A Fresh Approach to International Investment Rules

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Executive Summary

Money makes the world go round. Nations compete for investment in the interest of stimulating trade, economic growth, productivity, access to new technologies, and employment. As a result, policymakers around the world have made attracting investment a priority. Outward global investment totaled $1.45 trillion in 2010, over 25 times larger than the $51.6 billion invested in 1980.

Although money flows are global, the system of rules governing investment is bilateral and regional. Cross-border investment is governed by a patchwork of over 3,000 bilateral investment treaties (BITs), regional and bilateral trade agreements (FTAs) with investment chapters, as well as the trade-related investment provisions of the World Trade Organization. Moreover, these international investment agreements (IIAs) do not cover all states, investors, and categories of investments. Taken as a whole, this agglomeration of ad hoc rules is failing investors, states, and their citizens. The current system has several problems:

1. **The rules governing international investment lack clear and consistent definitions and norms.**

2. **Many investment agreements allow foreign investors to challenge direct or indirect seizures of property by requesting an independent tribunal. But there is no unified, transparent, and multilateral mechanism for resolving investment disputes. Tribunals are issuing inconsistent decisions and causing uncertainty for investors and states.**

3. **These tribunals have no effective means of enforcing their decisions.**

4. **Some investors game the system by picking specific treaties or forums to hear disputes. Moreover, some investors may rely on BITs to jump over their domestic legal systems in the belief they may be better positioned to gain compensation.**

5. **Investors are increasingly challenging government regulatory or budgetary action as "indirect expropriations."While government regulatory or budgetary decisions may often affect the value of an investment, governments must preserve their policy space—their flexibility to govern in the public interest.**

We believe that investors, states, and citizens would benefit from a more universal, consistent and accountable system of rules to govern international investment. Unfortunately, the international community has failed four times to create a universal system since 1948, and few countries today seem eager to try again. Although a more comprehensive and coherent regime would provide investors with greater certainty, many investors have learned to work with the current bilateral and regional system, and thus, they prefer the status quo. But business and governmental leaders can no longer ignore the problems of this uneven system. We suggest three practical steps that will move us toward a more consistent, universal, and accountable system.

Step 1: At the behest of the G-20, the WTO should work with relevant international organizations to develop a code of norms and best practices. G-20 members should use this code as a basis for future investment agreements and encourage all WTO member states to do so.

Step 2: WTO members should set up an Investment Appellate Body to review and if necessary, override controversial arbitrations, where the rights of investors or governments were inadequately protected. The Investment Appellate Body will stand beside the WTO's Trade Appellate Body.

Step 3: At the behest of one or more WTO member states, the WTO Secretariat should explore whether the Investment appellate body should authorize member states to use trade policy to retaliate against states that repeatedly ignore investment tribunal decisions.

Key Abbreviations:

BIT-bilateral investment treaty
IIA-international investment agreement
FTA-free trade agreement
WTO-World Trade Organization

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A Brief Overview of the Problem

Investment is sustenance: every country on the planet needs some foreign investment to stimulate growth. Despite the importance and global nature of investment, it is governed by a hodgepodge of rules that don't consistently provide clear guidance to investors or states. As of 2011, the UN Conference on Trade and Development (UNCTAD) reported that the 193 countries of the world participate in 3,164 international investment agreements (hereafter IIAs) which include 2,833 BITs and 331 "other IIAs," including free trade agreements (FTAs) with investment provisions, economic partnership agreements, and regional agreements (see Appendix Chart 2 for a look at the increase in IIAs over time).[2]Although BITs are plentiful, they are not universal. UNCTAD admitted, "Today's…regime…is too big and complex to handle for governments and investors alike…Yet it offers protection to only two-thirds of global FDI stock and covers only one fifth of possible bilateral investment relationships."[3]

The patchwork of rules governing cross-border investment is fraying. These agreements have diverse definitions of investment, dissimilar strategies for settling disputes between investors and states, no means of enforcing decisions, and increasing dissonance in decision-making. Moreover, most IIAs do not clearly spell out investors' responsibilities, or delineate the investor-state disputes that should be governed by investment agreements and those that should be decided by host country courts.

Governments enter into international investment agreements to promote investment by reassuring investors that their property rights will be protected in an independent and unbiased forum. But these treaties don't always work as promised. Many BITs allow investors to ask for an independent tribunal to weigh whether or not a state has expropriated an investment, and then to determine just compensation. Some governments, such as Argentina, simply refuse to pay up because these tribunals have no means of enforcing their decisions. In early 2001-2002, the Argentine economy was in freefall. Facing a dramatic rise in unemployment, the government was forced to devalue its currency and eventually defaulted on its debt. To obtain greater control over the economy, the government also nationalized several companies. Foreign investors were understandably outraged and determined to fight for just compensation for their loss of property. After several arbitration tribunals required Argentina to pay compensation, the government failed to do so, insisting instead that claimants resort to Argentine courts for execution of these awards.[4]

Just last year, Argentina seized control of the country's largest oil company, YPF. The Spanish energy company Repsol,which owned 51% of YPF, challenged the government's action as an expropriation. The government asserted that it took over the company because Repsol used its profits to invest overseas rather than developing energy in Argentina.Repsolcountered that the decline in exploration and production stemmed from government controls on exports and price controls on domestic oil and gas.[5]Although this case has not yet been decided by arbitration, Argentina has signaled to investors that the government would not always meet its obligations to protect foreign investors' property rights.[6] In the face of this action, the Spanish government curtailed Argentine biodiesel shipments for some eight months, using trade to send a message of disapproval.[7] Although Argentina and Repsol began talks to achieve a settlement, in late June 2012, Repsol's board unanimously rejected a proposed settlement and voted to continue to proceed with a dispute.[8]

