law – many jurisdictions do not allow for the direct applicability of IIAs, which would be a prerequisite for local enforcement of treaty obligations. In order for local enforcement to function therefore, such countries would have to transform the treaty into national law.

#### Adding new elements to the existing ISDS mechanisms

These policy options add new elements to complement the existing investor-State arbitration mechanism.

They can be combined with the above-mentioned improvements of the mechanism.

- **Appeals facility**

This option would preserve the structure of the existing investment arbitration mechanism and add a new layer to it. An appeals facility could take two main forms: either a standing or an ad hoc body. It would have the competence to undertake a substantive review and correct the arbitral tribunals' first instance decisions.

An appellate mechanism would be given review jurisdiction that goes beyond the scope of review available under the existing annulment procedures under the ICSID Convention. The current ICSID annulment procedure, for example, does not entail a review of the merits and is limited to review on certain specified and limited grounds, e.g. irregular constitution or corruption of the arbitral tribunal, serious departure from a fundamental rule of procedure, failure to state reasons for the award or a manifest excess of power. As a result, an ICSID annulment committee may find itself unable to annul or correct an award, even after having identified "manifest errors of law". An appeals facility could be given this broader power of review. In so doing, it could serve to enhance the predictability of treaty interpretation and improve consistency among arbitral awards. All this could significantly contribute to enhancing the political acceptability of ISDS and the IIA regime as a whole.

A joint committee established under a treaty could be tasked to hold consultations on the establishment of an appellate mechanism and identify specific issues for consideration, including the nature and composition of an appellate mechanism, and the applicable scope and standard of review (Canada–EU CETA (draft 2014), United States model BITs (2004, 2012)).

Should countries decide to opt for establishing such an appeals mechanism, several sets of issues would need to be resolved:

- *First, issues regarding the establishment of such a body, notably whether it would have a bilateral, regional or multilateral nature.* Although an appeals body may be easier to set up in a bilateral context, its expected function of fostering legal consistency and predictability would be more pronounced in a pluri- or multilateral context. In this connection, one would need to consider how the new mechanism could

be reconciled with, and perhaps integrated into, the ICSID Convention (e.g. to replace the existing annulment procedure), the UNCITRAL Arbitration Rules, the rules of other arbitral forums used in ISDS and potentially other relevant international instruments such as the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Furthermore, developing an appeals facility capable of promoting interpretive harmonization and legal consistency would seem to require a mechanism under which it has the competence for reviewing all awards rendered under a particular treaty.

- *Second, issues regarding whether the appeals facility would be permanent (an appellate body) or ad hoc.* Although ad hoc mechanisms would be easier to realize and involve lower costs, a permanent body may be more apt to ensure coherence in arbitral practice. An appellate body with permanent judges, appointed by States from a pool of eminent jurists, would allow the appeals facility to become an authority capable of delivering consistent – and balanced – opinions, which would rectify some of the legitimacy concerns about the current ISDS regime. Authoritative pronouncements by an appeals facility on issues of law would guide both the disputing parties (when assessing the merits of their respective cases) and arbitrators adjudicating disputes. At the same time, however, an appellate body with the authority to issue rulings with the force of precedents could place new limitations on the sovereignty of contracting parties through the establishment of an independent body of jurisprudence.
- *Third, issues regarding organization and institutional set-up of such a body.* For example, who would elect the members of an appeals facility? How would they be elected? What would be the length of their tenure? What principles or code of conduct would govern their activities both with respect to their work within the facility and without it? What type of secretarial support would they receive? Who would finance it? Where would it be located?
- *Fourth, issues with regard to the added time and cost of the proceedings.* The introduction of an appellate stage would add another layer of proceedings to the arbitration process, and care would need to be taken to put in place an efficient process, including timelines (e.g. as for the WTO Appellate Body).



Further, proceedings at an appellate stage would also involve additional costs for both investors and host States.

- *Fifth, issues related to the competence of such a body.* These issues include the type of review available, the standard of review to be applied and the type of IIA decisions/awards which the body would be competent to address. For example, would the body be able to review only issues of law or also issues of fact? Would the body be able to remand an erroneous decision for reconsideration only by the tribunal that adopted it, or would it have the power to correct errors directly? Would the appellate facility have review power only over final awards or also over other decisions, e.g. on provisional measures and on jurisdictional issues?

• **Building in effective alternative dispute resolution**

This approach to ISDS reform promotes the use of alternative dispute resolution (ADR) mechanisms as a step before the commencement of international investment arbitration (UNCTAD, 2010d, UNCTAD 2010e). Although ADR cannot in itself solve key ISDS-related challenges, it can reduce the number of disputes which result in full-scale arbitration. This renders it a complementary, rather than a stand-alone, avenue for ISDS reform.

Whereas arbitration – like adjudication – follows an adversarial procedure leading to a binding decision by a third party, the outcome of ADR mechanisms ultimately requires acceptance by both parties. ADR has value because it can help resolve disputes at an early stage, thereby preventing them from severely and permanently damaging the relationship between the investor and host country. Because of its consensual nature, ADR may be particularly useful in cases of disputes where the parties consider it important to continue their investment cooperation beyond the present dispute. ADR also tends to be more informal and flexible than investor-State arbitration: its purpose is to find a solution that will be acceptable to both parties. If successful, therefore, ADR can help save time and money.

A limitation of ADR is that there is no guarantee that ADR procedures will lead to the resolution of a dispute; unsuccessful ADR can, therefore, increase the costs and time involved. That said, even if unsuccessful, ADR can serve to clarify the issues in dispute between

the parties and help to streamline subsequent arbitral proceedings.

ADR may not always be feasible or acceptable to the host country, depending on the nature of the policy measure challenged by an investor, e.g. where the case relates to legislative measures. Moreover, given the consensual nature of ADR, a mediated outcome of the dispute that has not been endorsed by both parties cannot be enforced. Therefore, if one party does not respect the compromise solution proposed by ADR, binding arbitration may still become unavoidable.

The following policy options suggest actions at different levels of governance: the national and the international level (the IIA). Again, implementation of these options can be complementary.

At the *national level*, countries may want to consider ways in which to strengthen dispute prevention and management policies by

- Emphasizing dispute prevention mechanisms through fostering information sharing between State agencies for the monitoring of sensitive sectors/industries for early warning signals of potential disputes.
- Establishing interinstitutional arrangements to address potential and emerging disputes more effectively.
- Empowering a particular agency to act as lead for the pursuit of amicable settlements (and potential subsequent arbitration).
- Creating investment ombuds offices or specific investment agencies to take the lead in resolving conflicts with investors early on.

At the *international level*, IIAs can include provisions on dispute prevention and management and integrate them into the IIA-based dispute settlement mechanism. Although a significant number of IIAs include the possibility of conciliation proceedings, policymakers may consider the need to strengthen existing mechanisms or add new ones (e.g. mediation). This can include

- Adding an ADR provision.
- Strengthening the use of existing ADR as a dispute prevention mechanism by making it a compulsory step before the commencement of investment arbitration, e.g. through establishing “negotiation periods” (specified time periods during which consultations and negotiations must be pursued).

- Providing for institutional State-State mediation and conciliation efforts prior to investor-State dispute settlement.
- Formulating new provisions for ADR and dispute prevention and management, as e.g. set out by Brazil in its recently concluded CFAs.

### Replacing the existing ISDS system with other dispute resolution mechanisms

The options below would abolish the existing system of ad hoc investor-State arbitration and replace it with other mechanisms for settling investment disputes. Potential replacements include (1) the creation of a standing international investment court, (2) State-State dispute settlement, and/or (3) reliance on domestic judicial systems of the host State.

The replacement options differ in the extent of change they bring. States can focus on one of the options or can pursue them in parallel or in combination. For example, option (3) can be combined with option (2) or option (1), which would preserve the possibility of some sort of international legal proceedings.

The option of replacing the ISDS has been recently pursued in the Australia–Japan Economic Partnership Agreement (EPA) (2014), the Australia–Malaysia FTA 2012, the Australia–New Zealand CEPA (2011), the Japan–Philippines EPA 2006, the Australia–United States FTA 2004, and the recently concluded CFAs by Brazil with Angola and Mozambique. These treaties leave investment disputes subject to domestic courts but complement this process with the possibility of State-State proceedings under the treaty.

#### 1. Standing international investment court

This option retains investors' right to bring claims against host States but replaces the system of multiple ad hoc arbitral tribunals with a single institutional structure, a standing international investment court. Such a court would consist of judges appointed or elected by States on a permanent basis; it would be competent for all investment disputes arising from IIAs made subject to its jurisdiction and could also have an appeals chamber.

A standing investment court would be a public institution serving the interests of investors, States and other stakeholders and, more broadly, strengthening

the legitimacy of the investor-State regime. A standing court could contribute to enhancing consistency and predictability in the interpretation of international treaties. It could also strengthen the perceived and actual independence and impartiality of adjudicators, by establishing them as judges with security of tenure and exclusivity of function, i.e. judges, unlike arbitrators in the present regime, would not be permitted to continue serving as counsel or expert witnesses. Moreover, a court could be competent for all investment disputes under an IIA, i.e. both investor-State and State-State proceedings. It has also been suggested, that the competence of the court be broadened, depending upon the content of the IIAs made subject to its jurisdiction, in particular by giving legal standing or procedural rights to other stakeholders (Bernasconi, 2015).

