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# Recent developments in the international investment regime: Taking stock of phase 2 reform actions

## Note by the UNCTAD secretariat

*Summary*

In the face of new global investment and development challenges, policymakers need to devise public policies that are conducive to sustainable development and strengthen existing investment policy frameworks with this objective in mind. At the international level, sustainable development has entered the mainstream of international investment policymaking. As the reform of international investment agreements (IIAs) has made significant progress, it is time to take stock of IIA reform actions and chart the way forward.

International investment policymaking is in a dynamic phase, with far-reaching implications. This note provides an update on the 10 policy options of UNCTAD for phase 2 of IIA reform, originally launched in *World Investment Report 2017*. Countries can adapt and adopt these options to pursue reforms in line with their policy priorities. The UNCTAD policy options have spurred initial action to modernize old-generation treaties. Increasingly, countries are interpreting, amending, replacing or terminating outdated treaties.

While IIA reform is progressing, much remains to be done. The stock of old-generation treaties is 10 times greater than the number of modern, reform-oriented treaties, and investors continue to resort to old-generation treaties when bringing investor–State dispute settlement cases. IIA reform actions are also creating new challenges. Effectively harnessing international investment relations for the pursuit of sustainable development requires holistic and synchronized reform through an inclusive and transparent process. UNCTAD can play an important facilitating role in this regard.

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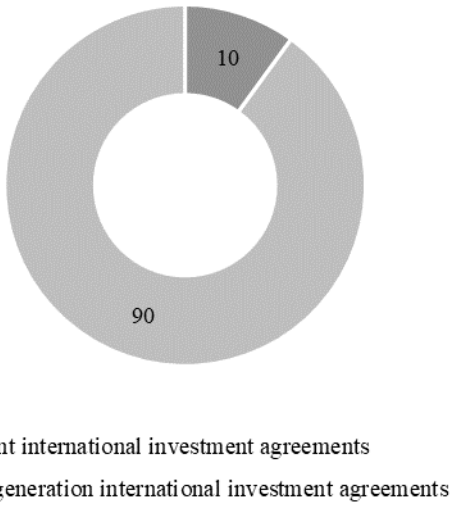
# I. Introduction

1. Forward-looking IIA reform is well under way. All treaties concluded in 2018 contain several reforms that are in line with the UNCTAD reform package for the international investment regime (2018) or the UNCTAD Investment Policy Framework for Sustainable Development.[1]

2. Twenty-seven of the 29 IIAs concluded in 2018 for which texts are available contain at least six reform features.[2] Provisions that were considered innovative in pre-2012 IIAs now appear regularly. Modern treaties often include a sustainable development orientation, the preservation of regulatory space and improvements to or omissions of investment dispute settlement. The most frequent area of reform is the preservation of regulatory space. Some recent IIAs or treaty models also contain explicit references to gender equality. Investor–State arbitration is also a central focus of IIA reform. It continues to be controversial, spurring debate in the investment and development community and the public at large. About 75 per cent of IIAs concluded in 2018 contain at least one investor–State dispute settlement reform element, and many contain several.

3. UNCTAD policy tools have also spurred initial action to modernize old-generation treaties. Countries are increasingly interpreting, amending, replacing or terminating outdated treaties. Given that, to date, such reform actions have addressed a relatively small number of IIAs, there is broad scope and urgency to pursue them further. Currently, the stock of old-generation treaties is 10 times greater than the number of modern, reform-oriented treaties (figure 1) and the majority of known investor–State dispute settlement cases have to date been based on old-generation treaties.

Figure 1
**Stock of old-generation (1959–2011) and recent (2012–2018) international investment agreements**
(Percentage)




*Source*: UNCTAD, 2019, *World Investment Report 2019: Special Economic Zones* (United Nations publication, Sales No. E.19.II.D.12, Geneva).

[1] See https://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1437 and https://investmentpolicy.unctad.org/publications/1190/unctad-s-reform-package-for-the-international-investment-regime-2018-edition-.

[2] In 2018, countries concluded at least 40 IIAs, namely 30 bilateral investment treaties (BITs) and 10 treaties with investment provisions. At the time of writing, texts were available for 29 IIAs.

4. This note provides an update on the 10 options for phase 2 of IIA reform, originally launched in *World Investment Report 2017* and subsequently included in the 2018 reform package for the international investment regime.[3] It reviews the most recent phase 2 reform actions and concludes by identifying four challenges that the international investment community needs to address for reform to become truly successful.