While Argentina provides an example of how investor-state arbitration can fail investors, Canada provides an example of how investors use this process to challenge government policies. Expropriation generally refers to the seizure of property, but at times governmental actions including regulating, cutting subsidies, or slashing budgets, can reduce the value of an investment. In 2000, the delivery giant UPS sued the Canadian government under NAFTA's investment provisions. The company alleged that Canada Post (a government-owned company that acts as a private company) engaged in anti-competitive practices because it provided "its courier products with advantages that were not provided to UPS Canada." In addition UPS alleged that the Canada Border Services Agency provided less favorable treatment to UPS Canada than to Canada Post's courier services.[9] In 2005, the parties established an investment tribunal to weigh UPS's allegations. The Tribunal rejected all of UPS'claims, arguing that certain activities of Canada Post were "arms-length" from the Canadian government and therefore not subject to challenge by the investor. Leaving its merits aside, the case raised important questions as to how far investors could go in using investment treaties to constrain policy decisions governments see as essential to serving the public interest.[10]

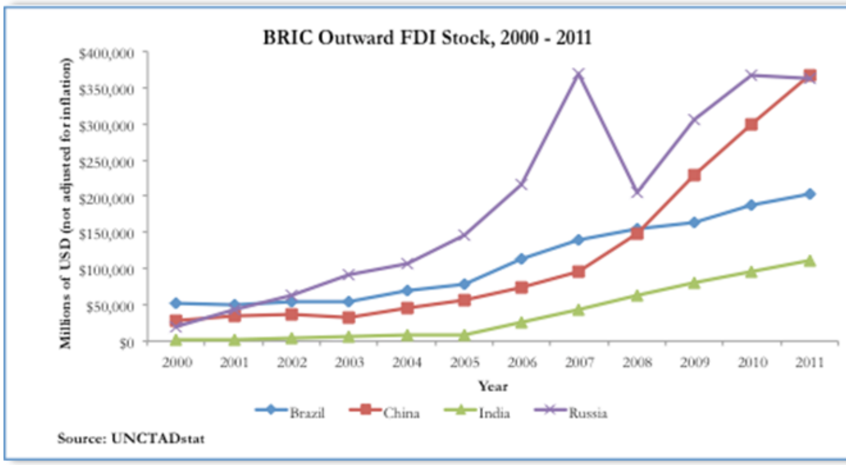
These cases underscore the need for a clear set of norms to underpin international investment agreements as well as a more uniform approach to investor-state dispute settlement. Although all parties would benefit from major systemic reform (an international investment system with clear uniform rules and one system of dispute settlement), policymakers, investors and even some critics of the status quo fear that international negotiations could yield a more universal but weaker system. Although some people argue that the world is stuck with the current piecemeal system,[11] we propose steps that will strengthen and unify investmentrules, make the investor-state regime more consistent and accountable, and provide a means of enforcement.

The Landscape for Investment

The current patchwork of bilateral treaties and free trade agreements cannot effectively govern the huge flows of capital moving between states. After plunging during the Great Recession (2007-2010), foreign direct investment rebounded from 2010-2011, rising 16%. Outward foreign investment from developed countries totaled $1.24 trillion in 2011, which reflects a 25% increase over its recession-affected 2010 levels.Although outward FDI from developing economies declined 4% from 2010 levels to $384 billion in 2011, developing countries' shareof global outflows remained high at 23 per cent.[12] These cross-border flows of money drive development, growth, and employment, both in America and abroad.

However, large scale foreign investment is a relatively recent phenomenon. In the years after World War II, many developing countries were hostile to foreign investment. Countries like India, Brazil, and Sri Lanka feared that investors would attempt to control their economic resources. But attitudes began to change in the 1980s, when a growing number of multinationals in the US, Japan, and the EU began to source production in emerging markets.[13] Policymakers in countries such as China, Brazil, and Mexico began to welcome that investment as a way to stimulate both development and growth. These nations began to offer incentives such as subsidized land to attract foreign investors, and they signed bilateral investment treaties (BITs) to reassure investors that their property would be protected.

Thirty years later, industrialized countries often compete with emerging nations for investment. Like the US or Germany in the 20th century, many emerging markets are both home (source) and host (recipient) countries for investment.[14] Today's foreign investors include multinational firms, investment funds, and individual investors, as well as state owned enterprises and sovereign wealth funds (state-owned and directed investors).[15] Brazil, Russia, India, and China (the BRIC countries) as well as Taiwan, Saudi Arabia, South Africa, and the United Arab Emirates, are now important sources of foreign investment (see Appendix Chart 3).[16]



Since Germany and Pakistan signed the first BIT in 1959, most countries have agreed to at least one treaty or agreement to encourage and protect investment. As South-South investment increases,Korea, India, Japan, and China actively negotiate BITs. Recently however, a growing number of nations, including the US, Singapore, China, and Canada, as well as the EU, have turned to free trade agreements as their principal vehicle to regulate cross-border investment.