Clearly, establishing such a court raises a number of important legal and political challenges, and, in its very nature, would constitute a long-term project. As countries move in this direction, they need to consider a number of key issues (see also appeals facility):

- *Issues regarding the establishment of such a court*, such as the need to build consensus among a critical mass of countries around a convention establishing such a court.
- *Issues regarding organization and institutional set-up*, such as the location, financing and staffing of the court.
- *Issues around the participation of countries* in the court, namely how to transition from a possible bilateral court established between key trading blocks, as recently proposed by the European Union (European Commission, 2015), to a more universal structure serving the needs of developing and least developed countries.
- *Issues around the competence of the court*, such as the type of IIAs and cases it is competent to address.

Multilateral consensus-building would help respond to the perception that such a court would work best in a plurilateral or multilateral context. It could help seek solutions for making a new court fit the fragmented global IIA regime, which consists of thousands of mostly bilateral IIAs. Similarly, multilateral consensus building would respond to the fact that a standing investment court may well start at a smaller scale, with an opt-in mechanism for those States wishing to join.

Table IV.7.

## Summary of arguments put forward in favour and against State-State arbitration

Main arguments made in favour of State-State dispute settlement	Main arguments made against State-State dispute settlement
<ul style="list-style-type: none"> <li>• Could avoid broader legitimacy concerns that have been raised in respect of ISDS.</li> <li>• Could help to filter out frivolous claims.</li> <li>• Only States can bring claims under international law as they are the principal subjects of the system.</li> <li>• May help to avoid controversial legal issues related to challenges to public policies.</li> <li>• States would not make certain types of legal arguments that could be used against them in the future.</li> <li>• Does away with the privileges that ISDS bestows on foreign investors.</li> </ul>	<ul style="list-style-type: none"> <li>• Could politicize investment disputes-commercial dispute would become a matter of State-State diplomatic confrontation.</li> <li>• Investor interests could become a bargaining chip in international relationships.</li> <li>• May be more cumbersome and lengthy for investors due to bureaucracy in either or both disputing States.</li> <li>• May disadvantage SMEs vis-à-vis larger companies.</li> <li>• Raises challenges for States in terms of costs of proceedings and legal remedies.</li> <li>• Has implications for States in terms of administrative and institutional resources.</li> </ul>

Source: UNCTAD.

## 2. Replacing ISDS with State-State dispute settlement

State-State arbitration is included in virtually all existing IIAs, and it is also the approach taken by the WTO for resolving international trade disputes.

Unlike the fostering of State-State dispute resolution as a complement to ISDS, this option presupposes that State-State proceedings would be the only way of settling investment disputes at the international level. The home State would have discretion on whether to bring a claim. States would need to decide on the court that should hear a case; options include the International Court of Justice, ad hoc tribunals or an international court as envisaged above.

State-State arbitration has a number of pros and cons (table IV.7).

Replacing ISDS with State-State dispute settlement could be one way to reinstate countries' confidence in the IIA regime, address the legitimacy concerns raised with ISDS – by filtering out frivolous claims and avoiding controversial legal issues related to challenges to public policies; issues that could also be addressed by reforming the ISDS system (see above). More generally, this option would do away with the privileges that ISDS bestows on foreign investors; relying on State-State dispute settlement would be in line with the principle that only States can bring claims under international law. Also, States may be less likely to make certain types of legal arguments that could be used against them in the future.

However, a number of challenges arise with this option. The main one relates to a possible politicization of investment disputes, with all that this could entail (e.g. State discretion to pursue claims, elevating commercial disputes to the sphere of international relations, corporate lobbying). State-State dispute settlement could also be more cumbersome and lengthy for investors because of bureaucracy in either or both of the disputing States. It could also place SMEs at a disadvantage vis-à-vis larger companies as regards having their case heard. There are also implications for States' administrative and institutional resources. Furthermore, there are questions about how rulings would be implemented, what kind of remedies would be appropriate, how these could be enforced, and who would bear the costs of the proceedings. One important implication to take into consideration is that State-State dispute settlement could lead to the losing party being asked to bring a domestic measure into compliance with treaty obligations, not merely compensate for it (as is the case with ISDS), which implies a far greater intrusion into States' right to regulate.

There are also two other considerations to keep in mind. First, this option requires an identifiable home State, which in the case of complex multinational corporations, with affiliates in numerous countries and multiple ownerships, may be difficult to ascertain. Second, host States may wish to avoid being confronted with diplomatic protection by investors' home States.

Given that there are so far only four known cases to date, it is difficult to draw lessons from State-State arbitration in IIAs.<sup>7</sup> Experience with State-State dispute settlement in the WTO or in the context of regional agreements (including with respect to the remedies used, i.e. pecuniary vs. non-pecuniary) can help offer insights regarding the pros and cons of this option, but one needs to bear in mind the specific characteristics of investment disputes.

Overall, although the option of replacing ISDS with State-State dispute settlement can help to address some of the concerns with regard to ISDS, it also raises a number of difficult challenges that would need to be addressed before taking this route.

### 3. Exclusive reliance on domestic dispute resolution

This option abolishes investors' right to bring claims against host States in international tribunals and limits their options for dispute resolution to domestic courts. Unlike the promotion of domestic resolution as a step preceding investor claims at the international level (e.g. exhaustion of local remedies, local litigation requirement), under this option, domestic judicial institutions would be the only and final mechanism for settling investor-State disputes. This option, it has been noted, has merits mainly in countries where reliance on ISDS is less important because of their sound legal systems, good governance and local courts' expertise.

As stated above, this option entails a number of pros and cons.

Arguments made in favour include that it treats foreign investors equally than domestic investors, and that it would help establish a level playing field among foreign investors. It may also support fostering sound and well-working legal and judicial institutions in host States through domestic reform, and could therefore help address some of the host-State institutional deficiencies which the IIA and the ISDS mechanism were designed to address. This would also respond to the increasing argument that rather than focusing exclusively on ISDS, domestic reforms aimed at fostering sound and well-working legal and judicial institutions in host States are important.

Arguments against this option rest on the concerns with regard to the independence, neutrality, efficiency,

and enforceability of local court rulings, especially in governance weak countries. In addition, there are concerns that local courts may take a long time to settle a dispute (including because of delaying tactics). In the end, this could render the IIA non-enforceable. Moreover, local courts may not have the legal competence to apply international law, since many jurisdictions do not allow for the direct applicability of IIAs (see above).

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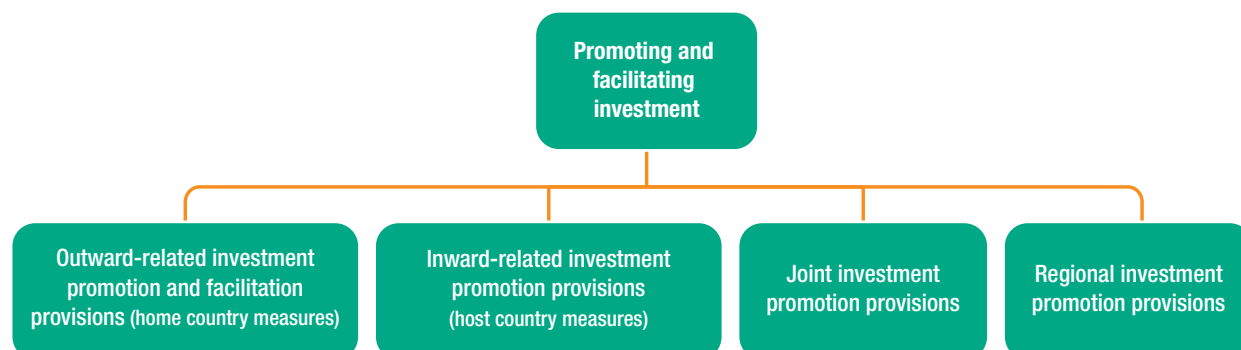
ISDS offers benefits for foreign investors and potential benefits for home and host States, but in its present incarnation the system suffers from significant drawbacks in its substance, procedure and functioning. There is thus a strong case for a systematic reform of investment dispute settlement. However, there are no quick and easy solutions. Reform options have their pros and cons, and pose their own specific challenges.

Some of the reform options discussed in this section, such as clarifying the content of individual IIA provisions or limiting the access of investors to ISDS, are less difficult to implement than others. Some of the reform options can be undertaken through unilateral or bilateral actions, while others require larger, regional, plurilateral or multilateral efforts. Although multilateral options would go furthest in systemically addressing areas of needed reform, they would also face more difficulties in implementation and require agreement between larger numbers of States on a series of important questions (see section C).

In addition, in reforming investment dispute settlement, attention needs to be given not only to the thousands of individual investment treaties, but also to the existing multilateral ISDS-related instruments, such as the ICSID Convention and the widely used UNCITRAL Arbitration Rules. In this context, it has to be noted that terminating membership in one arbitral institution (e.g. ICSID), depending on the language used in the treaty, may have the effect that investors bring cases in other arbitration forums or under other arbitral rules (UNCTAD, 2010a). Hence, this option would not only fall short of preventing State liability, but, depending on the circumstances, could also entail exposing the State to less favourable procedures.

Finally, ISDS is an enforcement mechanism for the substantive provisions of IIAs. Hence, ISDS cannot

Figure IV.7. Promoting and facilitating investment



Source: UNCTAD.

be looked at in isolation, but only together with the substantive investment protection rules embodied in IIAs. Without a comprehensive package that addresses both the substantive content of IIAs and ISDS, any reform attempt risks achieving only piecemeal change and potentially creating new forms of fragmentation and uncertainty.

### c. Promoting and facilitating investment

*Options include adding inward and outward investment promotion provisions, and joint and regional investment promotion provisions.*

States generally conclude IIAs with a view to attracting investment and benefitting from it. However, IIAs rarely include proactive investment promotion or facilitation provisions that effectively encourage outward or inward foreign investment. Instead, IIAs only indirectly promote investment – by protecting it. And IIAs lack the provisions to ensure a certain “quality” of the investment attracted (i.e. investment that delivers concrete and measurable sustainable development benefits to the host country). Given that fostering investment and ensuring its quality is crucial for bridging the financing gap for the SDGs (WIR14), this is an important element of IIA reform.

