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**Expert Meeting on the Transformation of the**  
**International Investment Agreement Regime: The Path Ahead**  
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**Item 3 of the provisional agenda**

### **Transformation of the international investment agreement regime**

#### **Note by the secretariat**

##### *Executive summary*

The international investment agreement (IIA) regime is at a critical juncture. The number of concluded IIAs continues to grow every year, as does the number of cases brought under investor–State dispute settlement (ISDS) mechanisms contained in many of these agreements. These disputes have raised several important issues, such as the interpretation of often broad and vague clauses contained in these agreements and the policy space that they preclude or allow countries to retain. As these issues rise to the surface, stakeholders have engaged in a broader discourse about the role and implications of the IIA regime. On the one hand, IIAs are still considered an important policy tool that serves the protection and attraction of foreign direct investment by helping create a stable and predictable business climate. At the same time, there is broad agreement on the need to reform both the IIA network and the dispute-settlement system.

This background note addresses a number of issues related to the transformation of the IIA regime: trends in IIAs and ISDS, five paths for reform of investment dispute settlement, four paths for reform of the overall IIA regime and the way forward. The attached annex offers information on treaty expiration and opportunities to terminate existing IIAs. This background note aims to support experts in their search for clear options for making the IIA regime work better for sustainable development.



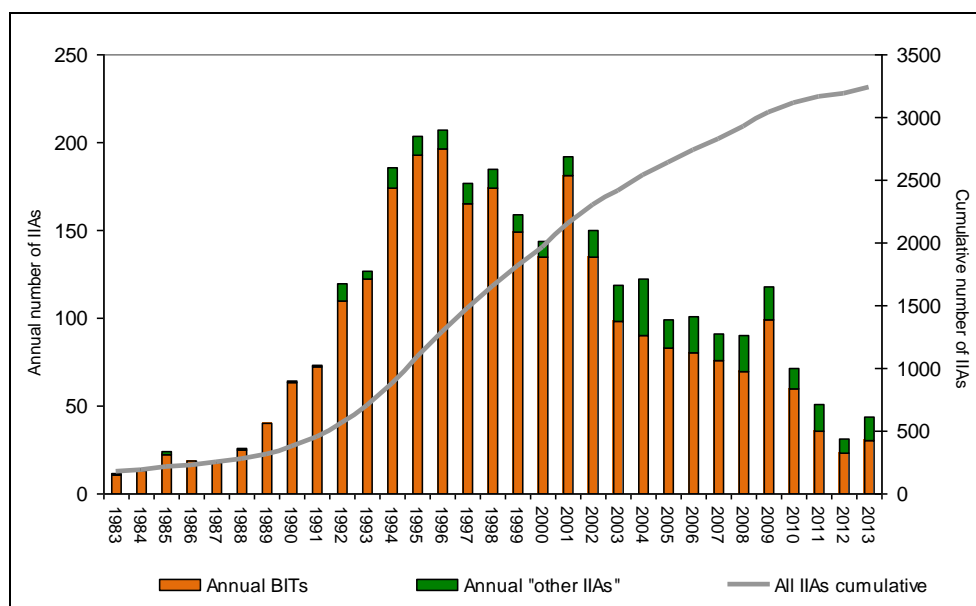
## I. Trends in international investment agreements and investor–State dispute settlement

### A. A growing dichotomy in investment treaty making

1. With the addition of 44 new treaties to the IIA universe (30 bilateral investment treaties (BITs) and 14 “other IIAs”<sup>1</sup>), the global IIA system comprised about 3,240 IIAs at the end of 2013 (figure 1). Recent developments brought about a growing dichotomy in investment treaty making. A rising number of developing countries in Africa, Asia and Latin America are disengaging from the system. At the same time, there is an upscaling trend in treaty making, which manifests itself in increasing dynamism (more countries are participating in ever more quickly sequenced negotiating rounds) and in an expanding depth and breadth of issues addressed.

Figure 1

#### Trends in international investment agreements signed between 1983 and 2013



Source: UNCTAD, based on IIA database.

Abbreviations: BIT, bilateral investment treaty; IIA, international investment agreement.

2. More and more, IIA negotiators are taking novel approaches to existing IIA provisions and adding new issues to the negotiating agenda. Provisions that bring a liberalization dimension to IIAs and/or strengthen certain investment protection elements are examples in point.

3. Moreover, new IIAs illustrate the growing tendency of crafting treaties that are in line with sustainable development objectives. A review of the 118 IIAs concluded in 2013 for which texts are available (11 BITs and 7 free trade agreements with substantive investment provisions) shows that most of the treaties include sustainable-development-oriented features, such as those identified in the Investment Policy Framework for Sustainable Development and the 2012 and 2013 editions of the *World Investment Report*.

<sup>1</sup> UNCTAD defines “other IIAs” as agreements that contain provisions on investment, for example free trade agreements and economic partnership agreements.

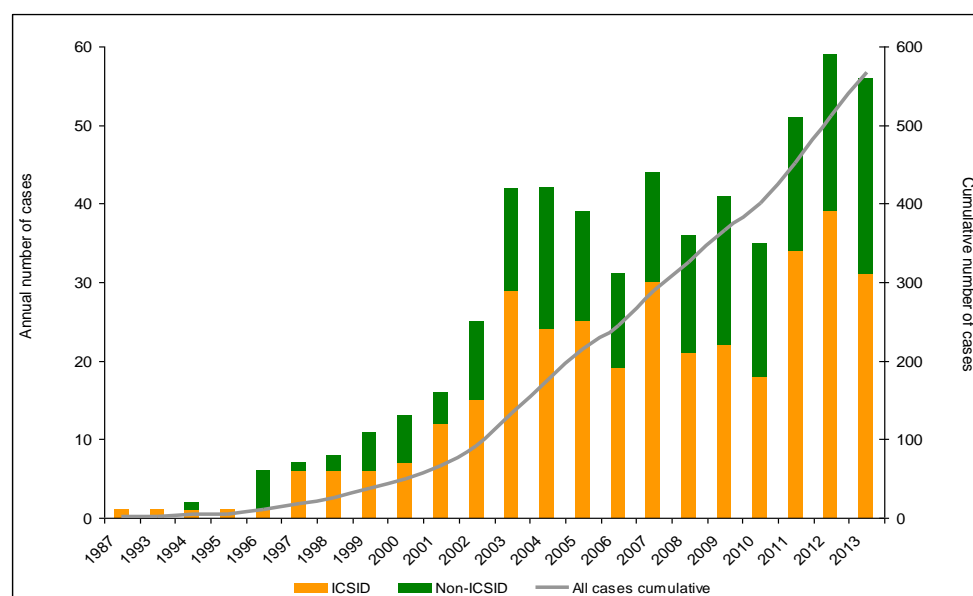
## B. Trends in investor–State dispute settlement

4. The year 2013 saw the second highest number of known investment arbitrations filed in a single year (56), bringing the total number of known cases to 568 (figure 2) In comparison, the World Trade Organization (WTO) had registered 474 disputes by the end of 2013.