Although each treaty or agreement is unique, most IIAs have some common characteristics. First, they generally define which investors are covered under the agreement. Individuals and companies are footloose, and recent IIAs contain language to ensure that investors are truly foreign and not nationals who have used shell corporations to gain access to a BIT or FTA. Second, each agreement defines the types of "investment," such as a portfolio (stock) or direct investment (more than 15% ownership of a company, real estate and other assets), that is covered. The US began to list the specific assets covered under its BITs and free trade agreements in 1993; they include intellectual property rights, real estate, turn-key and services contracts, and holding companies. However, some BITs such as the German or U.K. variants define investment quite broadly. In fact, some scholars say that investors cherry pick treaties and structure their investments to maximize protection under various BITs, because the definition of investment is so uneven among IIAs. UNCTAD has noted that because investments are defined vaguely in many BITs, arbitrators disagree as to what is and is not covered.[17]

These agreements commit nations to give private foreign investment "fair and equitable treatment," and to treat foreign investors the same as domestic ones ("national treatment"). Many

IIAs also set limits on expropriation and guarantee fair compensation when it occurs. Crucially, investment treaties also give investors the right to transfer funds in and out of host countries using market exchange rates. Finally, the parties to an investment pact often set up state-to-state, and more frequently, investor-state dispute settlement provisions.[18] These provisions allow investors to challenge state actions and policies that may affect the value of an investment. Recently, some agreements have included provisions affirming governments' ability to pursue important national regulatory objectives such as promoting labor rights or protecting the environment. Scholars call this ensuring that governments have "policy space."[19]

Economists are divided as to the effects of these treaties and agreements. While scholars generally believe investment can promote development,[20] they disagree as to whether BITs and FTAs increase investment.[21] Although research confirms the common sense notion that investors are attracted to states with good governance,[22]scholars have been unable to show that BITs influence investment decisions – influence being measured by statistically significant, substantively meaningful correlations between the number of BITs a host state has signed and FDI inflows.[23]

As noted above, a growing number of nations have utilized FTAs as a tool to liberalize and protect investment. In so doing, policymakers can create a set of shared rules to govern cross-border trade as well as investment. Although FTAs are more comprehensive and hence harder to negotiate than BITs, they may deliver larger economic benefits for all parties. BITs also have a limited duration (US BITs are often for 10 years); while a trade agreement lasts forever (unless participating states renounce it).[24]

In theory, more FTAs might help rationalize the patchwork of investment rules. But there is no common template for FTAs; some countries cover investment as well as services, labor and environmental issues, while others simply cover trade in goods. Moreover, US FTAs' language on investment can be very different from that found in German, Dutch, or Chinese FTAs. Thus, policymakers' growing reliance on FTAs does little to simplify or harmonize the patchwork of investment rules.

The WTO's investment provisions provide a final element of complexity. During the Uruguay Round of the GATT, member states agreed to regulate trade-related investment in an agreement called Trade Related Investment Measures (TRIMs). The General Agreement on Trade in Services (GATS) also includes rules governing foreign investment in services.[25] However, although TRIMS and GATS are designed to stimulate trade-related investment, they do not *protect* investment per se, or delineate the rights and responsibilities of investors. So the WTO's rules are part of the international investment system, but they are not designed to protect investors.

The Case for Reform

We have identified five major problems with the current system of rules governing investment:

1. In contrast with trade, the rules governing international investment lack clear definitions and norms.
2. There is no unified, transparent, and multilateral mechanism for resolving investment disputes.As a result, the many IIAs are yielding contradictory decisions on the same issue using the same IIA, leading to uncertainty for states and investors.

3. Investor-state tribunals have no enforcement mechanism to use against recalcitrant states.
4. Some investors game the system; they pick specific treaties or forums to hear disputes. Moreover, some investors may rely on BITs to jump over their domestic legal systems in the belief they may be better positioned to gain compensation.
5. Investors are increasingly challenging government regulatory or budgetary action as "indirect expropriations."While government regulatory or budgetary decisions may often affect the value of an investment, governments must preserve their "policy space"—their flexibility to govern in the public interest.

Problem 1. No Agreed Upon "Rules of the Road"

Trade and investment are complementary, yet they are governed under separate and unequal rules.[26] Just as traders benefit from a uniform system of rules that creates efficiency, clarity, and predictability, so would investors. Governments have signed bilateral, regional and international trade agreements, but all such agreements must conform to the WTO's comprehensive trade rules. But while trade agreements regulate only the behavior of states, investment agreements regulate the behavior of private investors and companies as well as states, and mixes international law and private law (commercial arbitration) governing states and investors.

Diplomats have been negotiating trade agreements for centuries. Over time, such agreements have developed shared definitions, norms, and principles such as transparency, nondiscrimination and due process. But the international system governing BITs is not as coherent. Although most BITs include the concepts of national treatment, most-favored nation (MFN) treatment, fair and equitable treatment, and full protection and security for investors they contain legal and/or textual variations, sometimes of a subtle nature. As a result, according to the OECD, arbitrators can developdivergent interpretations of the same general obligation under different agreements.[27]Moreover, each BIT or FTA may or may not have investor-state provisions, provisions for transparency, or include definitions of key terms such as direct and indirect expropriation.

Problem 2.No unified, transparent, and multilateral mechanism for resolving investment disputes; as a result, tribunals are yielding inconsistent decisions.