This WIR offers a number of policy options for countries wishing to pursue this reform objective (figure IV.7). None of the options envisages a binding commitment for any of the contracting parties that would be enforceable through dispute settlement procedures. Most of the

options require a certain financial and institutional capacity to implement them and therefore would need to be complemented with technical assistance (on a non-reciprocal basis) or special and differential treatment, particularly where the agreement involves structurally weak and vulnerable economies. Finally, there is some doubt about the value added of including such provisions in IIAs, given that actual investment promotion and facilitation measures are largely undertaken at the national level. At the same time, regional initiatives have set best practices in this regard.

- **Outward-related investment promotion and facilitation provisions (home-country measures)**

Usually, IIAs regulate the behaviour of host countries. However, they can also include provisions directed at home countries. These options can, for example, emphasize the importance of specific home-country measures for promoting investment and/or stress home countries’ endeavours to undertake such measures.

A first option is to refer to home-country promotion measures and encourage countries to proactively implement them. Such measures can include granting financial support; e.g. loans, grants (including R&D funding), providing investment guarantees (i.e. to protect investors against certain political risks in the host country) or holding equity participation in investment projects.

A second option is to refer to home-country technical assistance. Such assistance can aim at improving host

countries' regulatory regimes and investment facilitation measures (e.g. help to simplify/streamline admission, registration or licensing procedures; to set up one-stop shops for registering an investment or a business; or to make available information on admission and establishment requirements, as well as on investment opportunities). Assistance can also aim at building institutional structures (e.g. judicial institutions, dispute prevention capacities, investment promotion agencies), at strengthening linkages between parties' research and academic centres or at facilitating feasibility studies for large investment projects.

A third option is to foster the sustainable development dimension of home-country investment promotion measures. Such provisions can state that the granting of outward incentives or investment insurance can be conditioned on the sustainable development impact or good governance record of the benefitting investment. The sustainable development impact can be specified, for example, by reference to specific sustainable development criteria (including for a specifically targeted region/community) or by reference to environmental and social standards (including (international) CSR standards). The United States' Overseas Private Investment Corporation (OPIC) uses about 30 development indicators to evaluate proposed projects. They include (i) job creation and human capacity-building (number of new jobs created, training and employee benefits); (ii) demonstration effects (e.g. technology and knowledge transfer, adoption of internationally recognized quality or performance standards); (iii) host-country impact (local procurement, and fiscal and foreign exchange impacts); (iv) environmental and community benefits (improvement of the environment and benefits to the local community); and (v) development reach (impact on basic infrastructure and/or its potential benefits to the poor and other underserved populations) (OPIC, 2012).

- **Inward-related investment promotion provisions (host-country measures)**

An IIA can identify actions by host countries. Similar to the outward-related provisions, such clauses can stress the importance of these measures and/or aim to link them to specific sustainable development outcomes. An option is to condition host-country incentives on the sustainable development impact of the benefitting investment and that these incentives are in line with other policy areas such as industrial development strategies and regional economic cooperation. A variant

is to condition the granting of investment incentives on the fulfilment of certain performance requirements, if this is permitted by the treaty.

Another variant is the establishment of an investment ombudsperson/facilitator in each contracting party. By monitoring and addressing investor concerns related to bureaucratic obstacles to doing business (e.g. business visas, obstacles to investment generally or to a specific investment project) an ombudsperson/facilitator can help ensure a business-friendly environment, and indirectly, affect a company's investment prospects and decisions. The ombudsperson/facilitator can be tasked with a number of activities, including addressing suggestions or complaints by investors and their home States; taking action to prevent, manage and resolve disputes; providing information on relevant legislative and regulatory issues; or promoting greater awareness and transparency.

Although such an ombudsperson/facilitator would mainly act at the national level, it can be mandated to report to and cooperate with the institutional mechanisms set up under the IIA. Some recent agreements, such as the CFAs signed by Brazil and Mozambique and by Angola and Brazil (2015), have such an ombudsperson/facilitator as one of their key features. The Foreign Investment Ombudsman in the Republic of Korea, which since 1999 has found solutions for grievances filed by foreign companies can also provide insights into the functioning of such a service.

- **Joint investment promotion provisions**

An IIA may also establish mechanisms, institutions and/or processes by which both home and host countries cooperate on investment promotion.

A first option is to establish a joint council or committee on investment promotion. Such a body can be part of the overall institutional framework between the contracting parties or be a self-standing specific element; it can be permanent or ad hoc. Such a body could meet regularly to oversee the implementation of the agreement and its investment promotion effect; to assess investment relations and identify new investment opportunities; to organize joint seminars, conferences, workshops or fairs; to monitor the implementation of specifically listed investment promotion and facilitation measures (e.g. related to the granting of business visas); to address specific concerns of investors (e.g. based on a report by an ombudsperson); or to design, implement and monitor progress on a thematic work

plan (e.g. on green investment, promotion of linkages, issues related to small and medium-sized enterprises (SMEs), global value chains (GVCs)).

A second option relates to linkages. For example, an IIA can seek to foster linkages and stimulate joint ventures, in particular with SMEs, by calling for the sharing of expertise on entrepreneurship and management, and by encouraging the publication of documents on SMEs and the exchange of information and know-how on topics such as taxes, finances and other conditions necessary for the setting up and expansion of SMEs.

A third option for joint investment promotion measures is to foster cooperation between national investment promotion agencies (IPAs). The IIA can provide a platform for IPAs to exchange experiences and best practices in investment promotion, to share information on concrete investment needs and opportunities (e.g. a pipeline of SDG-related investment projects), and to jointly present and prepare large investment projects identified as bilateral investment priorities. Again, all of this work can have a thematic focus. A related option is to expand such cooperation beyond IPAs and also include trade promotion organizations, including, for example, *joint trade and investment promotion missions*. This would respond to the emergence of GVCs where ever-intensifying trade and investment links call for closer coordination between domestic trade and investment promotion agencies.

Another option is cooperation and partnerships between outward investment agencies (OIAs) in home countries and IPAs in host countries, including for example, for the development and marketing of pipelines of bankable SDG investment projects (WIR14). Stimulating such OIA-IPA partnerships can bring information sharing, technical assistance and exchanges, the marketing, financing and facilitation of SDG investment projects as well as joint monitoring and impact assessment.

- **Regional investment promotion provisions**

IIAs could also harness the potential of regional cooperation. Building on the promotion-related experiences of regional economic cooperation initiatives, a regional IIA could call for facilitating investment and for establishing joint investment promotion mechanisms and institutions for regional infrastructure projects (e.g. regional development corridors) and regional industrial

zones. This can also take the form of regional SDG investment compacts (WIR14).

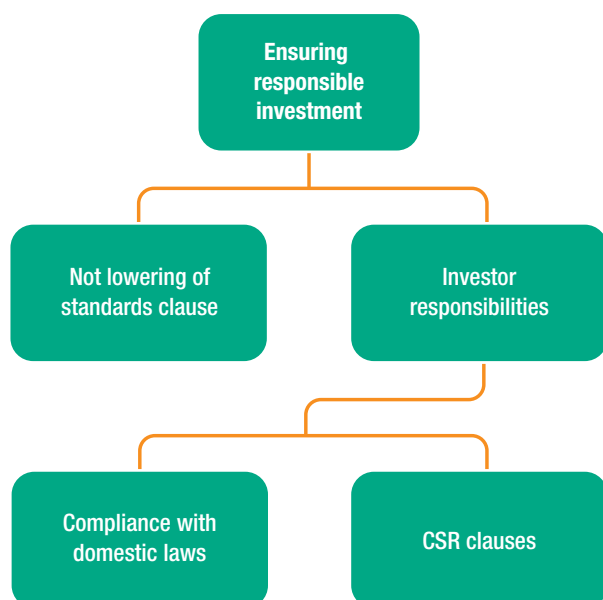
Regional investment promotion initiatives exist around the globe. The ASEAN Investment Agreement (2009) refers to the joint promotion of the region as an integrated investment area, offering special and differential treatment to new ASEAN members (technical assistance to strengthen their capacity for investment promotion) and tasking the AIA Council to provide policy guidance on investment promotion. Investment promotion is also included in the ASEAN–India Investment Agreement (2014) and the ASEAN–China Investment Agreement (2009). The COMESA Treaty (1993) establishes a centre for the promotion of industrial development that works closely and exchanges information with the investment promotion centres in the member States. The COMESA Investment Agreement (2007) obliges member States to strengthen the process of investment promotion, and the COMESA Coordinating Committee on Investment includes chief executives of IPAs. The SADC Investment Protocol (2006) sets out the activities of IPAs, e.g. to proactively identify business opportunities for investments, to encourage the expansion of existing investments, to develop a favourable investment image of their countries, to make recommendations for improvements of their countries as investment destinations, to keep track of all investors entering and leaving the country for the purpose of analysis in terms of investment performance, or to advise investors upon request on the availability, choice or sustainability of partners in joint venture projects. Finally, the Central American Common Market (CMA) Agreement on Investment and Trade Services (2002) provides for the promotion of investments within the region. For example, parties are mandated to provide, upon request, available information on investment opportunities (e.g. information on prospective strategic alliances among investors, and information on investment opportunities in specific economic sectors of interest to the parties), and to exchange information concerning foreign investment trends and available investment opportunities.