5. Of the new claims, more than 40 per cent were brought against Member States of the European Union – all but one were cases between an investor of one Member State against another Member State. Investors continued to challenge a broad number of measures in various policy areas, particularly in the renewable energy sector.

Figure 2

### Known investor–State dispute settlement cases, 1987–2013



Source: UNCTAD, based on ISDS database.

Abbreviations: ICSID, International Centre for Settlement of Investment Disputes.

## II. Mapping five broad paths towards reform of investment dispute settlement

6. In light of the increasing number of ISDS cases, the debate about the usefulness and legitimacy of the ISDS mechanism has gained momentum, especially in those countries and regions where it is on the agenda of high-profile IIA negotiations.

7. Originally, the mechanism was designed to ensure a neutral forum that would offer investors a fair hearing before an independent and qualified tribunal, granting a swift, cheap, and flexible process for settling investment disputes. Moreover, ISDS gives disputing parties considerable control over the process, for example, by allowing them to select arbitrators. Given that investor complaints relate to the conduct of sovereign States, taking these disputes out of the domestic sphere of the State concerned aggrieved investors with an important guarantee that their claims will be adjudicated in an independent and impartial manner. Moreover, it is common for the rights enshrined in international treaties to have an international means of enforcement.

8. However, the actual functioning of ISDS under investment treaties may disprove many of the advantages that arbitration purports to offer. Indeed, systemic deficiencies of

the ISDS regime have emerged.<sup>2</sup> Deficiencies have been well documented in the literature and summarized in the *World Investment Report 2012*.

(a) Legitimacy. It is questionable whether three individuals, appointed on an ad hoc basis, can be entrusted with assessing the validity of States' acts, particularly when they involve public policy issues. The pressures on public finances<sup>3</sup> and potential disincentives for public-interest regulation may pose obstacles to countries' sustainable development paths;

(b) Transparency.<sup>4</sup> Although the transparency of the system has improved since the early 2000s, ISDS proceedings can still be kept fully confidential if both disputing parties so wish, even in cases where the dispute involves matters of public interest;<sup>5</sup>

(c) Nationality planning. Investors may gain access to ISDS procedures using corporate structuring, that is to say, by channelling an investment through a company established in an intermediary country with the sole purpose of benefiting from an IIA concluded by that country with the host State;

(d) Consistency of arbitral decisions. Recurring episodes of inconsistent findings by arbitral tribunals have resulted in divergent legal interpretations of identical or similar treaty provisions, as well as differences in the assessment of the merits of cases involving the same facts. Inconsistent interpretations have led to uncertainty about the meaning of key treaty obligations and lack of predictability as to how they will be read in future cases;<sup>6</sup>

(e) Erroneous decisions. Substantive mistakes of arbitral tribunals, should they arise, cannot be effectively corrected through existing review mechanisms. In particular, annulment committees under the auspices of the International Centre for Settlement of Investment Disputes (ICSID), in addition to having extremely limited review powers,<sup>7</sup> are individually set up for each specific dispute and can also disagree between themselves;

<sup>2</sup> Deficiencies have been well documented in the literature and summarized in the *World Investment Report 2012*; M Waibel et al., eds., 2010, *The Backlash against Investment Arbitration: Perceptions and Reality* (Alphen aan den Rijn, the Netherlands, Kluwer Law International); D Gaukrodger and K Gordon, 2012, Investor-State dispute settlement: A scoping paper for the investment policy community, OECD Working Papers on International Investment, No. 2012/03, available at [http://www.oecd.org/daf/inv/investment-policy/WP-2012\\_3.pdf](http://www.oecd.org/daf/inv/investment-policy/WP-2012_3.pdf); C Olivet, 2012, *Profiting from Injustice: How Law Firms, Arbitrators and Financiers are Fuelling an Investment Arbitration Boom* (Brussels/Amsterdam/Corporate Europe Observatory and the Transnational Institute), available at <http://corporateeurope.org/sites/default/files/publications/profitting-from-injustice.pdf>.

<sup>3</sup> In July 2014, a tribunal sitting in three related investment treaty arbitrations issued by far the largest award to date – a total of \$50 billion in damages. *Hulley Enterprises Ltd. v. the Russian Federation* (Permanent Court of Arbitration (PCA) Case No. AA 226), *Veteran Petroleum Ltd. v. the Russian Federation* (PCA Case No. AA 228) and *Yukos Universal Ltd. v. the Russian Federation* (PCA Case No. AA 227). Final Awards of 18 July 2014.

<sup>4</sup> UNCTAD, 2012, *Transparency: A Sequel*, UNCTAD Series on Issues in International Investment Agreements II (New York and Geneva, United Nations publication).

<sup>5</sup> It is indicative that of the 85 cases under the Arbitration Rules of the United Nations Commission on International Trade Law administered by the PCA, only 18 were public as of end 2012. (Source: International Bureau of the PCA.)

<sup>6</sup> In some cases divergent outcomes can be explained by the different wording of IIAs; however, for the most part they represent differences in the views of individual arbitrators.

<sup>7</sup> It is notable that even having identified “manifest errors of law” in an arbitral award, an ICSID annulment committee may find itself unable to annul the award or correct the mistake. *CMS Gas Transmission Company v. The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision of the ad hoc Committee on the application for annulment of the Argentine Republic, 25 September 2007.

(f) Arbitrators' independence and impartiality. An increasing number of challenges to arbitrators may indicate that disputing parties perceive them as biased or pre-disposed. Particular concerns have arisen from the perceived tendency of each disputing party to appoint individuals sympathetic to their case. Arbitrators' interest in being re-appointed in future cases, and their frequent "changing of hats" – serving as arbitrators in some cases and counsel in others – amplify these concerns;<sup>8</sup>

(g) Financial stakes. The high cost of arbitrations can be a concern for both States and investors, especially small and medium-sized enterprises. From the State perspective, even if a government wins the case, the tribunal may refrain from ordering claimant investors to pay the respondent's costs, leaving the average \$8 million spent on lawyers and arbitrators as a significant burden on public finances and preventing the use of those funds for other goals.<sup>9</sup>

9. These issues have prompted a debate about the challenges and opportunities of ISDS. This debate has been conducted in multiple forums, among them under the auspices of the Investment Commission and expert meetings of UNCTAD, the World Investment Forum,<sup>10</sup> UNCTAD fireside talks<sup>11</sup> and Freedom-of-Investment round tables held by the Organization for Economic Cooperation and Development (OECD).<sup>12</sup>

10. Five broad paths for reform emerged from these discussions and were also reviewed at the 2014 World Investment Forum Conference on IIAs:

- (a) Promoting alternative dispute-resolution methods;
- (b) Tailoring the existing system;
- (c) Limiting investors access to ISDS;
- (d) Introducing an appeals facility;
- (e) Establishing a standing international investment court.