The WTO has a widely-used system of dispute settlement as well as an appellate body to judge disputes. The dispute settlement system underpins the rule of law among members, and makes the trading system more predictable. The system has clearly-defined rules, procedures and timetables for completing a case.[28]It features credible enforcement mechanisms and ways to punish those who violate trade rules. If the dispute settlement body decides that a member state has violated WTO obligations, the complaining party can seek compensation from the nation in violation. If the complaining and violating parties can't reach agreement on such compensation, the complaining country may ask the Dispute Settlement Body for permission to impose trade sanctions against the respondent that has failed to implement the decision.[29]

But as noted above, IIAs do not share a formal system of dispute settlement. Each tribunal is made up of different arbitrators and each arbitration venue has different procedures; as such it is not surprising that different tribunals yield varied results for investors and states.Decisions are not supposed to be based on precedent, although panelists frequently cite other tribunal decisions.[30]Sometimes arbitrators make contradictory decisions on the same issue using the same

BIT.[31] For example, Argentina reneged on some of its obligations under its BIT with the United States after the financial crisis in 2001-2002. Argentina claimed that its actions were "necessary"to preserve public order and security, and therefore "non-precluded measures" (that is, they were acceptable expropriations) under Article XI of the US-Argentina BIT. In five disputes under this BIT, two arbitration panels accepted Argentina's "necessity" defense; three rejected it, leaving both investors and states with a lack of clarity.[32] At other times different tribunals under different investment treaties decide disputes involving a similar commercial situation and similar investment rights but come to opposite conclusions.[33]

<u>Problem 3.</u>Toothless Arbitration Process.

In contrast with the trade system, there is no one forum for arbitrating investment disputes, nor is there a straightforward means of enforcement. Many, but not all, IIAs rely on the International Centre for Settlement of Investment Disputes (ICSID), an arm of the World Bank, which was designed to resolve disputes. ICSID, which began operations on October 14, 1966, is the only international arbitration tribunal specifically designed to address complex disputes over foreign investment contracts where one party is a national government Other treaties rely on the UN Commission on International Trade Law (UNCITRAL) to resolve disputes; still others use commercial arbitration facilities such as those at the International Chamber of Commerce.[34] We know little about the disputes at many of these venues; because only the ICSID is fully transparent about the disputes it arbitrates.

Typically the tribunals consist of three arbitrators: one appointed by the investor, one appointed by the State, and the third, presiding arbitrator appointed by agreement of both parties.[35]Once the arbitrators reach a decision, it can't be challenged in national courts. Moreover, there is no appellate body for any of the tribunals.[36]

No BITs or FTAs include regulations to ensure that tribunal decisions are enforced. When the decision favors states, investors must give up their claims. However, when governments refuse to pay compensation for property they've expropriated, investors have several options. The claimant (the investor) can seek to enforce the award in its home country, seek diplomatic protection from its home state, or settle with the respondent state.[37] After they lose a case, sometimes governments delay paying compensation, or pay less than the value of the property expropriated. For example, claimants have settled claims with Mexico and Georgia for lesser amounts than originally determined by the tribunals in order to get some money. As of 2012, three nations have flatly refused to pay their awards. According to UNCTAD, Argentina has not paid three awards to US investors and one to a French investor. Kyrgyzstan and Zimbabwe have also refused to comply.Argentina also has the dubious distinction of the most investment disputes over time, with52 cases; they are followed by Venezuela (34), Ecuador (23), Mexico (21), Czech Republic (20), Canada (19) and the US (17).[38]

States have also experienced problems with enforcement. In theory, states could bring a counterclaim for frivolous cases, but no state has ever succeeded with a counterclaim. States can be awarded costs, and at times firms have refused to pay these costs.[39]

<u>Problem 4.</u> Some Investors Are Gaming the System through Venue and Treaty Shopping

Some investors are taking unfair advantage of the complex and uneven BIT system to win disputes. For example, several tribunals have ruled that MFN clauses allow investors to invoke more investor-friendly language from treaties between the host state and a third country, making the "base" treaty (the treaty between the investor's home country and the host country) functionally irrelevant. Opponents of this practice deem it "cherry picking" of favorable clauses.[40]

In addition to cherry-picking treaties, both UNCTAD and the OECD report that some investors engage in "treaty shopping."These investors adopt strategies that allow them to invoke the protection of bilateral investment treaties to which they are not a party.[41] Some investors have effectively gained the use of an IIA by setting up holding companies in foreign countries where the BIT might be most favorable. Other investors have transferredownership to a foreign entity in a country with a favorable IIA, which then enables the firm to bring a case.[42]When local firms bring suits as foreign investors, they effectively jump over national laws and regulations.[43]

The Japanese company Nomura provides an example of how a firm can take advantage of the investor state system. Japan and the Czech Republic did not have a bilateral investment treaty, so Nomura set up a shell company named Saluka in the Netherlands in order to gain investor protection under the Ukraine-Lithuania BIT. In 2000 the Czech Republic expropriated Nomura's investment. Nomura, working through its shell Saluka, then challenged the Czech government's expropriation. The Czech Republic challenged the standing of Saluka, arguing that they were a shell company that existed solely for the purpose of taking advantage of the BIT. Ultimately, the tribunal ruled that Saluka was entitled to qualify as an investor under the Dutch-Czech BIT. The arbitrators explainedthat they "cannot in effect impose upon the parties a definition of "investor" other than that which they themselves agreed. That agreed definition required only that the claimant-investor should be constituted under the laws of (in the present case) The Netherlands and it is not open to the Tribunal to add other requirements which the parties could themselves have added but which they omitted to add."[44] As a result, Saluka was granted standing and ultimately won the decision. (See Appendix Chart 4 for other examples of treaty shopping.)

