

**ALL-PARTY PARLIAMENTARY GROUP ON EU-US TRADE & INVESTMENT**

**Meeting on TTIP and ISDS**

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**Investment Treaty Making: Trends, Challenges and Way Forward**

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**Introduction**

It is my honour to be invited to Westminster to make a presentation and exchange views with UK Parliamentarians and other stakeholders on a very important topic of international investment rule-making – investor-State dispute settlement (ISDS), particularly in the context of Transatlantic Trade and Investment Partnership (TTIP), currently negotiated between the United States and the European Union.

Allow me to start with the big picture and broader context. In the absence of a multilateral investment system, the current international investment regime is multi-layered and multi-faceted, consisting of close to 3,240 investment treaties at the bilateral, regional and plurilateral level (by the end of 2013). The overwhelming majority of countries are party to at least one international investment agreement (IIA), some even have signed over 100.

The United Kingdom is among the countries that have signed more than 100 bilateral investment treaties (BITs) – 105 treaties by the end of 2013, to be precise – and is also party to 63 "other IIAs".<sup>2</sup>

**I. IIA regime: three key messages**

1) The IIA regime shows diverging trends; 2) the IIA regime has to overcome three major challenges; 3) reforms could be the way forward.

**1. The IIA regime shows diverging trends**

- On the one hand, we see an up-scaling of treaty making in two respects: First, in terms of participation, up-scaling means that more and more countries are actively engaged in negotiating IIAs. For example, 44 IIAs were concluded in 2013; and 88 countries are currently involved in negotiating seven mega-regional agreements with investment chapters. The EU alone is engaged in negotiating more than 20

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<sup>1</sup> This statement is built largely on UNCTAD policy analysis led by the speaker, but it does not necessarily represent the views of the UNCTAD Secretariat or its member States.

<sup>2</sup> Unlike UK BITs, the country's "other IIAs" are agreements signed by the EU and EU member States. So far, all of these the agreements that have entered into force do not contain an ISDS mechanism.

agreements that are expected to include investment-related provisions (which may vary in their scope and depth).

Second, up-scaling occurs with regard to the substance of agreements. They become broader in the coverage of issues (i.e. they expand existing treaty elements and include new ones) and they introduce more sophisticated treaty standards.

- On the other hand, some countries are disengaging from the IIA regime. Over the past two years, some countries unilaterally terminated existing treaties (e.g. South Africa and Indonesia), and some others denounced multilateral investment arbitration conventions (e.g. Bolivia, Ecuador and Venezuela).
- In addition, there is a continued trend of re-adjusting treaty negotiating positions. At least 40 countries and 4 regional integration organizations have been recently reviewing and revising their model investment agreements and negotiation strategies, partially through a multi-stakeholder approach.

## **2. The IIA regime has to overcome three major challenges**

The investment-development paradigm has been shifting towards sustainable development, in terms of both national and international investment policy making. At the national level, this manifests itself in investment policy measures, such as those taking the form of regulations for the pursuit of environmental or social objectives or industrial policies.

At the international level, while almost all countries are parties to one or several IIAs, many are dissatisfied with the current international investment regime. The international investment-development community is facing three main challenges:

- First, how to integrate sustainable development objectives into the IIAs? Most existing IIAs follow the "traditional" approach of focussing more or less exclusively on investment promotion and protection, and largely neglect the sustainable development impact of investment. New IIAs, in turn, illustrate the growing tendency to craft treaties that are in line with sustainable development objectives.
- Second, how to rebalance the rights and obligations between investors and States? There is growing concern that IIAs in their common content could unduly restrict policy space for host countries. Broad and vaguely formulated IIA provisions create a risk that investors challenge core domestic policy decision, for instance in the area of environmental, energy or health policies.
- Third, how to address the systemic complexity of the IIA regime, including ISDS, and ensure coherence between investment policies and other public policies. Investment policies do not exist in isolation, but interact with other policy areas, such as environmental policies, trade policies, social policies, labour policies, industrial policies and others. However, the current IIA regime does not make a link to these other policy areas and risks to create inconsistencies.

### 3. Reforms could be the way forward

A broad consensus is emerging on the need to address the above challenges and improve the system. The question is how. In my view, we should adopt a holistic approach to addressing the multiple challenges:

- Establishing a set of global guiding principles for international investment policy making;
- Addressing policy coherence not only from the international investment policy side, but also between investment policies and other public policy areas, so as to avoid inconsistencies and create synergies between these various areas of policy making;
- Dealing with IIA reform in a systemic and gradual manner. Improving investment dispute settlement should be part and parcel of it.