# II. Ten options for phase 2 of international investment agreement reform: Challenges and choices

5. Countries have numerous options in modernizing their stock of first-generation treaties and reducing fragmentation of the IIA regime. This note recaps and analyses 10 options and their pros and cons, for countries to adapt and adopt in line with their specific reform objectives. Determining which reform option is right for a country in a particular situation requires a careful and facts-based cost-benefit analysis, while addressing a number of broader challenges.

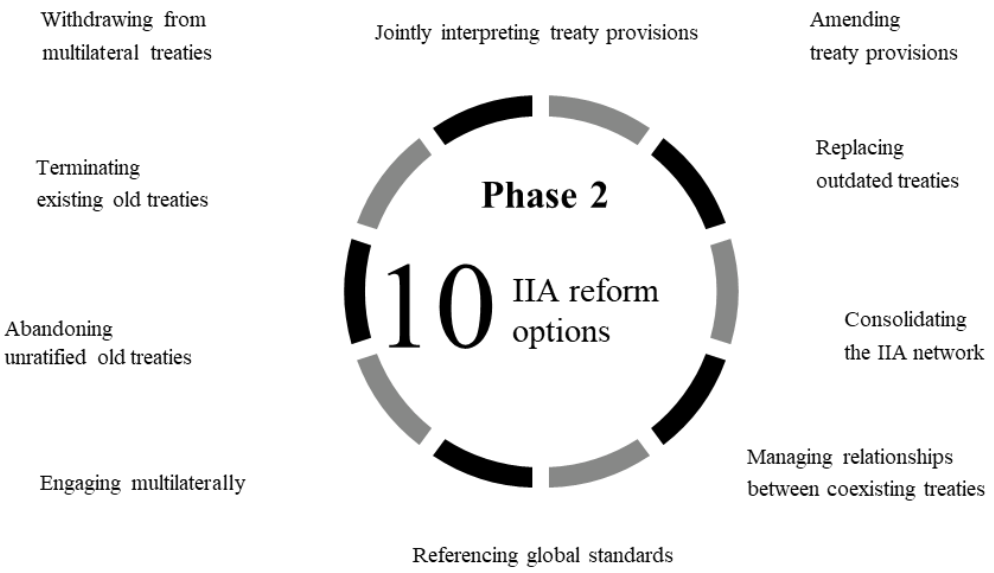
6. There are at least 10 options available for countries that wish to change existing treaties to bring them into conformity with new policy objectives and priorities and to address the challenges arising from the fragmentation of the IIA regime (figure 2). These mechanisms are not mutually exclusive and can be used in a complementary manner, especially by countries that have extensive IIA networks.

7. The 10 options differ in several respects, as they encompass actions that are more technical (e.g. interpreting or amending treaty provisions) or political (e.g. engaging multilaterally), focus on procedure (e.g. amending or replacing treaties) or also on substance (e.g. referencing international standards) or imply continuous engagement with the IIA regime (e.g. amending or replacing treaties or engaging multilaterally) or exit from it (e.g. terminating without replacement or withdrawing from multilateral mechanisms). They represent modalities for introducing change to the IIA regime (the "how" of reform), although they need to be seen and considered in combination with treaty content design (the "what" of reform, or phase 1 of IIA reform).

8. In making a determination of whether a reform mechanism is right for a country in a particular situation, a careful and facts-based cost-benefit analysis, which addresses a number of broader challenges, is needed. Strategic challenges include producing a holistic and balanced result, rather than overshooting on reform and depriving the IIA regime of its purpose of protecting and promoting investment. Systemic challenges arise from gaps, overlaps and fragmentation that create coherence and consistency problems. Coordination challenges require prioritizing reform actions, finding the right treaty partners to implement them and ensuring coherence between reform efforts at different levels of policymaking. Capacity challenges make it difficult for smaller countries, in particular the least developed countries, to address the deficiencies of first-generation IIAs.

[3] UNCTAD, 2017, *World Investment Report 2017: Investment and the Digital Economy* (United Nations publication, Sales No. E.17.II.D.3, Geneva).

Figure 2
**Ten options for modernizing the existing stock of old-generation international investment agreements**




*Source*: UNCTAD, 2017.

9. Choices must be made in identifying the best possible combination of the 10 policy options. For example, treaty termination is frequently combined with replacement or consolidation. The chosen combination of options should ultimately reflect a country's international investment policy direction in line with its national development strategy. Moreover, when implementing IIA reform, policymakers should consider the compound effect of options. Some combinations of reform options may result in a treaty regime that is largely deprived of its traditional investment protection rationale or may result in a complete exit from the IIA regime. Reform efforts, particularly comprehensive ones, should harness the benefits that can be obtained from the rule of law and respond to investors' expectations of predictability, stability and transparency in policymaking.