#### d. Ensuring responsible investment

*Options include not lowering of standards clauses and provisions on investor responsibilities, such as clauses on compliance with domestic laws and on corporate social responsibility.*

Figure IV.8.

### Ensuring responsible investment



Source: UNCTAD.

Ensuring responsible investment has several dimensions. First, this reform objective may refer to maximizing the positive contribution that investors can bring to societies and/or to avoiding investors' negative impacts (e.g. on the environment, human rights, public health). Second, this reform objective may relate to investors' obligation to do what is required by law and/or to investors' response to societies' expectations that businesses comply with voluntary standards, i.e. that they do more than what is required by the law. The relevance and suitability of the policy options below differ depending on which of these aspects is the prime objective (figure IV.8).

#### Not lowering of standards clause

There is a concern that international competition for foreign investment may lead some countries to lower their environmental, human rights and other laws and regulations, and that this could result in a "race to the bottom" in terms of regulatory standards.

There are a number of options to address this concern.

A first option is to explicitly reaffirm parties' commitments under international agreements that they have concluded (e.g. in human rights, core labour rights or the environment). Doing so would not only help address

concerns about a "race to the bottom", but also help foster overall coherence and synergy between different bodies of international law (systemic policy challenge).

A second option is to include a "not lowering of standards" clause in the IIA. The normative intensity of the clause may be increased by stating that each contracting Party "shall ensure" (instead of "shall strive to ensure") that it does not waive or derogate from environmental, labour or other laws (United States model BIT (2012)). This option has similar benefits as the explicit reaffirmation option, as it can (partly) respond to concerns regarding a potential race to the bottom and help manage the interaction between IIAs and national policies.

Both of these options move the IIA regime beyond its traditional role of focusing solely on investment protection, and towards the goal of establishing and maintaining a regulatory framework that is conducive to sustainable development. By helping maintain – and build – a sound regulatory framework, these options can help promote responsible behaviour by investors and better manage the interaction between IIAs and domestic laws – and, possibly, help tip the balance in an ISDS case. However, there is a concern that such clauses, while constituting commitments of the contracting parties, are not enforceable in the traditional sense through ISDS and may have little concrete impact. Moreover, much of their impact depends on the quality of the host country's regulatory framework and its implementation.

A third option is to complement the above with a follow-up mechanism. This can include a mechanism for reporting on issues related to the implementation of the clause (including reporting on improvements of investment-related social, environmental or other laws and regulation).

#### Investor responsibilities

Most IIAs are asymmetrical in that they set out obligations only for States and not for investors. To correct this asymmetry, an IIA can also include provisions on investor responsibilities, as a few recent IIAs have done.

Although ensuring the responsible conduct of investors is a key objective of IIA reform, there are different views on the role of IIAs (in addition to, for example, national legal frameworks) in ensuring such conduct. Given the



wide recognition of investors' responsibility to respect human rights and to conduct business in a responsible manner (e.g. as set out in the UN Guiding Principles on Business and Human Rights), the recognition of a need to rebalance IIAs, including as part of IIA reform, is gaining prominence.<sup>8</sup>

Noting the evolving views on the capacity of international law to impose obligations on private parties, there are two broad sets of options: raising the obligations to comply with domestic laws to the international level and designing CSR clauses.

- **Compliance with domestic laws**

Numerous IIAs include a requirement for investors to comply with laws of the host State when making an investment. This general obligation could be further specified in the IIA; for instance, by stipulating that the investment can be held legally responsible for damage caused to human health or the environment. The potential impact of this stipulation would be even more relevant if extended to damages arising in the post-operations stage of an investment; e.g. when foreign investors fail to ensure orderly divestment or environmental clean-up of their activities. This raises the issue under which conditions a parent company could be held responsible for damage caused by its foreign subsidiaries (*WIR13*).

More broadly, countries can strengthen their domestic regulatory frameworks by incorporating international principles and standards related to social, human rights, health, environmental and other risks associated with investment. Again, sharing of experiences and best practices, technical assistance and capacity-building can facilitate efforts in this regard (*WIR11*).

- **CSR clauses**

The last decade has seen the development of corporate social responsibility (CSR) standards as a unique dimension of "soft law" that is rapidly evolving. CSR standards typically focus on the operations of MNEs and, as such, are increasingly significant for international investment.

The current landscape of CSR standards is multilayered, multifaceted, and interconnected. The standards of the UN, the ILO and the OECD serve to define and provide guidance on fundamental CSR issues. In addition, there are dozens of international multi-stakeholder initiatives, hundreds of industry association initiatives and thousands of individual

company codes providing standards for the social and environmental practices of firms at home and abroad (*WIR11*).

In the past, the two universes of international rules affecting investment, CSR standards and IIAs, were largely disconnected. However, strengthening the responsibility dimension of IIAs calls for improving and strengthening the interaction between these two universes of international rules affecting investment.

There are a number of policy options to do so.

A first option is to encourage investors to comply with widely accepted international standards (e.g. the UN Guiding Principles on Business and Human Rights). This can be done either through a general reference, without listing the relevant CSR standards; by giving a list of the relevant standards; or by spelling out the content of relevant CSR standards. Each of these approaches has pros and cons. For example, building on the work done by CSR experts rather than reinventing the wheel saves time, costs and efforts and brings together two different bodies of law and policymaking, fostering coherence and improving systemic interaction. Referring to widely recognized and well-regarded instruments can add legitimacy and secure acceptance by different stakeholders.

A second, related option is to require tribunals to consider an investor's compliance with CSR standards, endorsed by the parties, when deciding an ISDS case. However, this raises the question of what legal consequences non-compliance would have. Furthermore, questions with regard to the cross-fertilization between different bodies of law; the need for arbitrators to familiarize themselves with the relevant, rapidly evolving normative standards; and the importance of managing interaction and coordination with CSR-related compliance processes and institutions arise.

A third option is to include a commitment by the parties to promote agreed best-practice international CSR standards. Parties can also commit to fostering compliance at the national level. Actions can include building local industries' capacity to take up CSR standards, by conditioning the granting of incentives on the observance of CSR standards, or introducing certain minimum standards (e.g. relating to anti-corruption, environmental, health and labour standards) into domestic laws.

A fourth option is to establish cooperation between the parties on CSR issues. Cooperation can involve the work of a special committee set up under the IIA and tasked to discuss CSR-related issues. Cooperation can also include promoting best-practice international CSR standards (e.g. by promoting the observance of applicable CSR standards and helping to implement them, including through specific industry support measures, market incentives and regulation), supporting the development of new voluntary standards (e.g. by cooperating on the above activities, and in the exploration and creation of new CSR standards), or other activities.

A fifth option that is worth considering, and that a number of countries are starting to pursue, is home-country efforts to regulate foreign investment for sustainable development. Whereas past CSR-related initiatives have largely taken a host-country perspective, an emerging policy development has home countries monitor or regulate the foreign activities of their companies, e.g. through export credit agencies and investment insurance (see above). Such an effort can address, among others, issues related to human rights, the environment or corruption.

All of the above options have their pros and cons. They can help support the spread of CSR standards, which are becoming an ever more important feature of the investment policy landscape. They can improve the interaction between different bodies of law and policy (see below), and help strengthen the “responsibility dimension” of IIAs. Although there are concerns that the “softer” approaches are unlikely to have a significant effect, they also carry certain advantages. For example, the softer the approach, the easier it will be to implement it and to make CSR part of the IIA. Moreover, soft approaches can have an important impact by “pushing the envelope” for conceptual debate and innovation in international investment policymaking.

#### **e. Enhancing systemic consistency of the IIA regime**

*Options include improving the coherence of the IIA regime, consolidating and streamlining the IIA network, managing the interaction between IIAs and other bodies of international law and linking IIA reform to the domestic policy agenda.*

In light of the high degree of atomization of the IIA regime, a key reform challenge is to avoid further fragmentation of the system, and to enhance, as far as possible, coherence between individual IIAs, as well as coherence between the IIA regime and other international policies. In addition, there is a need to manage the systemic links between the IIA regime and domestic policies.

#### **Improving coherence of the IIA regime**

- **Seeking common IIA reform solutions**

With over 3,200 different agreements concluded over 60 years, reflecting different levels of economic development, different interests and different treaty models, the global IIA universe is known for its systemic complexity, incoherence, gaps in coverage and overlapping commitments.

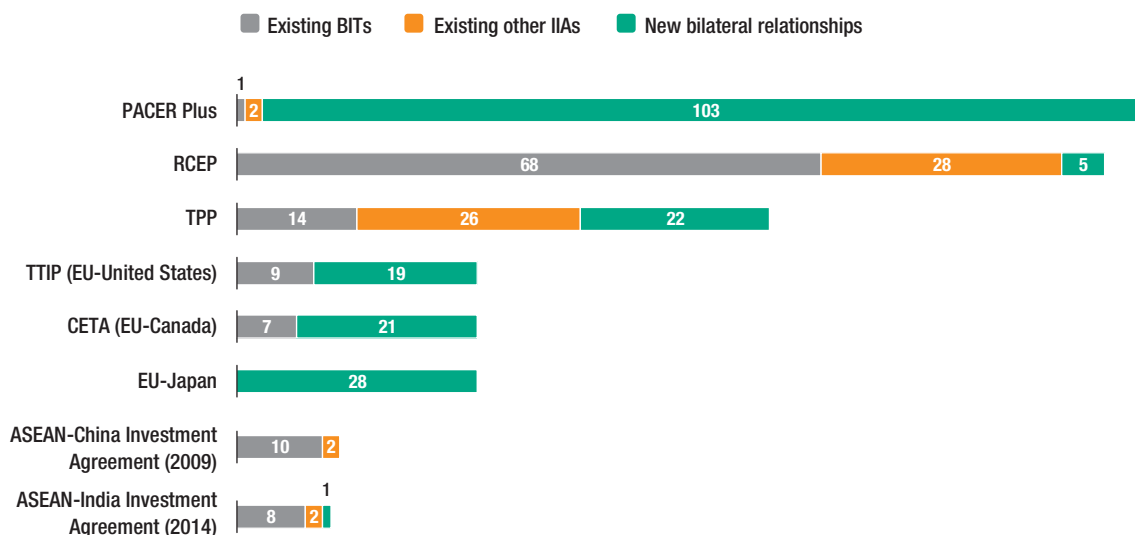
In terms of content, the main differences in the global IIA regime relate to the policy issues of (i) treaty scope (limited to post-establishment treatment or including the pre-establishment phase); (ii) coverage (only FDI or all kinds of investments); (iii) the degree of investment protection; (iv) the number and degree of treaty exceptions; (v) the inclusion of sustainable development considerations; and (vi) the handling of investment disputes.