11. These five paths are described below.

## **A. Promoting alternative dispute-resolution methods**

12. This approach advocates resorting increasingly to alternative dispute resolution methods and dispute prevention policies, both of which have formed part of UNCTAD technical assistance and advisory services on IIAs. Alternative dispute resolution and dispute prevention can either be enshrined in IIAs or implemented at the domestic level, without any specific references in an IIA.

13. Compared with arbitration, alternative dispute resolution methods, such as conciliation and mediation, place less emphasis on legal rights and obligations. They involve a neutral third party whose main objective is not the strict application of the law but finding a solution that would be recognized as just by the disputing parties. Alternative dispute resolution methods can help save time and money, find a mutually acceptable solution, prevent escalation of the dispute and preserve a workable relationship between the

<sup>8</sup> For further details see Gaukrodger and Gordon, 2012, pp. 43–51.

<sup>9</sup> Lawyers' fees, which may go as high as \$1,000 per hour for partners in large law firms, represent the biggest expenditure item: on average, they have been estimated to account for about 82 per cent of the total costs of a case. See Gaukrodger and Gordon, 2012, p. 19.

<sup>10</sup> <http://unctad-worldinvestmentforum.org/>.

<sup>11</sup> Informal discussions, organized or co-organized by UNCTAD, held in a small group of various stakeholders with a view to generating tangible outputs on how to improve the ISDS system.

<sup>12</sup> <http://www.oecd.org/daf/inv/investment-policy/foi.htm>.

disputing parties. However, there is no guarantee that the dispute will be resolved; in that case, the procedure will add to the costs involved. Also, depending on the nature of the State act that is challenged by an investor (for example, a law of general application), alternative dispute resolution may not always be an option.

14. Alternative dispute resolution can go hand in hand with the strengthening of dispute prevention and management policies at the national level. Such policies aim to create effective channels of communication and improve institutional arrangements between investors and respective agencies (for example, investment aftercare policies) and between different government ministries dealing with investment issues. An investment ombudsman office or a specifically assigned agency that takes the lead, should a conflict with an investor arise, can help resolve investment disputes early on, as well as assess the prospects for international arbitration, and, if necessary, prepare for it.<sup>13</sup>

15. In terms of implementation, this approach is relatively straightforward, and much has already been put in place by countries around the globe. Importantly, with respect to national-level efforts to implement alternative dispute resolution and dispute prevention policies, individual countries can also proceed without the need for their treaty partners to agree. However, alternative dispute resolution does not in itself solve key ISDS-related challenges. The most alternative dispute resolution and dispute prevention policies can do is to prevent disputes, which would render this reform path a complementary, rather than a standalone, avenue for ISDS reform.

## **B. Tailoring the existing system**

16. This option implies that the main features of the existing system would be preserved and that individual countries would apply “quick fixes” by modifying selected aspects of the ISDS system in their new IIAs. A number of countries have already embarked on this course of action.<sup>14</sup> Procedural innovations, many of which are also featured in the Investment Policy Framework for Sustainable Development, have included the following:<sup>15</sup>

(a) Setting time limits for bringing claims to limit State exposure and prevent the resurrection of “old” claims (for example, three years from the events giving rise to the claim);

(b) Increasing the role of contracting parties in interpreting the treaty to avoid legal interpretations that go beyond their original intentions (for example, providing for binding joint-party interpretations, requiring tribunals to refer certain issues to the treaty parties to interpret, facilitating interventions by the non-disputing contracting party);<sup>16</sup>

(c) Establishing a mechanism for consolidation of related claims, which can help deal with the problem of related proceedings, contribute to the uniform application of the law (thereby increasing the coherence and consistency of awards) and help reduce the cost of proceedings;

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<sup>13</sup> See UNCTAD, 2010, *Investor–State Disputes: Prevention and Alternatives to Arbitration*, UNCTAD Series on International Investment Policies for Development (New York and Geneva, United Nations publication); UNCTAD, 2011, *Best Practices in Investment for Development: How to Prevent and Manage Investor–State Disputes – Lessons from Peru*, Investment Advisory Series, Series B, No. 10, (New York and Geneva, United Nations publication).

<sup>14</sup> For example, Canada, Colombia, Mexico and the United States of America.

<sup>15</sup> Policy options for individual ISDS elements are further analysed in UNCTAD, 2014, *Investor–State Dispute Settlement: A Sequel*, UNCTAD Series on Issues in International Investment Agreements II (New York and Geneva, United Nations publication).

<sup>16</sup> On various means that can be used by States, see UNCTAD, 2011, *Interpretation of IIAs: What States can do*, IIA Issues Note, No. 3, available at [http://unctad.org/en/docs/webdiaeia2011d10\\_en.pdf](http://unctad.org/en/docs/webdiaeia2011d10_en.pdf).

(d) Providing for more transparency in ISDS, for example, granting public access to documents and hearings, and allowing for the participation of interested non-disputing parties;

(e) Including a mechanism for an early discharge of frivolous claims (that is to say, manifestly meritless claims) to avoid wasting resources on full-length proceedings.

17. The approach whereby countries provide focused “fixes” through their IIAs allows for individually tailored solutions and numerous variations. For example, in their IIAs, specific countries may choose to address the issues and concerns that appear most relevant to them. At the same time, however, this option leaves many of the fundamental ISDS problems untouched.

18. This approach would require comprehensive training and capacity-building to enhance awareness and understanding of ISDS-related issues.<sup>17</sup> It would also benefit from high-quality legal defence provided to developing countries at an affordable price.

19. Implementation of this option is fairly straightforward, given that only two treaty parties (or several in case of a plurilateral treaty) need to agree. However, the approach is limited in effectiveness: unless the new treaty is a renegotiation of a previous one, the “fixes” are applied only to newly concluded IIAs, while the 3,000 previous ones remain intact. Moreover, one of the key advantages of this approach – namely, that countries can choose whether or not to address certain issues – is also one of its key disadvantages, as it turns this reform option into a piecemeal approach that stops short of offering a comprehensive and integrated way forward.