<u>Problem 5.</u>Indirect Expropriations and the Challenge of Maintaining Government Policy Space

In 2012, UNCTAD reported 58 new investor-state challenges, the highest number of known treaty-based disputes.[45]Many times investors were challenging unfair expropriations, but other times, investors were using investment agreements to challenge domestic law and regulations that the investor believed could reduce the value of their holdings. For example, Eli Lilly is suing the Canadian government under NAFTA for $100 million over a decision by a Canadian court to cancel the patent for its drug Strattera. The court ruled the drug did not work as asserted over time. Although Canadian law doesn't recognize patents as "investments," patents are included in NAFTA's investment chapter. After Eli Lilly exhausted all of its domestic litigation options, the company decided to sue Canada under NAFTA's investor-stateprovisions. The company alleged that the loss of its patent is the equivalent of an indirect expropriation.[46] This case has yet to be decided, but it has sparked concern among activists that companies will repeatedly sue over such patent decisions, so that ultimately governments may not be able to set their own patent standards.[47]

In another example, tobacco giant Phillip Morris in 2011 initiated an investment dispute against Uruguay's efforts to regulate the marketing of tobacco to discourage smoking. Uruguay maintained that it acted out of concern for its citizens' health, while Phillip Morris said the government's actions are unreasonable and effectively reduced the value of its investments in Uruguay.[48] Although this case has also not gone to arbitration, over 100 countries have enacted some restrictions on the sale of cigarettes or restricted where people can smoke since Mexico issued the first smoking ban – in 1575.[49]

Investors have also challenged environmental policies as regulatory takings. In October 2012, after the province of Ontario banned offshore wind farms in 2011, Canada was challenged under NAFTA by several foreign companies. These clean energy investors claimed the ban violated their contracts with Canadian companies.[50] Similarly, a Swedish investor demanded compensation for the loss of German subsidies for nuclear power, after the German government announced plans to phase out its nuclear power plants following the Fukushima disaster in Japan.[51]

In many countries, activists are concerned that the growing number of claims of indirect expropriation could limit governments' ability to regulate in the public interest. They argue that if such a case were brought in domestic courts, the trial would be open and decided by judges with expertise in public regulation. But investment arbitration panels are less transparent and are not charged with protecting a government's legitimate policy space. Moreover, theyworry that policymakers might be reluctant to regulate, given the rising number of investor-state disputes coupled with the costs of defending regulations.[52]In the US, EU, Australia, and New Zealand civil society groups are trying to focus public attention on investor-state provisions in the upcoming US/EU negotiations and among the 11 nations negotiating the Trans-Pacific Partnership.[53]

The global financial crisis has also spawned new investment disputes, especially in response to government austerity policies. When governments have to cut budgets, procurements, or subsidies, firms may lose contracts, market share, or experience higher costs. They may also see their stock values plunge. Some turn to investor-state arbitration for redress. For example, a Cypriot bank is initiating arbitration proceedings against Greece, arguing that Greece discriminated against the company's subsidiary when implementing its bank bail-out program. After Italy, Spain and the Czech Republic cut subsidies for solar energy in order to meet EU-mandated austerity targets, some investors challenged these policy changes in arbitrations.[54] These cases may stem from unclear language in investment treaties, which does not draw clear boundaries between general public policies that any sovereign state has a right to change, and actions intended to seize or devalue the property of foreign investors. But the growing number of these cases has raised concern that these foreign investors have rights to challenge government actions that domestic firms lack.

Investment agreements do not only create direct problems for investors, governments, and their citizens. They may be undermining the rule of law and reducing the legitimacy of governments.

Do Investment Treaties Undermine the Rule of Law?

In the 20th century, developing countries (investment hosts) generally signed BITs to reassure foreign investors that they would be protected by the rule of law. If a host countries' legal system failed to protect their investments, these investors could invoke the investor-state arbitration process.[55]Today, however, there are indications that investor-state arbitration can unwittingly weaken the rule of law. By allowing investors to jump over domestic courts to commercial arbitration, they may stunt the development of host country judicial systems. Here's why. Judges learn by experience – by mediating real disputes and in so doing, balancing investor rights and responsibilities.[56]

Moreover, in countries where the rule of law is weak, bilateral investment treaties can give foreign investors rights that domestic citizens, civil society groups, and domestic investors don't enjoy. For example, the government of Zimbabwe did not protect all landowners equally as it worked to achieve land reform. From 1979-2000, Zimbabwe bought and redistributed land from large to small landowners with the owners' assent. However, starting around 2000, organized gangs began forcibly ejecting farmers and workers from their land. The government tacitly allowed the seizure of domestic farms as well as plots held by foreigners or foreign passport holders. The government limited seizures from Dutch farmers, because it had signed a BIT with the Netherlands. However, it continued to expropriate land from Zimbabweans as well as citizens of the UK, neither of which were protected by a BIT.[57] Zimbabwe is an extreme example, but, as investment treaty analyst Luke Peterson has asserted, such invidious discrimination among property rights holders illuminates why a multilateral system protecting all property rights holders would be fairer.[58]

Investment treaties may also undermine the rule of law in the developed world. They allow investors to bypass domestic court systems that are widely seen as effective, transparent, and legitimate.[59] Moreover, as investors increasingly use investor-state disputes to challenge budgetary or regulatory decisions, some critics see investor-state disputes as a covert means of undermining democracy and the rule of law.