In terms of type, one can distinguish between “pure” investment agreements, such as BITs, on the one hand, and sectoral, regional and plurilateral treaties, or economic cooperation treaties, covering both investment and trade, on the other hand (“other IIAs”).

Differences within the IIA universe can partially be explained by the different “age” of treaties – first-generation IIAs look significantly different from more recent agreements. Variations in content may also derive from the fact that IIAs have been concluded with countries at different levels of economic development, or within the context of regional economic cooperation. Different experiences of countries with ISDS and their reflection in IIAs may be an additional factor. The bargaining power of negotiating parties may play a role as well – the stronger the bargaining strength of a country, the fewer difficulties it will have in ensuring coherent treaty practices.

Working towards more coherence in an IIA regime consisting of thousands of agreements is a global challenge that calls for common responses through

**Figure IV.9.** Existing IIAs and new bilateral relationships created, for eight regional agreements concluded or under negotiation (Numbers)



Source: UNCTAD, IIA database.  
 Note: "New bilateral IIA relationships" refers to the number of new bilateral IIA relationships created between countries upon signature of a megaregional agreement.

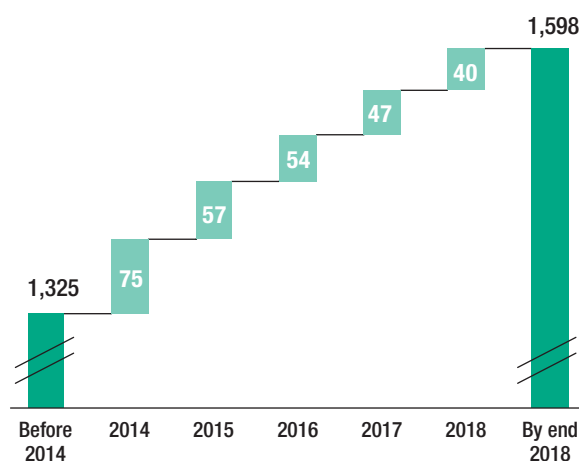
a combination of individual, bilateral, regional and multilateral reform steps (see section C). Regional IIA reform, if undertaken properly, can help promote harmonization of investment rules. The backstopping and support function of regional secretariats and international organizations can play a role in this regard.

**• Consolidating and streamlining the IIA network at the regional level**

Regional investment policymaking has led to increasing overlaps and inconsistencies within the IIA universe. Most of the regional agreements to date have not phased out pre-existing BITs between members of the regional grouping, which leads to a multiplication of treaty layers. The parallel existence of such prior BITs and the subsequent regional agreements poses a number of systemic legal and policy questions, adds to the "spaghetti bowl" of intertwined treaties and complicates countries' ability to pursue a coherent, focused international engagement on investment policy issues (UNCTAD, 2013b; WIR13).

Although to date parallelism has been the prevalent approach, current regional and megaregional IIA negotiations (e.g. negotiations for the EU–United States Transatlantic Trade and Investment Partnership (TTIP) or for the Trans-Pacific Partnership (TPP)) present an

**Figure IV.10.** Cumulative number of BITs that can be terminated or renegotiated at any time



Source: WIR13.

opportunity to consolidate the existing network of BITs. Eight megaregional agreements concluded or under negotiation in which BIT-type provisions are on the agenda overlap with 140 agreements (45 bilateral and regional "other IIAs" and 95 BITs) (figure IV.9; see also WIR14).

If the States that are parties to these forthcoming agreements opted to replace the pre-existing BITs between them, it would be a noticeable step towards streamlining the global IIA regime. A similar approach could be envisaged for existing regional agreements or initiatives with an investment dimension, where the abrogation of the BITs between the respective treaty partners could help consolidate the global IIA regime. Should the underlying BIT provide for desirable features that are absent in the subsequently negotiated regional agreement, such features could be included – if necessary over time – in the region's legal framework for investment. Current discussions in the European Union offer valuable insights in this regard; similar initiatives have also been discussed in other regions with developing-country members. Importantly, any such actions would need to cater to regional specificities. The fact that between 2014 and 2018, more than 1,500 BITs will reach the stage where they could be terminated by a party at any time creates a further opportunity for consolidation and streamlining (figure IV.10). Abrogation could commence with those treaties, in which the initial duration has expired or is soon to expire. In order to use treaty expirations to instigate change in the IIA regime, there is a need to understand how BIT rules on treaty termination work, so as to identify when opportunities arise and what procedural steps are required (UNCTAD, 2013c; *WIR13*).

To this can be added more options on how regional IIA reform can contribute to the streamlining of the IIA regime. For example, a common regional IIA model can serve as the basis for future negotiations with third parties, with the potential to result in treaties that will be similar to each other; regional sharing of experiences and consensus-building can generate common approaches and inform countries' actions at the national, bilateral and multilateral levels, thereby contributing to a more coherent, more harmonious and possibly also more consolidated IIA regime (see also section C).

### Managing the interaction between IIAs and other bodies of international law

IIA reform needs to take into account the interaction between investment treaties and other bodies of international law in order to avoid inconsistencies and seek synergies (mutual supportiveness).

First, IIAs interact with other areas of international law, such as international environmental law, labour law, human rights law or trade law. Owing to the fragmentation of international law into different “systems” that pursue their own objectives, past ISDS cases have revealed tensions between IIAs and these other parts of international law. Addressing this relationship in IIA reform can help avoid conflicts and provide arbitral tribunals with guidance on how to interpret such interaction.

In practice, reform efforts may reaffirm, in the IIA, parties' commitments under other relevant international law instruments, such as the ones mentioned above. A variant of this approach is to clarify that the IIA needs to be read in line with parties' obligations under international law in other areas (i.e. States' duty to protect, respect and fulfil human rights). Countries may also include general exceptions in favour of certain public policies covered by such other international law obligations.

Second, reform steps in IIAs would also benefit from parallel reform efforts in other international law instruments dealing with foreign investment. For example, future treaties dealing with policy areas that potentially interact with IIAs could specify that States' efforts to implement these treaties are not constrained by any IIAs they have signed.

A third type of interaction arises in areas where IIA reform efforts and developments in other bodies of law go hand in hand, as is the case with CSR standards. IIAs do not need to establish their own CSR provisions, but instead may refer to other relevant non-binding instruments, such as the ILO Tripartite MNE Declaration, the UN Principles on Business and Human Rights, the FAO/World Bank/UNCTAD/IFID Principles on Responsible Agricultural Investment, or the OECD Guidelines on Multinational Enterprises. This approach avoids lengthy and difficult negotiations on CSR issues in the IIA, and it also allows any potential future reinforcements, updates or subsequent developments of existing CSR principles and guidelines to make their way into the IIAs referring to them. Interaction could also extend to the areas of implementation. And, interaction could extend to encouraging those who design CSR and business and human rights strategies to consider IIAs and investment policymaking when doing so.

A final type of interaction arises with respect to IIA reform in the area of investment dispute settlement. Not only IIAs, but also other international conventions – in particular the ICSID Convention, the UNCITRAL Arbitration Rules and the New York Convention – lay down the rules for investor access to dispute settlement, arbitration procedures, and recognition and enforcement of arbitral awards. To the extent that IIA reform modifies investors' access to ISDS, changes procedural rules or introduces new mechanisms (e.g. an appeals facility or an international court), this might require reform steps not only in the IIA, but also in these other international conventions.

This last aspect also offers opportunities for synergies, because there is the option to translate reform actions at the multilateral level into a great number of existing IIAs, thereby avoiding the need for many time-consuming renegotiations. The recently adopted UNCITRAL Transparency Rules and the UN Transparency Convention provide an example: together they create an opt-in mechanism for countries that wish to incorporate enhanced transparency standards for ISDS proceedings, including in those ISDS cases that are brought pursuant to pre-existing IIAs concluded by these countries.

#### Linking IIA reform to the domestic policy agenda

IIA reform does not exist in isolation, but has important linkages to the domestic policy agenda. Investment policies interact with numerous other policy areas, including trade, finance, taxation, industrial policy, intellectual property, environmental protection, social and labour policies, human rights, health and cultural policies. It is critical that different government authorities work together in identifying common IIA reform goals and implementing a joint reform strategy.

In particular, IIA reform needs to take into account the following linkages with the domestic policies of host and home countries.

First, it must be re-emphasized that primary conditions for admission and operations of investors,

the legislative framework within which all investors exist, are created at the national level. This internal environment, which includes the ability of domestic institutions to maintain and enforce applicable laws and regulations, is a crucial factor determining investors' decisions about the location of their investments. IIAs act as a complement but do not replace the need for a high-quality domestic policy environment and effective institutions. IIA clauses that emphasize the importance of such a well-functioning regulatory environment, including modern environmental, health or labour standards, can help support States in their efforts in this regard.