### C. Limiting investor access to investor–State dispute settlement

20. This option narrows the range of situations in which investors may resort to ISDS. This could be done in two ways: by reducing the subject-matter scope for ISDS claims and introducing the requirement to exhaust local remedies before resorting to international arbitration. The extreme version of this approach would be abandoning ISDS as a means of dispute resolution altogether and returning to State–State arbitration proceedings.

21. Some countries have adopted policies of the first kind, for example, by excluding certain types of claims from the scope of arbitral review.<sup>18</sup> Historically, this approach was used to limit the jurisdiction of arbitral tribunals, such as allowing ISDS only with respect

<sup>17</sup> Such capacity-building activities are, among others, being carried out by UNCTAD and partner organizations. Latin American countries, for example, have since 2005 benefited annually from UNCTAD advanced regional training courses on ISDS. See [http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20\(IIA\)/IIA-Technical-Cooperation.aspx](http://unctad.org/en/Pages/DIAE/International%20Investment%20Agreements%20(IIA)/IIA-Technical-Cooperation.aspx),

<sup>18</sup> For example, claims relating to real estate (Cameroon–Turkey BIT); claims concerning financial institutions (Canada–Jordan Foreign Investment Protection and Promotion Agreement); claims relating to the establishment and acquisition of investments (Japan–Mexico economic partnership agreement); claims concerning specific treaty obligations such as national treatment and performance requirements (Malaysia–Pakistan Closer Economic Partnership Agreement); and claims arising out of measures to protect national security interests (India–Malaysia Closer Economic Partnership Agreement). For further analysis, see UNCTAD, 2014, *Investor–State Dispute Settlement: A Sequel*, UNCTAD Series on International Investment Agreements II (New York and Geneva, United Nations publication).

to expropriation disputes.<sup>19</sup> Some recent treaties have dropped the ISDS mechanism altogether.<sup>20</sup>

22. The duty to exhaust local remedies serves as a mandatory prerequisite for gaining access to international judicial forums in public international law. Most IIAs, however, dispense with this duty, thus turning foreign investors into a privileged class that can evade domestic judiciaries. Requiring investors to exhaust local remedies or, alternatively, to demonstrate the manifest ineffectiveness or bias of domestic courts would reinstate balance and make international arbitration more of an exceptional remedy.

23. The option of limiting investor access to ISDS does not address problems relating to it, but rather reduces their acuteness. It can help slow down the proliferation of ISDS proceedings, limit States' financial liabilities arising from ISDS awards and preserve resources. It can also help strengthen domestic judicial systems and encourage the stronger involvement of a host State's legal community. To some extent, however, this approach would be a return to the earlier system where investors could lodge their claims only in the domestic courts of the host State, negotiate arbitration clauses in specific investor-State contracts or apply for diplomatic protection by their home State.

24. In terms of implementation – akin to the first option – this alternative does not require coordinated action by a large number of countries and can be put into practice by parties to individual treaties. Implementation is straightforward for future IIAs; past treaties would require amendment, renegotiation or unilateral termination.<sup>21</sup> Like the first option, however, this results in a piecemeal approach towards reform.

#### D. Introducing an appeals facility

25. An appeals facility implies<sup>22</sup> a standing body with the competence to undertake a substantive review of awards rendered by arbitral tribunals. It has been proposed as a means to improve the consistency of case law, correct mistakes of first-level tribunals and enhance predictability of the law.<sup>23</sup> This option is being contemplated by some countries.<sup>24</sup> If

<sup>19</sup> For example, Chinese BITs concluded in the 1980s and early 1990s (Albania–China (1993), Bulgaria–China (1989)) provided investors with access to international arbitration solely with respect to disputes relating to the amount of compensation following an investment expropriation.

<sup>20</sup> Recent examples of IIAs without ISDS provisions are the Australia–United States Free Trade Agreement (2004), Japan–Philippines economic partnership agreement (2006) and Australia–Malaysia Free Trade Agreement (2012).

<sup>21</sup> Termination of IIAs is complicated by survival clauses that provide for the continued application of treaties, generally for 10–15 years after their termination.

<sup>22</sup> In 2004, the ICSID Secretariat mooted the idea of an appeals facility but at that time the idea failed to garner sufficient State support. See ICSID, 2004, Possible improvements of the framework for ICSID arbitration, ICSID Discussion Paper, part VI and annex, available at [https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Archive\\_Announcement14](https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Archive_Announcement14). In the eight years that have since passed, views of many governments may have evolved.

<sup>23</sup> For the relevant discussion, see C Tams, 2006, An appealing option? A debate about an ICSID appellate structure, Essays in Transnational Economic Law Working Paper No. 57.

<sup>24</sup> Several IIAs concluded by the United States have addressed the potential establishment of a standing body to hear appeals from investor–State arbitrations. The Chile–United States Free Trade Agreement was the first one to establish a “socket” in the agreement into which an appellate mechanism could be inserted should one be established under a separate multilateral agreement (article 10.19(10)). The Dominican Republic–Central America–United States Free Trade Agreement (2004) went further and required the establishment of a negotiating group to develop an appellate body or similar mechanism (annex 10-F). Notwithstanding these provisions, no announcement of any such negotiations has been made and nothing in writing has been issued regarding the establishment of any appellate body.



constituted of permanent members appointed by States from a pool of the most reputable jurists, an appeals facility has the potential to become an authoritative body capable of delivering consistent – and more balanced – opinions, which could rectify the legitimacy concerns regarding the current ISDS regime.

26. The authoritative pronouncements of an appeals facility on points of law would guide both the disputing parties (when assessing the strength of their respective cases) and arbitrators adjudicating disputes. Even if today's system of first-level tribunals remains intact, concerns would be alleviated through the effective supervision at the appellate level. In sum, an appeals facility would add order to the existing decentralized, non-hierarchical and ad hoc system.

27. At the same time, absolute consistency and certainty would not be achievable in a legal system that consists of approximately 3,000 legal texts; different outcomes may still be warranted by the language of specific applicable treaties. Also, the introduction of an appellate stage would further add to the time and cost of the proceedings, although that could be controlled by putting in place strict timelines similar to the ones set forth for the WTO Appellate Body.<sup>25</sup>

28. With regard to implementation, for the appeals option to be meaningful, it needs to be supported by a significant number of countries. In addition to an in-principle agreement, a number of important choices would need to be made: Would the facility be limited to the ICSID system or be expanded to other arbitration rules? Who would elect its members and how? How would it be financed?<sup>26</sup> All of the above turns this reform option into one that is likely to face major practical challenges.

## **E. Creating a standing international investment court**

29. This option implies the replacement of the current system of ad hoc arbitration tribunals with a standing international court. The latter would consist of judges appointed by States on a permanent basis, for example, for a fixed non-renewable term. It may also have an appeals chamber.