Finally, tribunals sometimes award investors huge payouts, which can cause financial difficulties for governments.[60] Although governments have important responsibilities to their investors, policymakers may spark a public backlash if they prioritize compensating foreign investors over providing basic public goods, such as education, health and defense.

Appendix Chart 5 illustrates some other interesting cases involving investor-state challenges to government regulation.

The Legitimacy Problem

To many observers, these agreements are increasingly seen as illegitimate, because they are not meeting the needs of states, investors, or citizens. States are the primary users of the system, are exposed to every claim, and thus policymakers must weigh whether any regulatory or budgetary decision could lead to an investor-state dispute. Moreover, they need to know that decisions will be consistent and the system will reject frivolous claims.[61] Meanwhile investors need consistency to obtain the trust, security, and predictability promised by these agreements. But, as noted above, investors too are challenged by inconsistent decisions, which don't provide clear guidance as to when investments will not be protected. Finally thebalkanized, uneven, and opaque investor-state arbitration process seems out of step with public expectations for governance in the Internet age. Citizens expect their laws and policymakers to be evenhanded, transparent and accountable, as well as informed by public consent. They also expect the system to be consistent, because if similar cases are not resolved in similar ways, "public confidence in the system is weakened," and legitimacy can be undermined.[62]

The system does not only yield inconsistency in results: it is inconsistent in its design. Investment agreements clearly delineate investor rights and state responsibilities, but these agreements rarely spell out investor responsibilities (although some have language pertaining to corporate social responsibility). In 2012, the International Chamber of Commerceissued voluntary guidelines for investors, as well as home and host governments. The ICC stressed that investors and states have "shared responsibilities," and investors must respect countries' policy space and help foster sustainable development.[63]

Some also question the legitimacy of arbitrators. Many of these attorneys work as lawyers in some cases and arbitrators in others. These functions require different skills: lawyers must aggressively defend their client's interests; arbitrators must have a judicial temperament and weigh issues from several perspectives.[64]Arbitrators may be asked to review government regulatory, administrative, and at times fiscal policy through the narrow lens of commercial arbitration.[65] As more cases focus on indirect expropriations related to government policy decisions, policymakers and investors acknowledge that even experienced arbitrators may lack expertise in public law adjudication and may not understand the policies they review.[66]Increased transparency could help promote consistency and, over time, facilitate a more legitimate system. Yet some BITs do not require governments to inform the public of ongoing cases. The most widely used platform, the World Bank's ICSID, maintains an open docket, so both its proceedings and decisions are public. However, the other venues are not open and do not even disclose disputes or decisions. For example, the OECD reported that about 33% of the claims were brought by investors about which there is little or no public information.[67]As a result, policymakers and other interested parties lack a full and accurate picture of the totality of ongoing investment disputes. Moreover, in some venues, neither the dispute nor the tribunal's decision is made public, yet taxpayers' dollars must be used to reimburse investors. Should disputes mount, the public could become increasingly concerned about the utility of investment agreements and in particular, investor-state dispute settlement. Certainly policymakers are becoming more wary. The OECD reports that "inconsistent rulings may compel states to renegotiate numerous treaties in order to reduce legal uncertainty."[68]

Rising Interest in Reform

Not surprisingly, many governments are clarifying their obligations under investment treaties. India and South Africa are reviewing all BITs and FTAs with investment chapters. Argentina and Ecuador have declared that they will agree to no new investment agreements, while Bolivia and Ecuador have withdrawn from the World Bank's arbitration body (ICSID). Ecuador has also unilaterally terminated some BITs.[69]

After US and Canadian officials admitted they were caught off-guard by investor-state claims under NAFTA in the 1990s,[70] both countries rewrote their model BIT (the platform on which all US bilateral investment treaties and investment chapters in free trade agreement) to clarify terms and procedures, prevent frivolous investor-state challenges, and clearly delineate the responsibilities of states to regulate.[71] Nonetheless, the US and the EU (and the EU and Canada) have decided they will include an investment chapter in the trade pacts they are negotiating.[72] The EU has promised to curb frivolous claims and to ensure that the agreement will not give foreign investors greater rights than domestic investors.[73]However, Australia refuses to sign investor-state provisions in FTAs because the current government believes they give foreign business greater legal rights than domestic firms and they constrain the government's ability to regulate.[74] And Brazil refuses to negotiate any investment agreements in the belief that they are not necessary.[75]

Yet nations are working together to improve the governance of investment. At the April, 2009 G-20 Summit, members pledged to maintain an open investment regime. They also called on the WTO and UNCTAD to monitor adherence to their efforts. And when the G-8 met later that year, its members declared, "We commit to enhance cooperation…to agree upon shared principles which may serve as the basis for a more structured and wider process towards an agreed common multilateral framework in the long run, creating a predictable and stable climate for investment."[76]

Some academics and international organizations have suggested ideas for reform that go beyond tinkering with investor-state provisions. Anders Aslund of the Peterson Institute for International Economics, as well as Karl Sauvant of the Vale Columbia Center on Sustainable International Investment,proposea new Multilateral Agreement on Investment. The World Economic Forum, as well as a consultative Board to the WTO, have called for policies to link trade and investment rules more holistically, by finding ways for the WTO to cover FTAs and other trade agreements with investment provisions.[77] In the interest of maintaining better relations between investors and states, both the OECD and UNCTAD have worked to encourage new ideas and procedural reforms. The OECD has sponsored a dialogue and public comment on dispute settlement provisions in investment treaties.[78] In May 2013, UNCTAD proposed five options to reform the dispute settlement system including limiting investor access to investor-state dispute settlement (ISDS), introducing an appeals facility, and creating a standing international investment court.[79]

Some business leaders are calling for reform as well. Although his company won an investment dispute against Mexico, Grant Kesler, CEO of the US waste management company Metalclad, fretted that the arbitration process had undermined years of good relations between his firm and the Mexican government. He said it would be preferable for companies to find a middle ground by relying on more informal measures of dispute settlement such as mediation.[80] Over time, other business leaders may worry that the sheer number of cases could lead governments to turn against investor-state provisions, and hence they too worry about frivolous cases and business misuse of the system.