## II. Investor-State Dispute Settlement: trends, concerns and reforms

Allow me to present the current trends, summarize the key problems and highlight some reform options.

### 1. Current trends and the broader perspective

Investor-State dispute settlement (ISDS) is a regular feature of international investment agreements. However, the first bilateral investment treaty that was concluded in 1959 between Germany and Pakistan did not contain an ISDS mechanism; it contained a clause for the settlement of disputes between the two States. Towards the end of the 1960s, States gradually started to include ISDS clauses in their treaties.

Today, the vast majority of BITs, as well as "other IIAs" – which we define as free trade agreements, economic cooperation agreements and other agreements with an investment chapter – contain provisions for the settlement of disputes between investors and the host State through international arbitration.

The total number of known treaty-based ISDS cases reached 568 by the end of 2013. Since some arbitration forums do not maintain a public registry of claims, the total number of cases is likely to be higher. The main features of these cases are:

- *Respondent States.* In total, over the years at least 98 governments have been respondents to one or more investment treaty arbitrations. Over 70 per cent of all known cases were brought against developing and transition economies. Argentina (53 cases) and Venezuela (36) continue to be the most frequent respondents. The Czech Republic (27) and Egypt (23) replaced last year's number three and four, Ecuador and Mexico.
- *Home States.* The overwhelming majority (85 per cent) of ISDS claims were brought by investors from developed countries. Arbitrations have been initiated most frequently by claimants from the European Union and the United States.

- *Legal instruments.* The three investment instruments most frequently used as a basis of ISDS claims have been NAFTA (51 cases), the Energy Charter Treaty (42) and the Argentina-United States BIT (17). At least 72 arbitrations have been brought pursuant to intra-EU BITs.
- *Arbitral forums.* The majority of cases have been brought under the ICSID Convention and the ICSID Additional Facility Rules (353 cases) and the UNCITRAL Rules (158). Other venues have been used only rarely, with 28 cases at the Stockholm Chamber of Commerce and six at the International Chamber of Commerce.
- *Outcomes.* 2013 arbitral developments brought the overall number of concluded cases to 274. Out of these, approximately 43 per cent were decided in favour of the State and 31 per cent in favour of the investor. Approximately 26 per cent of cases were settled. In settled cases, the specific terms of settlement typically remain confidential.

*ISDS cases involving EU and US as respondents.* Looking more closely at the 568 known ISDS cases, we found that about 20 per cent of those were brought against EU Member States (117 cases). The United States has faced 16 arbitrations – about three per cent. In the majority of cases brought against EU Member States, the respondents are the "new" Member States (those which acceded to the EU in 2004 or later) - not the "old" Member States like Germany or the United Kingdom. The Czech Republic and Poland as well as the United States appear in the global list of most frequent respondents.

*The claimants and their home States.* Claimants from the US and EU Member States account for 75 per cent of the investment treaty arbitrations. Claimants from EU Member States have initiated 300 cases, while claimants from the US have filed 127 disputes. Within the EU, we are mostly seeing investors from the Netherlands (with 62 initiated cases), the United Kingdom (43) and Germany (39). Investors from these three countries are the most active in terms of bringing ISDS cases.

*Putting ISDS cases into a broader perspective.* In the context of \$26 trillion of global FDI stock undertaken by 104,000 multinational companies with over 892,000 foreign affiliates worldwide, the 568 cases that mainly occurred over the past two decades may indicate that ISDS has not been extensively used by the foreign direct investors. There are also questions about the effectiveness with which investors have used ISDS so far. And, a large number of IIAs have not been used as legal basis for ISDS cases. Having said that, a number of ISDS cases do have far reaching implications for international investment policies and sustainable development. It is therefore important to carefully assess the benefits and costs of ISDS and design a system for investment dispute settlement that best serves the needs of investors, governments and other affected stakeholders alike.

## **2. Key problems and concerns**

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 ISDS is on the agenda of high-profile IIA negotiations.

Originally, the ISDS 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 provides aggrieved investors with an important guarantee that their claims will be adjudicated in an independent and impartial manner.