30. For some, a private model of adjudication (i.e. arbitration) is inappropriate for matters that deal with public law.<sup>27</sup> The latter requires objective guarantees of independence and impartiality of judges, which can only be provided by a security of tenure – to insulate the judge from outside interests such as an interest in repeat appointments and in maintaining the arbitration industry. Only a court with tenured judges, the argument goes, would establish a fair system widely regarded to be free of perceived bias.<sup>28</sup>

Figure 3

### **Five paths for reform of investor–State dispute settlement**

<sup>25</sup> At WTO, the appeals procedure is limited to 90 days.

<sup>26</sup> Other relevant questions include: Would the appeal be limited to the points of law or also encompass questions of fact? Would it have the power to correct decisions or only a right of remand to the original tribunal? Would the establishment of an appellate review mechanism imply the phase-out of the ICSID annulment mechanism and national court review? How to ensure the coverage of earlier concluded IIAs by the new appeals structure?

<sup>27</sup> This approach rests on the theory that investment treaty arbitration is analogous to domestic judicial review in public law because “it involves an adjudicative body having the competence to determine, in response to a claim by an individual, the legality of the use of sovereign authority, and to award a remedy for unlawful State conduct”. G Van Harten, 2008, A Case for an International Investment Court, Society of International Economic Law Inaugural Conference 2008, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1153424](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1153424).

<sup>28</sup> See G Van Harten, 2008.

*Tailoring the existing system through individual IIAs*

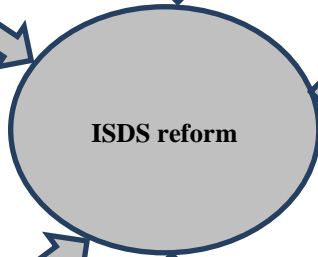
*Promoting alternative dispute resolution*

- Fostering alternative dispute resolution methods for example, conciliation or mediation
- Promoting dispute prevention policies, for example, ombudsman
- Emphasizing mutually acceptable solutions and preventing escalation of disputes
- Implementing at the domestic level, with or without reference in IIAs

- Setting time limits for bringing claims
- Expanding the contracting parties' role in interpreting the treaty
- Providing for more transparency in ISDS
- Including a mechanism for early discharge of frivolous claims

*Limiting investor access to ISDS*

- Reducing the subject-matter scope for ISDS claims
- Denying protection to investors that engage in "nationality planning"
- Introducing the requirement to exhaust local remedies before resorting to ISDS



*Introducing an appeals facility*

- Allowing for the substantive review of awards rendered by tribunals (e.g. reviewing issues of law)
- Creating a standing body, for example made up of members appointed by States
- Requiring subsequent tribunals to follow the authoritative pronouncements of the appeals facility

*Establishing a standing international investment court*

- Replacing the current system of ad hoc tribunals with a new institutional structure
- Establishing a standing international court of judges (appointed by States)
- Ensuring security of tenure (for a fixed term) to insulate judges from outside interests
- Considering the possibility of an appeals chamber

Source: UNCTAD, *World Investment Report 2013*.

31. A standing investment court would be an institutional public good serving the interests of investors, States and other stakeholders. The court would address most of the problems outlined above: it would go a long way to ensure the legitimacy and transparency of the system, and facilitate consistency and accuracy of decisions and independence and impartiality of adjudicators.<sup>29</sup>

32. However, this solution is also the most difficult to implement, as it would require a complete overhaul of the current system through coordinated action by a large number of States. At the same time, the consensus would not need to be universal. A standing investment court may well start as a plurilateral initiative, with an opt-in mechanism for those States that wish to join.

33. A separate concern would be to determine whether a new court would be fit for a fragmented regime that consists of a large number of mostly bilateral IIAs. It appears that this option would work best in a system with a unified body of applicable law.

34. Given the numerous challenges arising from the current ISDS system, it is timely for States to make an assessment thereof, weigh options for reform and decide upon the most appropriate route.

35. Among the five options outlined in this paper, some imply individual actions by governments and others require joint action by a significant number of countries. While the collective action options would go further to address the problems, they would face more difficulties in implementation and require agreement between a larger number of States on a series of important details. A multilateral policy dialogue on investment dispute settlement could help develop a consensus on the preferred course for reform and ways to put it into action.

36. An important point to bear in mind is that investment dispute settlement is a system of application of the law. Therefore, improvements to the dispute settlement system should go hand in hand with reform of the IIA regime, as discussed below.

### **III. Reform of the international investment agreement regime: Four paths of action and a way forward**

37. The IIA regime is undergoing a period of reflection, review and reform. While most countries are parties to one or more IIAs, few are satisfied with the current regime for several reasons: growing unease about the actual effects of IIAs in terms of promoting foreign direct investment or reducing policy and regulatory space, increasing exposure to ISDS and the lack of specific pursuit of sustainable development objectives. Furthermore, views on IIAs are widely diverse, even within countries. Add to this the complexity and multifaceted nature of the IIA regime and the absence of a multilateral institution, such as WTO for trade. All of this makes it difficult to take a systematic approach towards comprehensively reforming the IIA regime and investment dispute settlement. Hence, IIA reform efforts have so far been relatively modest.

38. Many countries follow a wait-and-see approach. Hesitation with respect to more holistic and far-reaching reform reflects a government's dilemma: more substantive changes might undermine a country's attractiveness for foreign investment, and the first countries to act could particularly suffer in this regard. In addition, there are questions about the specific content of a new IIA model and fears that some approaches could aggravate the current complexity and uncertainty of the regime.

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<sup>29</sup> A system where judges are assigned to the case, as opposed to being appointed by the disputing parties, will also save tens of thousands, if not hundreds of thousands, of dollars normally spent by lawyers on researching arbitrator profiles.

39. Nevertheless, IIA reform has been occurring at different levels of policymaking. At the national level, countries have revised their model treaties, sometimes on the basis of inclusive and transparent multi-stakeholder processes. At least 40 countries and 5 regional organizations are currently reviewing and revising their approaches to international-investment-related rulemaking. Countries have also continued negotiating IIAs at the bilateral and regional levels, with novel provisions and reformulations. Megaregional agreements are a case in point. A few countries have walked away from IIAs, terminating some of their BITs or denouncing international arbitration conventions. At the multilateral level, countries have come together to discuss specific aspects of IIA reform.

40. Based on these recent experiences, four broad paths of action aimed at reforming the international investment regime can be distinguished (see table):

- (a) Maintaining the status quo;
- (b) Disengaging from the system;
- (c) Introducing selective adjustments;
- (d) Engaging in systematic reform.