Second, the domestic policy framework is key for determining how much regulatory freedom a country requires in order to ensure that its current and future regulatory needs are not inhibited by IIA obligations. This has emerged as a particularly important issue in respect of pre-establishment IIAs. It is important therefore, that IIA negotiations are informed by a proper assessment of its existing, and potential future, domestic regulatory environment.

Third, IIA obligations must be aligned with the relevant domestic laws and regulations. Thus, for example, if IIA reform seeks a clarification of the FET standard or of the concept of indirect expropriation, care needs to be taken in how these principles are dealt with under domestic law in order to avoid differences. This is especially important if the country follows the "no greater rights" philosophy in relation to IIAs. In addition, if IIA reform limits investor access to ISDS, it becomes important to ensure that local remedies are adequate.

Finally, in some cases, IIAs may trigger reform steps at the national level. One case in point is IIA-driven investment liberalization, which may necessitate changes in the host countries' entry policies for foreign investment. Another example is the possible need for modifications in host countries' domestic investment guarantee schemes if IIAs call for environmental or social impact assessments.

## C. IIA REFORM: GUIDELINES AND ACTIONS

### 1. Guidelines for IIA reform

*IIA reform should be guided by the goal of harnessing IIAs for sustainable development, focusing on key reform areas, and following a multilevel, systematic and inclusive approach.*

Six Guidelines for IIA Reform guide any reform action, be it undertaken at the national, bilateral, regional or multilateral levels (table IV.8). Inspired by the UNCTAD Investment Policy Framework's Core Principles, the lessons learned from 60 years of IIA rule making and the specific reform challenges of today, these six guidelines aim at harnessing IIAs for sustainable development.

### 2. IIA reform: actions and outcomes

*IIA reform actions should be synchronized at the national, bilateral, regional and multilateral levels. In the absence of a multilateral system, the best way to make the IIA regime work for sustainable development is to collectively reform the regime with a global support structure.*

Actions for sustainable-development-oriented IIA reform can be and have to be undertaken at all levels – the national, bilateral, regional and multilateral levels

(table IV.9). At each level, the reform process would broadly follow a sequence of steps that include (1) taking stock and identifying the problems, (2) developing a strategic approach and an action plan for reform, and (3) implementing actions and achieving the desired outcomes.

The actions described below differ in their complexity, ease of implementation and impact. It is therefore important for each country to establish some sort of sequencing of reform actions, identifying actions for the near-, medium- and long-term future.

#### a. Actions at the national level

In its very nature, national-level reform action is unilateral. Accordingly, its potential to create actual change in terms of a new and more sustainable-development-friendly IIA regime is limited. However, national-level action is crucial for preparing proper IIA reform actions at the other (i.e. bilateral, regional and multilateral) levels, and it constitutes the very first step to harness the potential of IIAs for the sustainable development of a country.

National IIA reform needs to be accompanied by domestic reform efforts geared towards improving the regulatory framework for investment.

**Table IV.8.**

**Guidelines for IIA Reform**

Description	
<b>1. Harness IIAs for sustainable development</b>	The ultimate objective of IIA reform is to ensure that the IIA regime is better geared towards sustainable development objectives while protecting and promoting investment.
<b>2. Focus on critical reform areas</b>	The key areas for reform are (i) safeguarding the right to regulate for public interest, (ii) reforming investment dispute settlement, (iii) strengthening the investment promotion and facilitation function of IIAs, (iv) ensuring investor responsibility, and (v) enhancing systemic coherence.
<b>3. Act at all levels</b>	The reform process should follow a multilevel approach and take place at the national, bilateral, regional, and multilateral levels, with appropriate and mutually supportive action at each level.
<b>4. Sequence properly for concrete solutions</b>	At each level, the reform process should follow a gradual, step-by-step approach, with appropriately sequenced and timed actions based on identifying the facts and problems, formulating a strategic plan, and working towards concrete outcomes that embody the reform effort.
<b>5. Ensure an inclusive and transparent reform process</b>	The reform process should be transparent and inclusive, allowing all stakeholders to voice their opinion and to propose contributions.
<b>6. Strengthen the multilateral supportive structure</b>	The reform process should be supported by universal and inclusive structures that help coordinate reform actions at different levels by offering backstopping, including through policy analysis, technical cooperation, and a platform for exchange of experiences and consensus-building.

Source: UNCTAD.

Table IV.9. Road map for IIA reform

Level	Take stock/identify problem	Strategic approach/action plan	Options for actions and outcomes
<b>National</b>	<ul style="list-style-type: none"> <li>National IIA review</li> <li>Treaty network and content profiles</li> <li>Impact and risk assessment</li> <li>Reform needs</li> </ul>	<ul style="list-style-type: none"> <li>National IIA action plan</li> <li>Design criteria and guidelines</li> <li>Reform areas and entry points</li> <li>Approaches for IIA reform</li> <li>Negotiating strategy</li> </ul>	<ul style="list-style-type: none"> <li>New model treaty</li> <li>Unilateral termination</li> <li>Implementation <ul style="list-style-type: none"> <li>Domestic reform</li> <li>Increased awareness</li> <li>Improved institutions</li> <li>Capacity-building</li> </ul> </li> </ul>
<b>Bilateral</b>	<ul style="list-style-type: none"> <li>Joint IIA consultations to identify reform needs</li> </ul>	<ul style="list-style-type: none"> <li>Plan for a joint course of action</li> </ul>	<ul style="list-style-type: none"> <li>Joint interpretation</li> <li>Renegotiation/amendment</li> <li>Consensual termination</li> </ul>
<b>Regional</b>	<ul style="list-style-type: none"> <li>Collective review</li> <li>Treaty network and content profiles (regional IIA and BIT network)</li> <li>Impact and risk assessment</li> <li>Reform needs</li> </ul>	<ul style="list-style-type: none"> <li>Collective IIA action plan</li> <li>Design criteria and guidelines</li> <li>Reform areas and entry points</li> <li>Approaches for IIA reform and for consolidating and streamlining the IIA network</li> </ul>	<ul style="list-style-type: none"> <li>Consolidation/rationalization of BIT networks</li> <li>Common model</li> <li>Joint interpretation</li> <li>Renegotiation/amendment</li> <li>Implementation/aid facility</li> </ul>
<b>Multilateral</b>	<ul style="list-style-type: none"> <li>Global review of the IIA regime (e.g. <i>WIR15</i>)</li> <li>Stocktaking/lessons learned</li> <li>Identification of systemic risks and emerging issues</li> </ul>	<ul style="list-style-type: none"> <li>Multilateral consensus-building on key and emerging issues</li> <li>Shared vision on systemic reform</li> </ul>	<ul style="list-style-type: none"> <li>Multilateral Action Plan <ul style="list-style-type: none"> <li>Multilaterally agreed criteria and guidelines for systemic reform</li> <li>Developing instruments and/or institutions for facilitating reform at all levels</li> </ul> </li> <li>Multilateral backstopping <ul style="list-style-type: none"> <li>Research and analysis</li> <li>Coordination, including “bridging” function with other bodies of law</li> <li>Technical assistance</li> <li>Platform/forum for consensus-building and exchange of best practices</li> </ul> </li> </ul>

Source: UNCTAD.

In other words, IIA reform needs to be accompanied by action regarding those issues that IIAs are supposed to address by overcoming deficiencies and providing guarantees and “insurance”. This is important not only for avoiding the potential negative effects of IIA reform in terms of creating transaction costs, but also for further fine-tuning the role of IIAs in a country’s development strategy. Indeed, one of the arguments for IIA reform is that the domestic regulatory regime of many countries has evolved to such a degree that classical “protection-focused” IIAs are no longer adequate instruments for harnessing investment for sustainable development.

All national level reform actions would benefit from involving all stakeholders, including through interministerial consultations, parliamentary engagement and inputs from academia, civil society and business.

### IIA review

The first step for national level IIA reform is an IIA review. Such a review takes stock of the country’s network of IIAs, assesses the impact and risks flowing from these agreements, and identifies concrete reform needs (Poulsen et al., 2013; Tietje et al., 2014).

More specifically, this includes analysing a country’s IIA profile, i.e. reviewing the country’s existing IIAs in terms of partners, coverage, types and content. A subsequent impact and risk assessment looks at the IIAs’ economic and policy impacts. This includes analysing their impact on investment flows and other economic indicators (e.g. trade flows, royalties and license payments flows, tax) and their interrelationship with other policies (e.g. overlaps, inconsistencies with national investment and other policies, with other

international obligations). Such an assessment would also look at the problems the agreements have caused and the risks they give rise to, for example, through ISDS cases (whether withdrawn, settled or decided in favour of the State or the investor). Putting these findings into the context of the country's socioeconomic and political realities (as stipulated in its national development strategy and by today's SDG imperative) enables policymakers to draw lessons learned and to identify concrete reform needs. Although such a risk assessment can never be comprehensive, even if undertaken in a rudimentary manner or in a sector-specific manner, it can offer important insights.

- **National IIA action plan**

The next step is the development of a national IIA action plan. Informed by a number of design criteria and guidelines (e.g. as outlined in the 2012 UNCTAD Policy Framework) and the results of the national IIA review, the country can develop its strategic approach towards IIA reform. Regarding the extent of reform, the country decides whether to comprehensively address all five reform objectives or to single out one or two, such as safeguarding the right to regulate and improving investment dispute settlement. This choice informs the selection of reform areas and entry points to focus on and the policy options best suited for doing so. This last step benefits from comprehensive information about international and/or regional best practice (and state-of-the-art treaty practice). The policy options in UNCTAD's Investment Policy Framework as well as those in this *WIR* serve as examples.