In sum, people from many different perspectives are thinking about how to make the current system more consistent, universal, and accountable. However, in charting a way forward, it may help to understand why past efforts to forge a comprehensive international investment regime have fallen short.

What Policymakers Can Learn from Past Attempts

Policymakers have tried and failed four times to establish an international system to govern investment. First, in the late 1940s, USand British officials hoped to establish an international organization to govern a wide range of domestic policies that could affect international economic relations. They drafted plans for an International Trade Organization (ITO) to cover trade, employment, business practices, and investment. US firms wanted the system of rules governing trade to also include investment, because many executives feared communist or socialist regimes might expropriate their investments. But in 1947, many nations were still recovering from the war, and they insisted that any new agreement include exceptions to the free flow of investment which might allow foreigners to control key productive assets. Meanwhile, many American firms that had pushed for investment provisions in the ITO became frustrated with these exceptions. The ITO lost support, the charter never came to a vote in the US Congress, and the United States abandoned the

ITO in 1950. US investors scuttled the ITO because it did not provide consistent rules for state responsibilities vis-à-vis investment.[81]

Western policymakers next tried to negotiate an international investment agreement at the United Nations. In 1972, the United Nations Economic and Social Council set up a study group and called for the negotiation of a code of conduct for international investors. UN diplomats spent twenty years trying to negotiate a code, but could never resolve its scope, legal standing, and implementation strategy. They abandoned this effort in 1992. At the same time, the OECD tried to develop a common code of business responsibility. In 1976 it issued a Declaration on Investment, as well as a code of conduct for investorscalled the OECD Guidelines for Multinational Enterprises. The Declaration set rules to stimulate investment, while the Guidelines gave policymakers recommendations regarding howtheir multinationals should behave overseas when they invested and produced abroad. The Guidelines have been updated six times since 1976.[82] Although a growing number of member states have signed onto the Guidelines, it is non-binding "soft-law." OECD nations have done little to prod their home country firms to follow the Guidelines.

In 1995, OECD members tried to go a step further and negotiate a multilateral agreement on investment (MAI) at the OECD. The effort foundered, however, as, like with the ITO, some countries insisted on exceptions to investment openness. When civil society groups in the US and Europe received a leaked copy of the draft MAI, they became vociferous opponents. Many development, consumer, and environmental groups feared that the MAI would empower firms to challenge public policies as regulatory takings, and could give foreign investors greaterrights than domestic investors because they could seek compensation for regulatory takings through the internationalagreement. With civil society opposition, and widening government ambivalence, the members of the OECD abandoned their efforts to negotiate the MAI.[83]

Nevertheless, Japan and several European countries weren't willing to give up on the quest for a multilateral investment agreement. In 1996, members of the WTO agreed to undertake exploratory work on investment. India, China and several other developing countries, however, were not enthusiastic. WTO members could not agree on the scope, timing, and strategy for investment negotiations. In September 2003, when negotiators arrived at Cancun for the WTO ministerial, many developing countries objected to discussing investment until other priority issues such as subsidies and agriculture were addressed. Since members could not agree on the scope or timing of negotiations, the talks collapsed.[84]

What can be learned from these failed efforts? Countries can agree on internationally acceptable rules that signal openness to investment and guarantee investor protections. However, states have been unable to find common ground on exceptions to the rules, on enforcement, or on investor responsibilities. Moreover, business leaders seem reluctant to accept changes that could limit their access to investor-state arbitration, while civil society groups worry that arbitration may undermine legitimate government efforts to protect people and the environment.

A Way Forward

This brief history suggests that it would be exceedingly difficult to achieve a single, binding multilateral treaty governing international investment. But we see growing interest among policymakers, investors and states in focused reforms that reinforce broadly accepted "rules of the road" for investment and create a more accountable mechanism for resolving disputes.

We believe reform should:

- Strengthen international norms byspelling out the rights and responsibilities of investors and states;
- Clearly and consistently define key terms such as investment, indirect expropriation, and policy space in such norms, and delineate best practice;
- Address concerns about the functioning of the investor-state system by establishing an appellate body to review complicated cases; and
- Clarify if governments can use trade policy as a means of enforcement when governments refuse to comply with tribunal decisions.

Step 1: Codify Investment Norms at the WTO:

The G-20 already wrestles with the relationship between investment and sustainable development. In future meetings, the G-20 leaders should address the patchwork of international investment rules by calling for a set of norms and best practices. Thus, the G20 should direct the WTO Secretariat to work with the OECD, ICSID, and UNCTAD to set up a committee of experts to develop "Norms for International Investment Rules," building on the OECD Guidelines, the ICC Guidelines for International Investment, as well as modern BITs and FTAs. The experts should clearly define key terms such as most favored nation, national treatment, and indirect expropriations, and highlight ways in which governments can preserve legitimate regulatory powers. Next, these experts should build on the OECD and ICC Guidelines and explain the rights and responsibilities of investors as well as home and host states. Finally, the WTO Secretariat and its partners should identify best practice for the functioning of investor-state mechanisms, including ways to increase transparency of decisions. Best practices should include a requirement that all investor state disputes and decisions be made public; reasonable time limits as to when investors can make claims (e.g. up to 18 months after an expropriation); and strategies to lower the costs of claims (which can especially tax developing country governments or small firms).