10. When choosing among reform mechanisms, policymakers should also consider the attendant challenges, both legal and practical. Among the legal challenges, three stand out as particularly pronounced: the most-favoured nation clause, the survival clause and the management of transitions between old and new treaties. Each of these challenges may be particularly relevant for certain specific reform options, as follows:

- Most-favoured nation clauses aim to prevent nationality-based discrimination. They typically prohibit the less favourable treatment of investors from a signatory State when compared with the treatment of like investors from any third country. Many tribunals have interpreted broadly worded most-favoured nation provisions as allowing the importation of more favourable provisions from IIAs signed by a host State with third countries. This has led to some controversy and subsequently more careful treaty drafting that limits the scope of application of the most-favoured nation provision. The inclusion of a broadly worded most-favoured nation clause in a new treaty can undermine reform efforts, as it allows investors to cherry pick the most advantageous clauses from a host State's unreformed treaties with third countries. For existing IIAs, challenges related to the most-favoured nation clause arise in particular with regard to four reform options: joint interpretation, amendment, replacement and management of treaty relationships.
- Survival clauses included in most BITs are designed to extend treaty application for a further period after termination (some for 5 years, but most frequently for 10, 15 or even 20 years). Depending on how they are formulated, survival clauses either apply only to unilateral termination or potentially also to joint treaty termination (including termination owing to replacement by a new treaty). Allowing an old-generation (unreformed) treaty to apply for a long time after termination would

undermine reform efforts, particularly if doing so results in parallel application with a new treaty. Survival clauses may therefore need to be neutralized in old treaties that are jointly terminated or replaced (including through consolidation). Challenges related to survival clauses are particularly pronounced with regard to reform options that terminate, replace or consolidate.

- Transition clauses delineate a treaty's scope of temporal application by clarifying in which situations, and for how long after a treaty's termination, an investor may invoke the old IIA to bring an investor–State dispute settlement case. If included in the new treaty, such clauses help ensure a smooth transition from the old to the new by limiting situations in which both treaties apply concurrently (or by clarifying that upon the new treaty's entry into force, the old treaty is phased out). Transition clauses effectively modify the operation of the survival clause in the outgoing treaty; they are particularly relevant with regard to reform options that replace old treaties, including through consolidation.

11. In addition to legal challenges, policymakers also need to keep in mind and plan for the many practical and political challenges that might arise, as outlined in the following chapter.

# III. Ten options for phase 2 of international investment agreement reform: Overview and stocktaking

## 1. Jointly interpreting treaty provisions

12. IIAs with broadly worded provisions can give rise to unintended and contradictory interpretations in investor–State dispute settlement proceedings. Joint interpretations, aimed at clarifying the meaning of treaty obligations, help reduce uncertainty and enhance predictability for investors, contracting parties and tribunals.

13. Authoritative joint interpretations can help reduce uncertainty and enhance predictability for investors, contracting parties and tribunals (table 1). This reform tool is the easiest with regard to its practical application as it allows treaty parties to voice their positions on a specific IIA clause without undertaking a comparatively higher cost and more time-consuming amendment or renegotiation of the treaty. By stating explicitly in the treaty that joint interpretation is binding on the tribunal, the parties can remove any doubt regarding its legal effect. However, even in the absence of such a provision, the Vienna Convention on the Law of Treaties obliges arbitrators to take into account, together with the context, "any subsequent agreement between the parties regarding the interpretation of the treaty" (article 31.3 (a)).

14. In 2018, Colombia and India signed a joint interpretative declaration with regard to their 2009 BIT. The declaration refines key clauses in the 2009 treaty to reflect sustainable development objectives, to strengthen the right of the parties to regulate in the public interest and to clarify the provisions on fair and equitable treatment, expropriation, national treatment, most-favoured nation treatment and investor–State dispute settlement.

15. In 2017, Bangladesh and India signed a similar joint declaration with regard to their 2009 BIT. In addition, in 2017, Colombia and France signed a joint interpretative declaration with regard to their 2014 BIT. The latter clarifies that article 16 on other dispositions should not be read as a stabilization clause and that a violation of a State contract between an investor and a party does not constitute a treaty violation.