Another key element of the national IIA action plan is the development of a negotiating strategy. Such a strategy sets out the concrete action steps for reforming the different IIA relationships the country maintains. This includes prioritizing certain relationships and setting timelines within which they will be addressed. IIA relationships to be prioritized include those IIAs that have reached the end of their initial duration, those with which major problems have occurred and those that can be rationalized (in the context of regional endeavours).

Determining the best way of reforming these relationships is also important. The country needs to decide whether certain IIA relationships should be terminated, renegotiated or amended, all of this with

concrete timelines, according to which the country approaches its IIA reform agenda with its preferred treaty partners. Finally, also joint interpretation or the negotiation of new IIAs are options to be considered.

- **New IIA model**

In terms of concrete outcomes of national-level IIA reform, this includes first and foremost a new IIA model. The new model will be based on the respective strategic choices (e.g. the extent of reform), selection of reform objectives and areas, and respective policy options. A new model IIA can imply either partial amendments or a complete overhaul of the pre-existing model. By now, at least 50 countries and 4 regional integration organizations have embarked on developing a new model IIA (chapter III). A new model can be accompanied by decisions on which of the new model's elements are priority objectives to be pursued and what fallback options exist if needed.

- **Interpretative statements or treaty termination**

Another set of concrete outcomes of national-level IIA reform action are unilateral actions, such as issuing interpretative statements for a treaty or terminating it. Regarding the latter, rules for treaty termination are typically set out in the BIT itself. Between 2014 and 2018, more than 1,500 BITs will reach the stage where they can be terminated at any time. Countries wishing to terminate their IIAs need to have a clear understanding of the relevant treaty provisions (especially the survival clause) as well as the broader implications of such actions (UNCTAD, 2013c; *WIR11*).

- **Addressing bottlenecks for domestic IIA implementation and IIA reform**

As a third element of the national IIA Action Plan, countries should identify their domestic IIA-implementation and IIA-reform bottlenecks. This could include at least four steps of government action. First, treaty implementation may require administrative actions to fully translate international obligations into national laws and administrative practices. Overall, IIA reform should go hand in hand with domestic regulatory adjustments to ensure coherence and create synergies. Second, the country may wish to create awareness at all levels of government concerning the countries' international IIA-related obligations (even in the absence of disputes). Information campaigns and active training of local officials directly dealing with



foreign investors are examples in point. Third, there may be a need to build the necessary institutions to deal with IIA-related implementation issues. This step could range from establishing early-warning systems or ombuds-like institutional set-ups that are geared towards dispute prevention, to creating dedicated “defence” teams in the ministry charged with dispute settlement, and/or to follow-through on the direct institutional commitments in IIAs, e.g. the establishment of joint committees. Finally, in all of this work governments could identify their technical assistance and capacity-building needs and take actions on their follow-up, through bilateral, regional or multilateral assistance programmes (such as UNCTAD’s IIA work, its Investment Policy Reviews or e-governance programmes). The latter is particularly important for least developed countries and for other small and vulnerable economies.

### **b. Actions at the bilateral level**

Bilateral reform action largely mirrors and builds on national-level actions. Bilateral action will usually create actual change in the legal instruments covering the pertinent bilateral relationship.

A joint IIA review aims at taking stock of the situation and at assessing the impact and the risks of the bilateral IIA relationship, and at identifying reform needs. This time, the review is undertaken jointly, involving the respective actors from the two countries. Such a review can take the form of consultations, possibly making use of joint review committees, and may be in the context of already existing joint economic committees or through a new, institutional set-up, whether ad hoc or permanent. Stakeholder involvement can help to inform the process.

Based on the review, the two countries would proceed to develop a plan for a joint course of action. Such a plan can include options such as (1) joint interpretative statements (in the form of memoranda of understanding) on an existing treaty (UNCTAD, 2011c), (2) amendments to or renegotiation of an existing treaty; (3) the consensual termination of the treaty either upon treaty expiration or if the treaty is superseded by a regional initiative to which both parties are members. The “survival clause” of the terminated treaty would require attention, as it affects how the termination takes effect. To limit the application of the survival clause, treaty partners could agree to amend

the IIA in question by deleting the clause before they terminate the treaty.

### **c. Actions at the regional level**

Regional reform action follows similar steps as national and bilateral actions, but with additional layers of complexity and greater potential for change.

In terms of greater complexity, regional IIA rule making implies overlaps and inconsistencies, particularly given the current practice in which new regional agreements do not provide for the phasing-out of older agreements covering the underlying respective bilateral relationships. At the same time, regional IIA reform provides an opportunity for more efficient and widespread reform as it involves more than two countries, and, if undertaken properly, would harmonize and consolidate existing investment rules. Moreover, regional endeavours may be subject to a different kind of dynamism than bilateral relationships in terms of setting a reform agenda and pursuing it. Regional integration organizations and their secretariats offer the platforms on which regional IIA reform could be pursued.

Again, the first step is an IIA review, this time undertaken collectively by the members of the regional organization/agreement and in a multi-dimensional manner. Similar to the above, such a review would look into the network and content profiles, assess impacts and risks, and identify reform needs, including through stakeholder consultations. In so doing, a collective regional review would consider the different treaty layers and relationships that exist in a regional context. This would be, first and foremost, the regional agreement in question. Second, this would include the existing BITs among the partners to the regional undertaking, internally (i.e. intraregional BITs with the other partners in the regional undertaking). Third, this would include IIAs with third parties, be they between a single member of the regional undertaking and a third, external treaty partner, or between the regional undertaking as such and a third, external treaty partner. When identifying impact and risk, attention would need to be given to the multilayered character of this IIA network, including the overlaps, gaps and inconsistencies, and the attendant risks arising from it.

This special nature of the regional dimension would inform the collective IIA action plan. For example, when defining reform objectives, the fifth one –

promoting systemic consistency – would deserve particular attention, not only in terms of substance of the rules but also in terms of managing the relationship between them. Collective approaches regarding areas for IIA reform and for consolidation and streamlining of IIAs would be particularly important.

Collective approaches will translate into specific, time-bound actions and outcomes. In terms of actions, they range from further discussions and consultations to negotiations, amendments/re negotiations or interpretation of treaties. When it comes to addressing existing treaties, underlying BITs that have reached their expiration dates could be the first to be tackled; however, also other regional undertakings that have long not been updated or modernized are candidates for IIA reform.

In terms of specific results, regional reform efforts could result in a new, common IIA model or a negotiating position for future treaties, a joint interpretation; a renegotiated/amended treaty; the consolidation/streamlining of underlying BITs. Again, the renegotiated treaties can be the regional treaty at issue, or a treaty between the region and third parties. A renegotiated regional treaty can also result in the termination of the underlying bilateral treaties. With this latter outcome, regional IIA reform action can directly support the broader IIA reform effort of streamlining and rationalizing the global IIA regime.

Similar to national-level reform action, regional IIA reform may require regulatory adjustments at the national level to ensure coherence and create synergies. This could be aided by creating new – or improving existing – regional facilities to provide coordination and technical cooperation. The latter could include legal aid and/or training for dispute management and/or prevention, help with translating regional obligations into national laws and administrative practices, follow-through on direct treaty commitments for regionally institutionalized investment promotion and facilitation, and, more broadly, assistance with the implementation of IIA reform at the regional and/or national level (e.g. assistance for conducting a national risk assessment, or the implementation of identified reform action, such as the termination or renegotiation of an existing agreement). Regional technical assistance and capacity-building bodies could serve as counterparts to, and benefit from, international organizations providing such support.

#### d. Actions at the multilateral level

Reforming an IIA regime consisting of thousands of agreements is a global challenge that calls for common responses from all parties involved. Such a global reform effort, if successful, would be the most efficient way of addressing the sustainable development challenges, inconsistencies and overlaps that characterize the current IIA regime. At the same time, multilateral IIA reform is the most challenging reform option, particularly regarding how to pursue it.

Several levels of multilateral IIA reform, with increasing intensity, depth and character of engagement, can be identified. They interact with the steps and actions undertaken at the other levels of IIA reform actions and, similarly to them, they could benefit from inclusive and transparent multistakeholder engagement.

- **Global IIA review**

First, there is a global review of the IIA regime, aimed at taking stock of experiences and at identifying systemic risks and emerging issues. Such a review could take the form of a series of brainstorming sessions or regular multilateral exchanges of experiences and information (e.g. in the form of consultations or hearings) and be supported by backstopping from a multilateral support structure. Exchanges of experiences would enable governments and other stakeholders to learn from each other's experiences and best practices; this could generate positive feedback on unilateral, bilateral or regional reform steps and lead to a greater harmonization of and coherence in ongoing reform efforts.

In terms of content, a global IIA review could cover the entire range of issues related to IIA reform (e.g. taking stock of all norms contained in IIAs and related instruments). It could also look at novel approaches to be considered for unresolved issues or emerging issues, together with their likely advantages and disadvantages for the sustainable development dimension of the IIA regime. Importantly, a review of the global IIA regime would give attention to issues of systemic importance.

- **Multilateral consensus-building**

Second, following the stocktaking, multilateral consensus-building on areas for improvement could aim at identifying areas of broad consensus and areas of disagreement. In terms of content, consensus-

building can aim to develop a common understanding of the key problems and emerging issues of the IIA reform agenda or go so far as to involve common reform objectives or a road map of steps or guidelines for moving towards such common solutions. Along these lines, the core of multilateral consensus-building could be to identify and consolidate consensus where it already exists, and to explore and seek a more coordinated approach where it does not.