Table

**Four paths of action: An overview**

<i>Path</i>	<i>Content of policy action</i>	<i>Level of policy action</i>
Status quo	Not pursuing any substantive change to IIA clauses or investment-related international commitments	Taking policy action at bilateral and regional levels: <ul style="list-style-type: none"> <li>• Continue negotiating IIAs based on existing models</li> <li>• Leave existing treaties untouched</li> </ul>
Disengagement	Withdrawing from investment-related international commitments	Taking policy action at different levels and/or regarding different aspects of investment policymaking: <ul style="list-style-type: none"> <li>• National (e.g. withdrawing consent to ISDS in domestic law and terminating investment contracts)</li> <li>• Bilateral/regional (e.g. terminating existing IIAs)</li> </ul>
Selective adjustments	Pursuing selective changes in a non-binding manner: <ul style="list-style-type: none"> <li>• To add a sustainable development dimension to IIAs (e.g. sustainable development in preamble)</li> <li>• To move towards rebalancing rights and obligations (e.g. non-binding corporate social responsibility in preamble)</li> <li>• To change specific aspects of ISDS (e.g. early discharge of frivolous claims)</li> <li>• To address policy interaction selectively (e.g. not lowering standards clauses)</li> </ul>	Selectively taking policy action at three levels of policymaking: <ul style="list-style-type: none"> <li>• National (e.g. modifying a new model IIA)</li> <li>• Bilateral/regional (e.g. negotiation of IIAs based on revised models or issuing joint interpretations)</li> <li>• Multilateral (e.g. sharing experiences)</li> </ul>
Systematic reform	Designing investment-related international commitments that: <ul style="list-style-type: none"> <li>• Draw up proactive sustainable-development-oriented IIAs (e.g. promote investment to further sustainable development goals)</li> </ul>	Taking policy action at three levels of policymaking (simultaneously and/or sequentially): <ul style="list-style-type: none"> <li>• National (e.g. creating a new model IIA)</li> </ul>

	<ul style="list-style-type: none"> <li>• Effectively rebalance rights and obligations in IIAs (e.g. add investor responsibilities, preserve policy space)</li> <li>• Comprehensively reform ISDS (i.e. follow five paths identified in chapter II of this paper and the <i>World Investment Report 2013</i>)</li> <li>• Properly manage interactions and foster coherence between different levels of investment policies and between investment policies and other public policies (e.g. multi-stakeholder review)</li> </ul>	<ul style="list-style-type: none"> <li>• Bilateral/regional: (re-) negotiating IIAs based on new model</li> <li>• Multilateral (multi-stakeholder consensus-building)</li> </ul>
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Source: UNCTAD.

41. Each of the four paths of action comes with its own advantages and disadvantages, and responds to specific concerns in a distinctive way (see table). Depending on the overall objective pursued, what is considered an advantage by some stakeholders may be perceived as a challenge by others. In addition, the four paths of action, as pursued today, are not mutually exclusive; a country may adopt elements from one or more of them, and the content of a particular IIA may be influenced by one or more paths of action.

42. Each path of action is discussed below from the perspective of strategic regime reform. The discussion begins with the two most opposed approaches to investment-related international commitments: at one end of the spectrum is the path that maintains the status quo; at the other is the path that disengages from the IIA regime. In between are the two paths of action that opt for reform of the regime, albeit in varying degrees.

43. The underlying premise of this analysis is that the case for reform has already been made. The Investment Policy Framework for Sustainable Development, with its dynamic policymaking principle – which calls for a continuing assessment of the effectiveness of policy instruments – is but one example. Today's questions are not about whether to reform international investment policymaking but how to do so. They are not only about the change to one aspect in a particular agreement but about the comprehensive reorientation of the global IIA regime to balance investor protection with sustainable development considerations.

## A. Maintaining the status quo

44. At one end of the spectrum is a country's choice to maintain the status quo. Refraining from substantive changes to the way that investment-related international commitments are made sends an image of continuity and investor friendliness. This is particularly the case when maintaining the status quo involves the negotiation of new IIAs that are based on existing models. Above all, this path might be attractive for countries with a strong outward investment perspective and for countries that have not yet had to respond to numerous – and highly politicized – ISDS cases.

45. Intuitively, this path of action appears to be the easiest and most straightforward to implement. It requires limited resources – there is no need for assessments, domestic reviews or multi-stakeholder consultations, for example. It also avoids unintended, potentially far-reaching consequences arising from innovative approaches to IIA clauses.

46. At the same time, however, maintaining the status quo does not meet any of the challenges arising from today's global IIA regime and might contribute to a further stakeholder backlash against IIAs. Moreover, as an increasing number of countries are beginning to reform IIAs, maintaining the status quo – maintaining BITs and negotiating new ones based on existing templates – may become increasingly difficult.

## **B. Disengaging from the international investment agreement regime**

47. At the other end of the spectrum is a country's choice to disengage from the international investment agreement regime, be it from individual agreements, multilateral arbitration conventions or the regime as a whole. Unilaterally quitting IIAs sends a strong signal of dissatisfaction with the current system. This path of action might be particularly attractive for countries in which IIA-related concerns feature prominently in the domestic policy debate.

48. Intuitively, disengaging from the IIA regime might be perceived as the strongest, or most far-reaching, path of action. Ultimately, for inward and outward investors, it would result in the removal of international commitments on investment protection that are enshrined in international treaties. Moreover, this would result in the effective shielding from ISDS-related risks.

49. However, most of the desired implications will only materialize over time, and for one treaty at a time. Quitting the system does not immediately protect the State against future ISDS cases, as IIA commitments usually last for some time through survival clauses. In addition, there may be a need to review national laws and State contracts, as they may also provide for ISDS (including ICSID arbitration), even in the absence of an IIA. Moreover, unless termination is undertaken on a consensual basis, a government's ability to terminate an IIA is limited. Its ability to do so depends on the formulation of the treaty concerned and may be available only at a particular limited point in time.

50. Moreover, termination of one international agreement at a time (treaty by treaty) does not contribute to the reform of the IIA regime as a whole, but only focuses on individual relationships. Only if such treaty termination is pursued with a view to renegotiation can it also constitute a move towards reforming the entire IIA regime.

## **C. Introducing selective adjustments**

51. Limited, or selective adjustments addressing specific concerns is a path of action that is rapidly gaining ground. It may be particularly attractive for those countries wishing to meet the challenges posed by IIAs and demonstrate their continued engagement with the investment system. It can be directed towards sustainable development and other policy objectives.