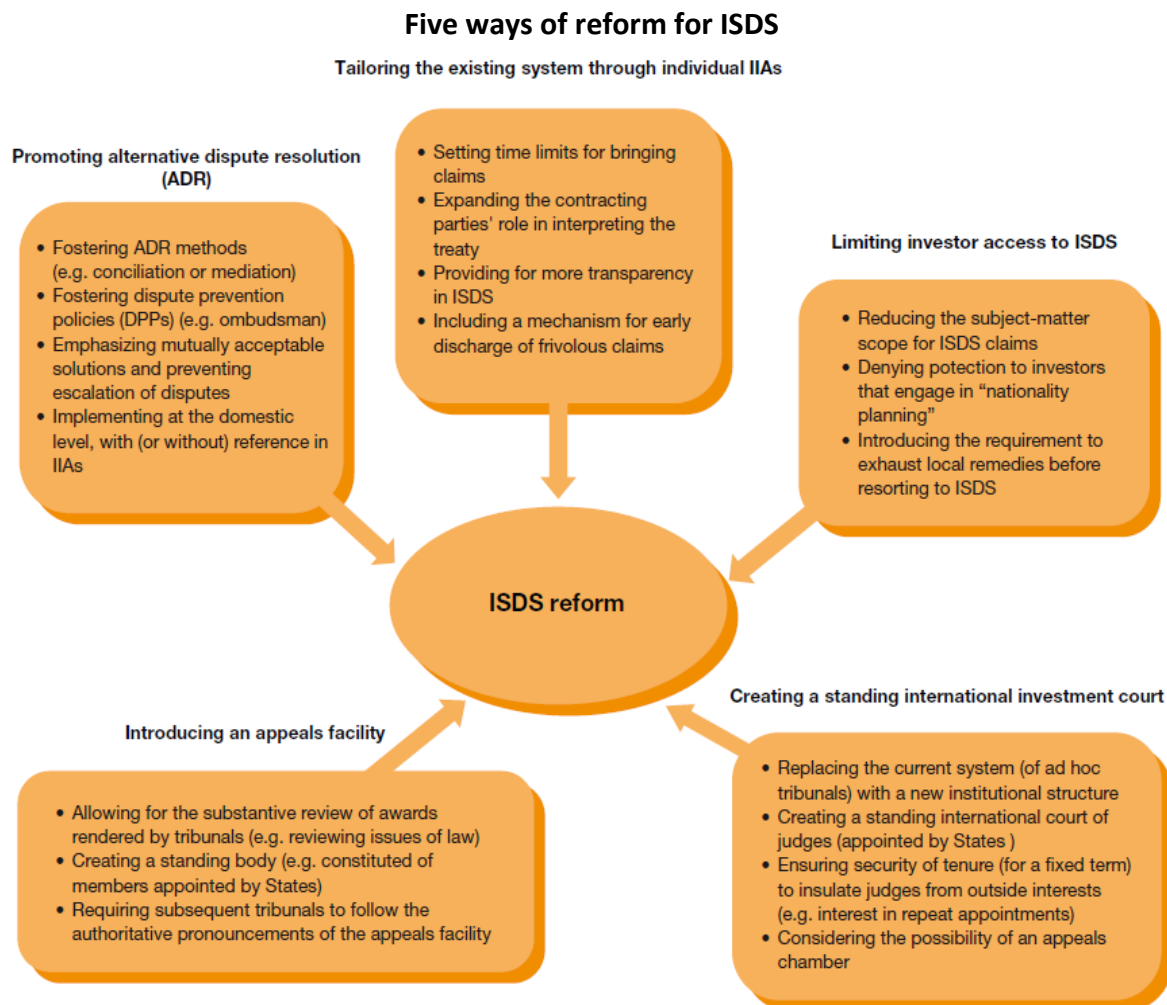
However, the actual functioning of ISDS under investment treaties may disprove many of the advantages that arbitration purports to offer. Indeed, systemic deficiencies of the ISDS mechanism have emerged. Deficiencies have been well documented in literature and summarized in UNCTAD's World Investment Report 2013.

- *Legitimacy.* It has been criticized that three individuals, appointed on an *ad hoc* basis, are entrusted with assessing the validity of States' acts, particularly when they involve public policy issues. The pressures on public finances and potential disincentives for public-interest regulation may pose obstacles to countries' sustainable development paths.
- *Transparency.* Even though the transparency of the system has improved since the early 2000s, ISDS proceedings can still be kept confidential, if both disputing parties so wish, even in cases where the dispute involves matters of public interest.
- *"Nationality planning"*. Investors may gain access to ISDS procedures using corporate structuring, i.e. by channeling an investment through a company established in an intermediary country with the sole purpose of benefitting from an IIA concluded by that country with the host State.
- *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.
- *Absence of an appeals mechanism.* Substantive mistakes of arbitral tribunals, should they arise, cannot be effectively corrected through existing review mechanisms.
- *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.
- *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 ends up winning 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.