16. Several recent IIAs and models also establish joint bodies with a mandate to issue binding interpretations of treaty provisions (e.g. Australia–Peru free trade agreement, 2018; Belarus–India BIT, 2018; Central America–Republic of Korea free trade agreement, 2018; Comprehensive and Progressive Trans-Pacific Partnership, 2018; European Union–Singapore investment protection agreement, 2018; European Union–Viet Nam investment protection agreement, 2019; Republic of Korea–United States of America free trade agreement (2007), 2018 amendments; United States–Mexico–Canada Agreement, 2018; and Netherlands model BIT, 2018).

Table 1
**Reform action: Jointly interpreting treaty provisions**

| *Clarifies the content of a treaty provision and narrows the scope of interpretive discretion of tribunals* | |
|---|---|
| *Outcomes (pros)* | *Challenges (cons)* |
| • Allows the parties to clarify one or several specific provisions without amending or renegotiating the treaty (no ratification required; less cost and time-intensive)<br>• Is particularly effective if the treaty expressly provides that joint interpretations by the parties (or their joint bodies) are binding on tribunals<br>• Becomes relevant from the moment of adoption, including for pending disputes<br>• Has authoritative power as it originates from the treaty parties | • Is limited in its effect as it cannot attach an entirely new meaning to the provision being interpreted<br>• Can raise doubts about its true legal nature (may not always be easy to distinguish between a joint interpretation and an amendment)<br>• Can leave tribunals with a margin of discretion<br>• Might be difficult to establish as genuine if either party has consistently acted in a way that does not comport with the interpretation<br>• May be difficult to negotiate in cases when a pending dispute involves the application of the provision concerned |

*Source*: UNCTAD, 2017.

### 2. Amending treaty provisions

17. It may be difficult to fix expansively formulated obligations commonly found in older IIAs through joint interpretations. By amending treaty provisions, the parties can achieve a higher degree of change and thereby ensure that the amended treaty reflects their evolving policy preferences.

18. Typically, amendments are limited in number and do not affect the overall design and philosophy of a treaty.[4] Where treaty parties are concerned only with certain specific provisions (e.g. most-favoured nation or fair and equitable treatment), discrete amendments might be preferred to the renegotiation of the whole treaty, an exercise that could be time-consuming and, depending on the other party (or parties), challenging (table 2).

19. Applicable amendment procedures depend on the treaty that is subject to change. For IIAs that do not regulate amendments, the general rules of the Vienna Convention on the Law of Treaties usually apply. However, many newer IIAs include their own provisions on amendment. This is particularly important for plurilateral or multilateral treaties, in which the large number of parties involved adds complexity to the process. IIA amendments are usually formalized through separate agreements (e.g. protocols or exchanges of letters or notes), which take effect following a procedure similar to that of the original treaty, i.e. after respective domestic ratification procedures have been completed.

20. In 2018, amendments were used in both bilateral and regional contexts. In megaregional IIAs, parties used protocols and exchanges of side letters or notes. The 11 parties to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership agreed to retain core elements of the Trans-Pacific Partnership text with amendments in selected areas. With regard to investment (chapter 9), the parties agreed to suspend the application of the provisions related to investor–State contracts and investment authorizations.

21. In September 2018, the Republic of Korea and the United States signed an amendment to their free trade agreement (2007). The amendment includes clarifications on the meaning of minimum standard of treatment and excludes investor–State dispute settlement procedures from the scope of the most-favoured nation clause. It also tasks the joint committee with considering improvements to the investor–State dispute settlement

[4] UNCTAD, 2013, *World Investment Report 2013: Global Value Chains – Investment and Trade for Development* (United Nations publication, Sales No. E.13.II.D.5, New York and Geneva).

provision that meet both countries' objectives (e.g. ways to resolve disputes and eliminate frivolous claims).

22. In 2019, the Energy Charter Conference approved the timeline for discussion on modernization of the Energy Charter Treaty and agreed on a set of topics to be reviewed as part of the discussion, including the right to regulate, sustainable development, corporate social responsibility, fair and equitable treatment and indirect expropriation.[5] The modernization process will identify possible policy options for each of the topics listed. The members of the subgroup of the conference will commence negotiations to modernize the treaty in accordance with the proposed topics and the identified policy options.

Table 2
**Reform action: Amending treaty provisions**

| *Modifies an existing treaty's content by introducing new provisions or altering or removing existing ones* | |
|---|---|
| *Outcomes (pros)* | *Challenges (cons)* |
| • Constitutes a broader, more far-reaching tool than interpretation; can introduce new rules rather than merely clarifying the meaning of existing ones<br>• Selectively addresses the most important issues on which the parties' policy positions align<br>• Can be easier to agree upon with the treaty partner and more efficient to negotiate compared with a renegotiation of the treaty as a whole | • Typically requires domestic ratification in order to take effect<br>• Only applies prospectively, i.e. does not affect pending disputes<br>• Does not lead to overall change in treaty design and philosophy<br>• May lead to horse trading, in which desired amendments are achieved only through a quid pro quo with parties demanding other amendments |

*Source*: UNCTAD, 2017.