52. This path of action has numerous advantages. The selective choice of modifications allows the prioritization of "low-hanging fruit" – concerns that appear most relevant and pressing – while leaving the core of the treaty untouched. Selective adjustments also enable a party to a treaty to tailor treaty modifications to individual negotiating counterparts in order to accommodate particular economic relationships. They also allow for the testing and piloting of different solutions, and the focus on future treaties facilitates straightforward implementation (i.e. changes can be put in practice directly by the parties to individual negotiations). Further, the use of soft, or non-binding, modifications minimizes risk. The incremental step-by-step approach avoids a "big-bang" effect and makes it less likely that the change will be perceived as a reduction of the agreement's protective value. Indeed, introducing selective adjustments in new agreements may appear as an appealing – if not the most realistic – option for reducing the mounting pressure on IIAs.

53. At the same time, however, selective adjustments to future IIAs cannot comprehensively address the challenges posed by the existing stock of treaties.<sup>30</sup> Selective adjustments cannot fully deal with the interaction that treaties have with each other and,

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<sup>30</sup> Unless a new treaty is a renegotiation of a previous one (or otherwise supersedes the earlier treaty), modifications are applied only to newly concluded IIAs, leaving existing ones untouched.

unless they address the most-favoured nation (MFN) clause, they can lead to “cherry-picking” and “treaty shopping”.<sup>31</sup> It may not satisfy all stakeholders. In addition it may ultimately lay the groundwork for further change, thus creating uncertainty instead of stability.

#### **D. Pursuing systematic reform**

54. Pursuing systematic reform means designing international commitments that are in line with the investment and development paradigm shift (*World Investment Report 2012*) and promote sustainable development. With policy actions at all levels of governance, this is the most comprehensive approach to reforming the current IIA regime.

55. This path of action would entail the design of a new IIA treaty model that effectively addresses the three challenges mentioned above<sup>32</sup> and that focuses on proactively promoting investment for sustainable development. Systematic reform would also entail comprehensively dealing with the reform of the ISDS system, as addressed above in chapter II .

56. At first glance, this path of action appears daunting and challenging on numerous fronts. It may be time- and resource-intensive. Its result – more balanced IIAs – may be perceived as reducing the protective value of the agreements concerned and offering a less attractive investment climate. Comprehensive implementation of this path requires dealing with existing IIAs, which may be seen as affecting investors’ acquired rights. And amendments or renegotiation may require the cooperation of a potentially large number of treaty counterparts.

57. Yet this path of action is the only one that can bring about comprehensive and coherent 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 sustainable development goals.

58. The IIA Conference held at the World Investment Forum in October 2014 generated a number of valuable insights in this regard. It was noted, for example, that IIA reform should be gradual and comprehensive; that individually, countries would only be able to undertake portions of the necessary IIA reform and that only a joint, multilateral effort can be truly effective. The Conference also sketched the contours of a road map for comprehensive IIA reform. Such a road map could provide a common reference point for governments, as well as regional and intergovernmental organizations. Conference participants also called upon UNCTAD, working in cooperation with other stakeholders such as ICSID, OECD and the United Nations Commission on International Trade Law, to provide a multilateral platform for engagement on investment policy issues.

59. Experts are invited to design the elements of such a road map for reform and generate tangible outcomes and solutions for transforming the IIA regime, so as to make it more conducive to sustainable development.

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<sup>31</sup> Commitments made to some treaty partners in earlier IIAs may filter through to newer IIAs through an MFN clause (depending on its formulation), with possibly unintended consequences.

<sup>32</sup> Increasing the development dimension, rebalancing rights and obligations, and managing the systemic complexity of the IIA regime.

## Annex

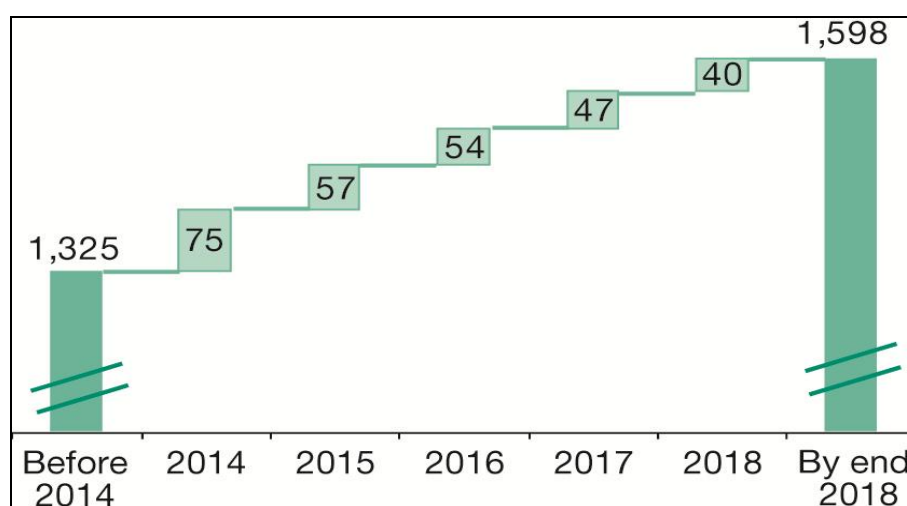
### Transformation of the international investment agreement regime: Opportunities derived from treaty expiration

1. The IIA regime has reached a juncture that provides opportunities for change. The signature of BITs peaked in the 1990s. Fifteen years on, the conclusion rate of new BITs has declined sharply (see figure A1.1), enabling the IIA regime to be in a position for effective systemic change.<sup>33</sup> As agreements reach their expiry date, a party to a treaty may opt for automatic prolongation of the treaty or notify the other party that it wishes to revoke a treaty.<sup>34</sup> The latter option gives parties to a treaty an opportunity to revisit their agreements, including by updating their content with cognizance of past experiences and incorporating provisions that accommodate novel policy objectives.

2. The significant number of expired or soon-to-expire BITs creates distinct opportunities for change. As of 1 January 2014, the number of treaties that can be terminated by a party at any time exceeded 1,300 (figure A1.1).

Figure A1.1

#### Cumulative number of bilateral investment treaties that can be terminated at any time



Source: UNCTAD.

Note: Methodology – data for BITs with an option for termination at any time – based on an examination of a representative sample of over 300 BITs, extrapolated to the universe of BITs in force after accounting for the initial fixed term of treaty duration.

Abbreviations: BIT, bilateral investment treaty; IIA, international investment treaty

<sup>33</sup> This section is limited to BITs and does not apply to “other IIAs”, as the latter raise a different set of issues. Importantly, an investment chapter in a free trade agreement cannot be terminated separately; the treaty must be terminated in its entirety.