These issues have prompted a debate about the challenges and opportunities of ISDS in multiple fora.

### 3. Options for ISDS reform

ISDS is one problem of the IIA regime, but not the only problem, nor the root of the problem. An important point to bear in mind is that ISDS is a mechanism of application of the law. Therefore, improvements to the dispute settlement mechanism should go hand-in-hand with reform of the IIA regime. ISDS issues should and can only be addressed in the context of overall reforms of the investment regime, not in isolation.



Source: UNCTAD.

In my view, the debate on ISDS issue should now go beyond the question of "to have or not to have". There have been many multi-stakeholders debates on the good and bad of ISDS over the past years. UNCTAD has taken stock of the different arguments brought forward in these debates. The question now should be: "What is the way forward in case we decide to drop ISDS?" And "What improvements need to be made to the ISDS mechanism in case we decide to retain it?"

UNCTAD outlined five sets of reform options for international investment arbitration, which are:

- Promoting alternative dispute resolution,
- Modifying the existing ISDS mechanism through individual IIAs,
- Limiting investors' access to ISDS,
- Introducing an appeals facility,
- Creating a standing international investment court.

Among the five options, 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.

### **Concluding remarks**

The content of most IIAs as they currently exist has been developed decades ago and does not correspond to today's realities. In the past, sustainability was not an issue, IIAs were rarely used as a liberalization instrument, and there were only very few investment disputes. It is only now that IIAs "bite".

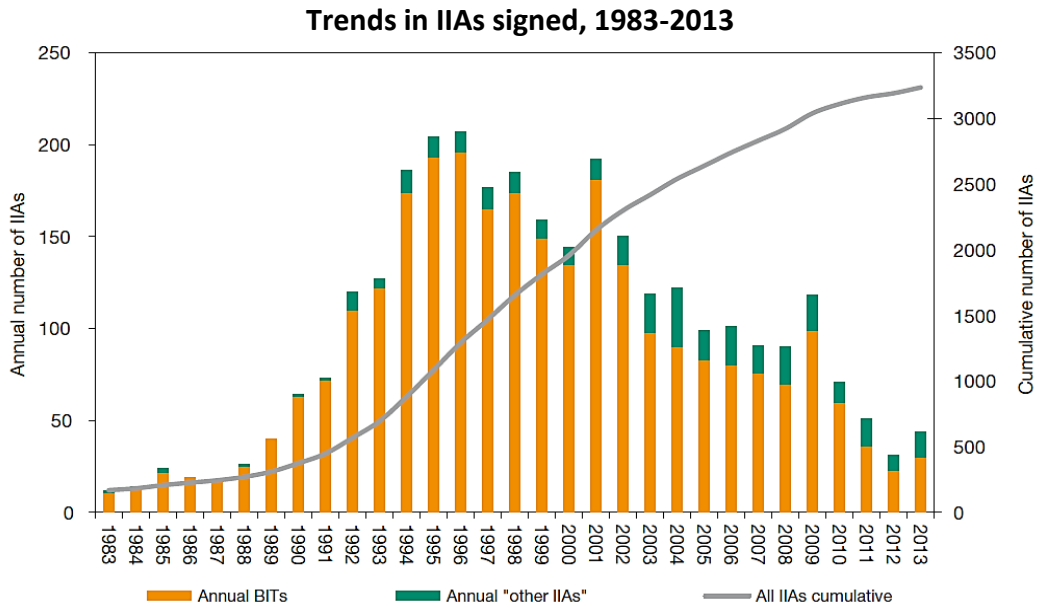
We therefore need a new generation of IIAs that addresses the challenges of investment policies in the 21st century. There is a strong case for systematic reform. Overall, a multilateral and multi-stakeholder approach could effectively contribute to a systemic reform which could address the complexities of the IIA regime and bring it in line with the sustainable development imperative.

Three weeks ago, UNCTAD hosted a conference on the reform of the IIA regime that brought together a broad range of stakeholders, including high-level policy makers and negotiators as well as senior business representatives, international organizations and civil society. The conference was part of the UNCTAD World Investment Forum 2014, and gave a voice to different interests, helping to bridge divides between different stakeholders.

