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The next phase of IIA reforms*

by

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Many countries are revisiting their international investment agreements (IIA). India drafted a revised model bilateral investment treaty (BIT) in December 2015 that attempts to strike a balance between investor protection and sovereign rights. The Model is based on the proposition that there are no magic wands, as updating the IIA regime is a gradual process that must be done step-by-step, taking each treaty and action into account. The Indian Model is merely one step in the overhaul of the entire system.

This *Perspective* is based partly on the author's experience with the Indian Model BIT reform process, but it addresses the need for reform of the entire IIA system from a broader angle.

Investment issues are far more deep-rooted within domestic economies and more complex in comparison to trade matters that often can be controlled by using border-related measures. This complexity has prevented investment issues from being brought under a multilateral umbrella. Thus, the investment regime, including the dispute-resolution mechanism, must not be viewed in the same way as the trade regime.

Yet, investor-state dispute settlement (ISDS) lies at the core of IIAs. It has proven to be a powerful tool for protecting foreign investors; but it also has raised extensive and diverse policy concerns. The current ISDS mechanism, which is ad-hoc, unpredictable and often arbitrary, needs urgent review. Concerns have already led to a shift toward reforming the existing mechanism, in the form of various proposals; for example, the EU has proposed an investment court system, Brazil has proposed an ombudsman and a country-to-country dispute-settlement approach and South Africa has passed the Protection of Investment Act.

The current ISDS regime can be quite costly for host countries. Per a UN Conference on Trade and Development report, as of end-2016, some 767 arbitration cases were publicly known to have been filed against host countries under IIAs.[1] A record high of 74 cases were filed in 2015, followed by 62 in 2016. Despite the obvious costs of the current ISDS mechanism, there is little empirical evidence establishing a link between the existence of

BITs and FDI flows. This is one area that requires substantial work to reinforce countries' trust in the legitimacy of IIAs.

Another factor that needs to be considered is the pro-investor bias of IIAs, due to the focus on the protection of capital and the return on capital. No such protection has been extended to labor, indigenous people, migrants, or consumers, all of whom have linkages with investment.

There are a number of principles that the future IIA regime should incorporate:

- The system must be capable of taking into account the different socio-economic conditions of host countries. The regulatory freedom of governments to pursue measures for welfare or legitimate public policy purposes must not be compromised. Some countries have specifically recognized the government's "right to regulate" in their treaties, which needs to be developed further. Addressing these concerns requires sensitivity to the differing socio-economic conditions of participating countries throughout any negotiations.
- Future systemic reforms should specifically examine the costs and benefits of the current and any proposed ISDS mechanism. An indicative schedule of fees for the different processes and participants of the ISDS mechanism would help clarify the costs for the parties in a dispute, which would be particularly relevant for governments. A schedule of fees should also help mitigate costs.
- There should be a greater focus on other alternative modes of dispute settlement, including domestic remedies or compulsory negotiation and mediation, wherever possible. Direct access to international mechanisms should be allowed only when there are no local remedies.
- A large number of ISDS disputes are being brought under the arbitration rules of the UN Commission on International Trade Law. Since these were mainly meant for private commercial dispute settlement, separate rules on investor-state arbitration should be developed.

Some specific features that should be included in the reformed system are:

- A protocol for arbitrators regarding impartiality, standards of disqualification, conflict-of-interest, and competence.
- The diversity of arbitrators needs to be enhanced, which can be accomplished by creating a pool and/or panel of arbitrators from diverse backgrounds and regions.
- Provisions for annulment and appeal.
- Incorporation of clauses to prevent multiplicity of proceedings and forum shopping.
- Incorporation of a mechanism for preliminary review of claims at the stage of filing, and rejection of claims manifestly lacking merits, with the potential awarding of costs in favor of governments for frivolous claims.
- Provisions on transparency, balanced with the right to non-disclosure of secret/protected/confidential information.

- Provisions regarding the reasonableness of arbitration awards and costs. Tribunals should also take into account counter-claims and other mitigating factors when calculating awards.
- A balance needs to be maintained between host country responsibilities and investor obligations, as well as between the defensive and offensive investment interests of countries.

Accordingly, the next phase of reform of the international investment regime will need to go beyond the limited improvements made in some recent treaties: it needs to correct fully the shortcomings and ambiguities of the current regime, in a step-by-step approach that builds on the concepts and issues stated above.

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[1] *See* UNCTAD, http://investmentpolicyhub.unctad.org/ISDS.

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