### 3. Replacing outdated treaties

23. Treaty replacements offer an opportunity to undertake a comprehensive revision of a treaty instead of selectively amending individual clauses.

24. This reform action replaces outdated IIAs by substituting them with new ones. New IIAs can be concluded by the same treaty partners (e.g. when one BIT is replaced by a new BIT) or by a larger group of countries (e.g. when several BITs are replaced by a plurilateral treaty (see option 4)). Approaching the treaty afresh enables the parties to achieve a higher degree of change (vis-à-vis selective amendments) and to be more rigorous and conceptual in designing an IIA that reflects their contemporary shared vision (table 3).

25. An increasing number of recently concluded IIAs are replacing old-generation treaties, typically substituting a new treaty for an old one. Of the 30 BITs signed in 2018, four replaced older BITs between two countries (e.g. the Belarus–Turkey BIT replaced their 1995 BIT; the Kyrgyzstan–Turkey BIT replaced their 1992 BIT; the Lithuania–Turkey BIT replaced their 1994 BIT; and the Serbia–Turkey BIT replaced their 2001 BIT).

26. Three treaties with investment provisions concluded in 2018 replaced one treaty each or are set to do so. The Singapore–Sri Lanka free trade agreement replaced one BIT (1980) and the Australia–Peru free trade agreement (2018) foresees the replacement of one BIT (1995), unless replaced upon the entry into force of the Comprehensive and Progressive Agreement for Trans-Pacific Partnership for the two countries. Once in force, the United States–Mexico–Canada Agreement (2018) will replace the North American Free Trade Agreement (1992). Three other treaties with investment provisions have replaced several agreements at once (see option 4).

27. The effective transition from an old to a new treaty can be ensured through transition clauses. Three recent treaties with investment provisions establish a transition period of

[5] See http://trade.ec.europa.eu/doclib/press/index.cfm?id=2017.

three years after the entry into force of the new agreement (namely, the Australia–Peru free trade agreement (2018), the Singapore–Sri Lanka free trade agreement (2018) and the United States–Mexico–Canada Agreement (2018)).[6] Transition clauses are a relatively new phenomenon and their prevalence is growing in recent regional and plurilateral IIAs. Treaty partners that are known to have used transition provisions at least once include Australia, Canada, Chile, Mexico, Panama, Peru, the Republic of Korea, Singapore, Viet Nam and the European Union.

Table 3
**Reform action: Replacing outdated treaties**

| *Substitutes an old treaty with a new one* | |
|---|---|
| *Outcomes (pros)* | *Challenges (cons)* |
| • Allows for a holistic approach to reform through a comprehensive revision of the treaty in line with the contracting parties' evolving policy objectives<br>• Allows for the revision of the treaty's philosophy and overall design and the inclusion of new policy issues<br>• Can be done at any time during the lifetime of the treaty | • Requires participation of a treaty partner or partners with similar views<br>• Can be cost and time-intensive, as it involves the negotiation of the treaty from scratch<br>• Does not guarantee inclusion of reform-oriented elements (depends on the negotiated outcome)<br>• Requires effective transition between the old and new treaties |

*Source*: UNCTAD, 2017.

### 4. Consolidating the international investment agreement network

28. A growing number of regional IIAs include specific clauses providing for the replacement of treaties between the parties. Abrogating two or more old treaties through the creation of a single new one can help to modernize treaty content and avoid fragmentation of the IIA network.

29. Consolidation is a form of replacement (see option 3). It means abrogating several pre-existing treaties and replacing them with one single new, modern and sustainable development-oriented treaty. From an IIA reform perspective, this is an appealing option as it has the dual positive effect of modernizing treaty content and reducing fragmentation of the IIA network, i.e. establishing uniform treaty rules for more than two countries (table 4).

30. As with replacement generally, when opting for consolidation, countries need to be mindful of termination provisions in the outgoing IIAs and ensure an effective transition from the old to the new treaty regime (see option 3).

31. Among the treaties with investment provisions concluded in 2018, three replaced more than one older BIT. Replacements were recorded in specific clauses in the text of the new IIAs or in letters providing for termination and replacement. For example, the