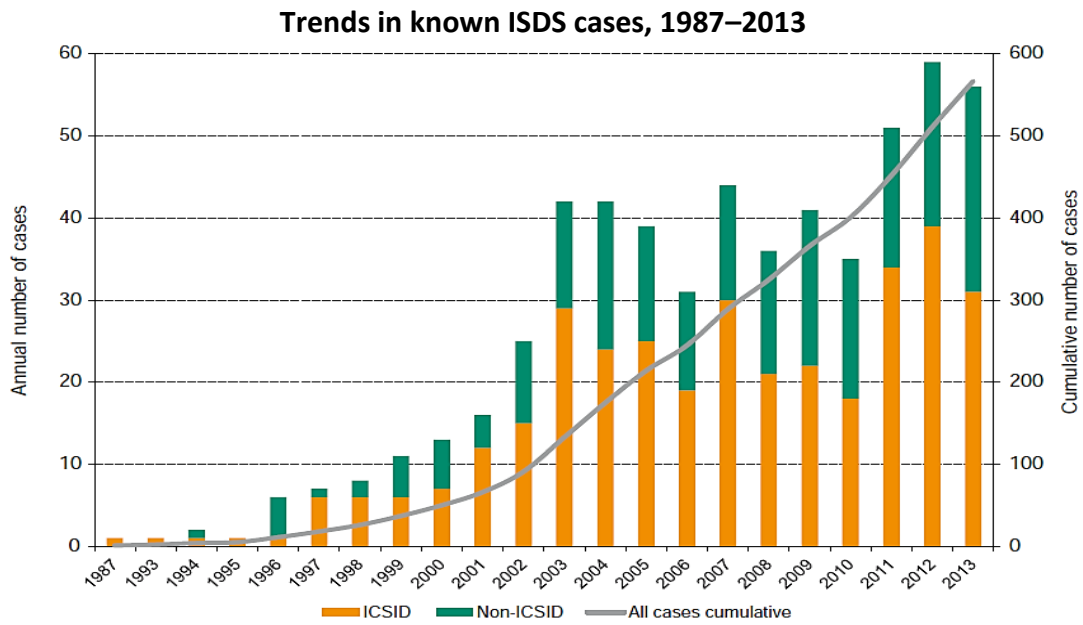
Many participants emphasized that IIAs remain an important policy tool that serves the protection and attraction of FDI by helping create a stable and predictable business climate. At the same time, a broad agreement emerged on the need to reform both the IIA regime and the dispute settlement mechanism, while taking into account the interests of a wide range of stakeholders. The view shared by many speakers was that a comprehensive reform was required, but that the changes should be introduced gradually.

Starting from a number of pressing reform issues, the meeting identified concrete and workable solutions to address them. In so doing, the conference participants sketched out a roadmap for comprehensive reform of the IIA regime, and called upon UNCTAD to further refine the elements of the roadmap together with governments, regional and inter-governmental organizations and other stakeholders.

**Annex:**



Source: UNCTAD, IIA database.

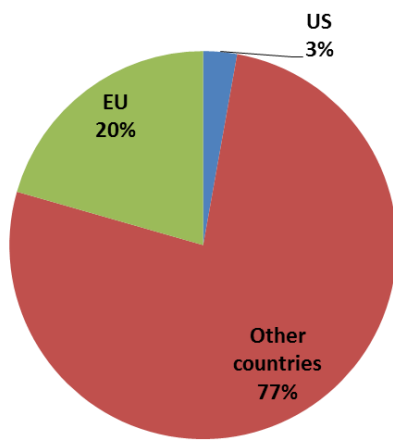


Source: UNCTAD, ISDS database.

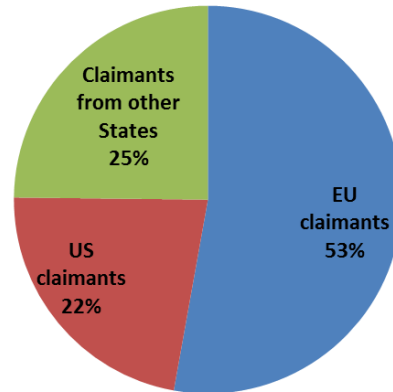


### ISDS cases involving the US and EU Member States

Cases brought against the US and EU Member States



Claimant investors' home States, including the US and EU Member States



Source: UNCTAD, ISDS database.