- **Multilateral action plan**

Third, a multilateral action plan could be envisioned that could build on the global IIA review and move multilateral consensus-building towards providing concrete reform elements. This could take the form of multilaterally agreed upon criteria and guidelines for systemic reform. Such criteria and/or guidelines can support reform efforts at the national, bilateral and regional levels. They can also support further multilateral action. Non-binding principles on the reform process could take the form of recommendations addressing member States, international organizations and other stakeholders. Multilaterally agreed criteria and guidelines could provide benchmarks against which certain parameters for IIA reform could be assessed. They could address systemic risks and emerging issues, and guide reform actions in this regard. Guiding principles for the content and implementation of investment policies and IIAs, as contained in UNCTAD's Investment Policy Framework, or for the process of IIA reform, as contained in this *WIR*, are examples in point. Again, an institutional support structure can facilitate the development of such criteria and their adoption.

Such a multilateral action plan could result in the development of a number of *multilateral instruments* that can facilitate reform on all levels. A range of options can be foreseen:

- *A checklist for IIA negotiators:* A checklist would identify those policy issues that IIA negotiators should take into account when negotiating or renegotiating an agreement as part of sustainable-development-oriented IIA reform.
- *Best practices in IIA rule making and/or IIA reform:* A compilation of individual case studies demonstrating how countries have reformed the IIA network to bring it in line with sustainable development considerations, distilling both positive

and negative experiences, can provide lessons for future reform-oriented IIA (re)negotiations.

- *Model provisions (or a model agreement):* Model texts for IIA clauses in line with certain reform objectives can guide concrete reform actions. If undertaken in a more comprehensive manner covering all possible reform objectives, this could also result in a “new-generation model agreement”. Model provisions or agreements can also address issues related to systemic reform.
- *Guidance for interpreting IIA provisions:* Guidance for interpreting treaties could improve the transparency, predictability and stability of international investment law, and help clarify the substance of key provisions, including their sustainable development dimension.
- *Multilaterally agreed guidelines for investment policymaking:* Multilaterally agreed guidelines or principles for investment policymaking such as UNCTAD's Policy Framework could ensure a coherent, holistic and synergetic approach to IIA reform.

A multilateral action plan could also result in *multilateral institution-building* related to IIA reform, as is already envisioned in the ISDS context – with a possible appeals mechanism or a potential international investment court. Although this is currently considered foremost in the bilateral context (e.g. various United States IIAs provide for the undertaking of an appeals mechanism in the future) and at the regional level (e.g. the European Commission's suggestions for a permanent investment court in future IIAs signed by the European Union (European Commission, 2015)), it could also take on an international dimension. One example is a possible appeals facility under the ICSID Convention. Another is the European Commission's proposal to “multilateralise the [permanent investment] court either as a selfstanding international body or by embedding it into an existing multilateral organization”.<sup>9</sup> It is important in this context to recall that ISDS is an *enforcement mechanism* as regards the substantive provisions of IIAs and cannot be looked at in isolation. Hence, multilateralizing the enforcement mechanism would greatly benefit from multilateralizing the underlying substantive investment rules as embodied in IIAs.

Multilateral engagement on IIA reform could also result in creating an instrument that would follow the

example of the Convention on Transparency in Treaty-based Investor–State Arbitration developed under the auspices of UNCITRAL; i.e. a multilateral consensus on a clearly defined key IIA reform issue. In this approach, States could sign on to a general statement clarifying the concept of a particular IIA provision and applying it to existing and/or future treaties. This could take the form of a multilateral instrument that would co-exist with the existing IIA network. It would address those provisions (common to most BITs) where need for sustainable-development-oriented reform is deemed most important by the parties, and in the manner agreed upon by the parties. This could allow countries to reform their entire portfolios of investment treaties at once; i.e. parties to the amended multilateral instrument could agree that the revised provision – transparency in case of the UNCITRAL Arbitration Rules – shall apply not only in respect of future IIAs, but also with regard to existing investment treaties. Although it could prove difficult to find consensus among all States on the formulation of controversial substantive provisions (such as FET or indirect expropriation), agreement that takes the form of softer instruments could be envisioned as a first step, thereby progressively moving towards finding common ground.

- **Backstopping**

Any multilateral engagement would benefit from a multilateral support structure that could offer backstopping functions. This includes collecting and disseminating comprehensive up-to-date information about international best practices, state-of-the-art treaty making and the latest developments in adjacent fields of law. It also encompasses acting as repositories of change initiatives, undertaking research and policy analysis on reform options and their pros and cons, coordinating among various processes at different levels and dimensions, and providing the “bridging” function with other bodies of law (e.g. human rights or environmental law) that would ensure two-way coherence and mutually beneficial exchange. Backstopping also entails the provision of technical assistance and capacity-building for implementing IIA reforms, ranging from advisory services and training to awareness-raising work and information dissemination.

Such technical assistance backstopping could take the form of a multilateral aid facility that would

provide legal assistance and/or training for dispute management and/or prevention, along the lines of what the Advisory Centre for WTO Law provides for certain developing-country WTO members. An investment aid facility could build on this by also helping beneficiaries, in particular least developed countries and other small and vulnerable economies, to ensure compliance with international obligations in national laws and administrative practices, provide institutionalized investment promotion and facilitation services on an international level and, more broadly, assist with the implementation of sustainable-development-oriented IIA reform actions.

Finally, backstopping services also include the hosting of a forum for exchange of experiences, lessons learned and discourse on the way forward. Engaging with treaty partners and the broader investment-development community can help ensure a universal, inclusive and transparent discourse and fact-finding and consensus-building. UNCTAD’s World Investment Report, its World Investment Forum and its Expert Meetings are cases in point.

A multilateral support structure could take the form of creating a new international coordination mechanism that would involve several international organizations active in this field of international investment rule making. Built around a core of international organizations that combine expertise in policy analysis, technical assistance and consensus-building on this matter, this could ultimately also include a variety of relevant stakeholder organizations.

IIA reform can take place at various levels of engagement – unilateral, bilateral, regional or multilateral – and countries can select processes and formats in line with their development strategies and needs and their strategic choices about the priority, intensity, depth and character of their engagement in IIA reform. Moreover, the various paths identified are not mutually exclusive. In fact, some options are sequential steps as part of a gradual approach, and most of the actions and options could be pursued in parallel. There is also room for cross-fertilization between different reform paths. However, ultimately collective action is required to ensure that IIA reform is for the benefit of all.

## CONCLUSION

The IIA universe is at a crossroads, and many countries and regional groupings are in the process of reviewing, reforming and revising their IIAs and their stances on the issues involved. This chapter takes stock of this ongoing debate, the arguments, the history and lessons learned, and offers an action menu or toolbox for IIA reform. It does not provide a single reform package. Rather, countries are invited to pick and choose which reform option to pursue, at which entry level and with which treaty option, and at what level and intensity of engagement. In other words, countries are invited to formulate their own reform packages.

The chapter advances UNCTAD's earlier work on this matter, in particular its Investment Policy Framework (WIR12), the reform paths for investment dispute settlement (WIR13) and the reform paths for IIA reform (WIR14). Taking into account contributions from other stakeholders, it develops this work further to provide a holistic, coherent and multilevel blueprint for addressing

the five main reform challenges for harnessing IIAs for sustainable development: safeguarding the right to regulate for pursuing sustainable development objectives, reforming investment dispute settlement, promoting and facilitating investment, ensuring responsible investment, and enhancing systemic consistency of the IIA regime.

The chapter stresses that engagement at all levels – national, bilateral, regional and multilateral – is important to achieve the common objective of IIA reform. However, it also underscores that reform needs to be pursued with a common agenda and vision in mind, since any reform step taken without multilateral coordination will only worsen fragmentation. Only a common approach will deliver an IIA regime in which stability, clarity and predictability help achieve the objectives of all stakeholders: effectively harnessing international investment relations for the pursuit of sustainable development.

### Notes

<sup>1</sup> One of the first cases was the Anglo-Iranian Oil Co. Case (*United Kingdom v. Iran*) 1951 I.C.J. Rep. 89, 1952 I.C.J. Rep. 93.

<sup>2</sup> One important difference, however, was that both the Abs-Shawcross Convention (Art. VII(2)) and the OECD Draft Convention (Art. 7(b)) provided for investor-State arbitration (conditioned upon separate advance consent of the contracting party concerned), an idea not taken up in investment treaty practice until the Indonesia–Netherlands BIT of 1968.

<sup>3</sup> *Asian Agricultural Products Ltd. (AAPL) v. Republic of Sri Lanka* (ICSID Case No. ARB/87/3, Award, 27 June 1990).

<sup>4</sup> Some countries also include a list (as described above) without explicitly including a provision entitled “FET”; the SADC model BIT and the draft Indian model BIT are examples.

<sup>5</sup> To this purpose, IIAs usually stipulate the requirements for a lawful expropriation, i.e. for a public purpose, non-discriminatory, in accordance with due process of law and against compensation.

<sup>6</sup> Another option is to include a broadly formulated exception for domestic regulatory measures aimed at pursuing legitimate public policy objectives.

<sup>7</sup> *Mexico v. United States* (2000), *Peru v. Chile* (2003), *Italy v. Cuba*, ad hoc arbitration (2003), *Ecuador v. United States*, PCA (2011).

<sup>8</sup> In June 2014, the UN Human Rights Council passed a resolution, by majority, that decided to establish an open-ended working group on a legally binding instrument on transnational corporations and other business enterprises with respect to human rights.

<sup>9</sup> European Commission, 2015, pp. 11–12.

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