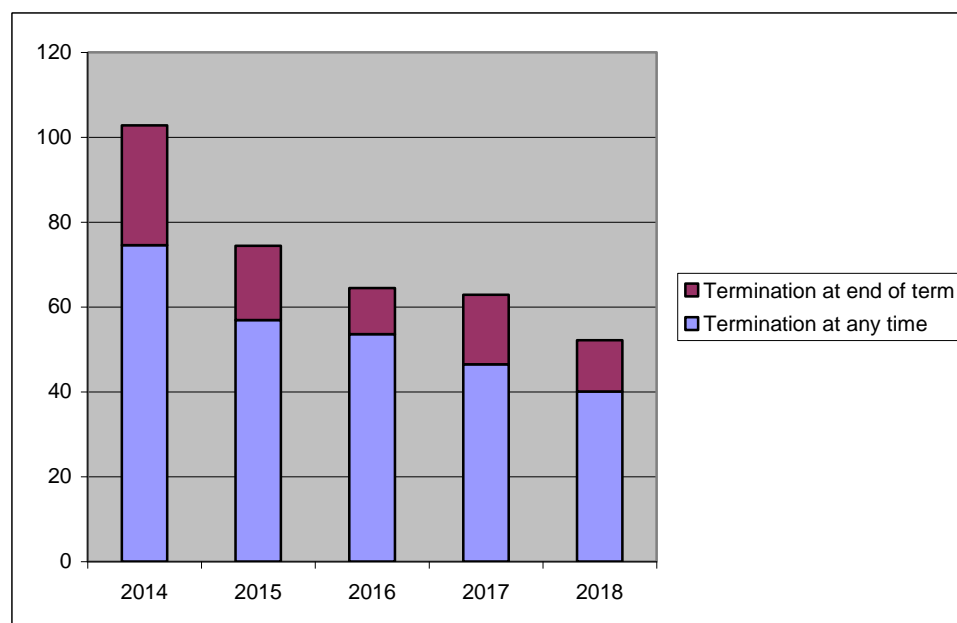
<sup>34</sup> In accordance with public international law, a treaty may also be terminated by consent of the contracting parties at any time, regardless of whether the treaty has reached the end of its initial fixed term (article 54(b) of the Vienna Convention on the Law of Treaties).



3. Moreover, between 2014 and 2018, at least another 350 BITs will reach the end of their initial duration. In 2014 alone, the initial fixed term in 103 BITs will expire (see figure A1.2).

Figure A1.2

**Bilateral investment treaties reaching the end of their initial term, 2014–2018**



Source: UNCTAD.

Note: Methodology – data, i.e. derived from an examination of BITs for which texts were available, extrapolated to BITs for which texts were unavailable. Extrapolation parameters were obtained on the basis of a representative sample of over 300 BITs.

4. Effectively using treaty expiration to prompt change in the existing IIA regime is not a straightforward endeavour. First, there is a need to understand how the BIT rules relate to treaty termination work, so as to identify opportunities as they arise and the associated required procedural steps.

**Treaty termination and prolongation clauses**

BITs usually specify that they shall remain in force for a certain, initial fixed period, most often 10 or 15 years. Only a few treaties do not set forth such an initial fixed term and provide for indefinite duration.

Those BITs that establish an initial term of application generally contain a mechanism for their prolongation. Two approaches are prevalent. In the first category, BITs state that, after the end of the initial fixed term and unless one party opts to terminate, the treaty shall continue to be in force indefinitely. However, each party retains the right to terminate the agreement at any time by giving prior written notice. The second category of agreements provide that the treaty shall continue to be in force for additional fixed terms, in which case the treaty can be terminated only at the end of each subsequent prolonged period.

Most BITs thus fall in one of the two categories: those that can be terminated at any time after the end of an initial fixed term and those that can be terminated only at the end of each fixed term. These two options may be defined as “termination at any time” and “termination at end of term”.

<i>Termination at any time</i>			<i>Termination at end of term</i>
Duration: Initial fixed term; automatic renewal for an indefinite period  Termination: <ul style="list-style-type: none"> <li>• End of initial fixed term</li> <li>• Any time after the end of initial fixed term</li> </ul> Example: Hungary–Thailand BIT (1991)	Duration: Initial fixed term; automatic renewal for further fixed terms  Termination: <ul style="list-style-type: none"> <li>• End of initial fixed term</li> <li>• Any time after the end of initial fixed term</li> </ul> Example: Iceland–Mexico BIT (2005)	Duration: No initial fixed term; indefinite duration from the start  Termination: <ul style="list-style-type: none"> <li>• Any time</li> </ul> Example: Armenia–Canada BIT (1997)	Duration: Initial fixed term; automatic renewal for further fixed terms  Termination: <ul style="list-style-type: none"> <li>• End of initial fixed term</li> <li>• End of each subsequent fixed term</li> </ul> Example: Azerbaijan–Belgium/Luxembourg BIT (2004)
<p>Termination at any time provides the most flexibility for review, as the parties are not tied to a particular date as to when they can notify the other party of their wish to terminate the BIT. In contrast, termination at end of term only provides for opportunities to terminate the treaty once every few years. Failure to give notice within a specified time frame (usually either 12 or 16 months prior to the expiry date) of the intention to terminate will lock the parties into another multi-year period during which the treaty cannot be unilaterally terminated.</p> <p><i>Source:</i> UNCTAD</p>			

5. The next challenge originates from the so-called survival clause contained in most BITs that prevents the termination of the treaty from having immediate effect under certain conditions. It does indeed prolong the exposure of the host State to international responsibility by extending the treaty's application for a further period (generally 10 or 15 years) with respect to investments made prior to the termination of the treaty.<sup>35</sup>

6. Next, renegotiation efforts aimed at reducing or rebalancing treaty obligations can be rendered futile on account of the MFN obligation. If the scope of the MFN clause in the new treaty is not limited, it can result in the unanticipated incorporation of stronger investor rights from IIAs with third countries. Hence, in case of amendments and/or renegotiations, IIA negotiators may wish to formulate MFN provisions that preclude the importation of substantive IIA provisions from other IIAs. This will ensure that past – or future – treaties do not spill over into carefully crafted agreements by way of an open-ended MFN clause (see Investment Policy Framework for Sustainable Development).<sup>36</sup>

<sup>35</sup> It is open to debate whether the survival clause becomes operative solely in cases of unilateral treaty termination or also applies in situations where the treaty is terminated by mutual consent of the contracting parties. The solution may depend on the wording of the specific clause and other interpretative factors.

<sup>36</sup> This will not automatically solve the issue of those older treaties that were not renegotiated or that are kept on the shelves, but it may gradually form a new basis on which negotiators can build a more balanced network of IIAs.