Once these "norms" are published, G-20 and WTO members should agree to use them as guidelines for all renegotiated or new international investment agreements. According to UNCTAD, by the end of 2013 more than 1,300 bilateral investment treaties will be at the stage where they could be terminated or renegotiated at any time. Such agreements account for 45 percent of the bilateral investment treaties in existence today.Furthermore, between 2014 and 2018, another 350 BITs will reach the end of their initial duration.[85]Hence, we believe that over time, these norms could make the hodgepodge of investment rules more universal, consistent and accountable.

Step 2: The G-20 should call for the creation of an Investment Appellate Body at the WTO. This body would be assigned to adjudicate tribunal decisions or situations where countries refused to comply with tribunal decisions. The body should be placed at the WTO to build on its expertise in adjudicating decisions, but it would be open to all countries participating in investment agreements or the WTO.

The appellate body would review disputes where one of the parties refused to accept the decision or where one party saw errors of jurisdiction, procedure or fact. This appeals court would be an impartial panel, consisting of individuals with acknowledged standing in the field of investment law and international trade, but not representing any particular government. They would bring deep understanding of administrative, trade, and commercial arbitration. Members would serve for four-year terms.[86]

Many states and international organizations have called for something along these lines. The US Congress suggested such a body in the Bipartisan Trade Promotion Authority Act of 2002,[87] and the ICSIDproposed a single Appeals Facility in 2004.[88] The EU called for such a body in its draft negotiating plan for the Trans-Atlantic Trade and Investment Partnership. University of Ottawa law professor Debra Steger notes"A standing appellate tribunal would bring coherence and over time legitimacy to a rules-based system, akin to the WTO appellate body."[89]

While WTO members set up this appellate body, they should also provide capacity building to developing countries which may need help in investor-state arbitrations. To this end, the WTO should also establish and fund an advisory center on investment law to work alongside its Center on Trade Law. This advisory center could advise developing countries on claims and in so doing help lower their costs for outside counsel.

Step 3: To give the Investment Appellate Body teeth one or more WTO member states should ask the WTO Secretariat to explore the feasibility of using trade policy to retaliate against states that repeatedly ignore investment tribunal decisions.

Some WTO member states are already using trade policy as a tool to change the behavior of countries that repeatedly ignore investment tribunal decisions. After Argentina lost several investment tribunal cases, it refused to pay some $300 million in compensation to US investors. The US Government decided to use trade policy as a lever. In March 2012, the US government suspended Argentina's preferential trade benefits under the US Generalized System of Preferences (GSP). This action meant that Argentina could no longer export a wide variety of products to the US with zero tariffs. When it acted the US was not violating WTO rules, because the GSP program is built on a waiver of WTO rules. Industrialized countries can use GSP to discriminate in favor of developing country exports. The US says the suspension is temporary until Argentina pays the awards in full.[90]

However, Spain took a different approach when it tried to use trade policy as a lever. After the Argentine government expropriated Repsol's share of YPF in April 2012, the Spanish government curbed biodiesel imports from Argentina. Argentina is the world's largest exporter of soybean biodiesel. The Spanish government justified its actions by saying that under EU law, it must use only EU fuel to meet quotas for biofuels used in transport. However, Argentina said the law was discriminatory, a violation of WTO rules, and so it threatened a trade dispute. On October 16, 2012, Spain said that it would abandon the order incorporating the EU's renewable energy law into national legislation and soon thereafter Argentina suspended its complaint.[91]

In the future other government officials may want to use trade policy to retaliate when a government repeatedly refuses to enforce its investment obligations. The WTO allows trade retaliation when member states violate its rules. The WTO's dispute settlement body can authorize members to retaliate when a nonmember refuses to comply with a WTO decision. Hence, at the behest of a member, the Secretariat should explore if WTO members could use trade policy as an enforcement tool if the Investment Appellate Body finds a significant violation and the country refuses to change its policies. Such clarification could help governments more effectively enforce investment tribunal decisions, strengthening the system.

A Final Word

Global investors and states have a synergistic relationship. To develop, innovate, and grow, countries need capital. To provide those funds, international investors need to know their investments will be protected. But the uneven system of investment treaties and investment chapters in FTAs cannot effectively and consistently provide investors and states with the predictability, consistency, and legitimacy they deserve. The three steps suggested above are practical and doable; they could build bridges among the many international investment agreements, create greater legitimacy for investor-state provisions, and over time, support increased trade and investment.

Appendix

Chart 1: Some Interesting Statistics and Facts about Investor-State Disputes

Some Interesting Statistics and Facts about Investor-State Disputes

⇒ 58 new cases began in 2012, bringing the known total of cases to 504. 244 of this total were concluded by 2012.
⇒ Most of cases involve investors suing developing countries.
⇒ Of the settled cases approximately 42% were decided in favor of the State and approximately 31% in favor of the investor. In 70% of the public decisions, investors were awarded money on the merits of the dispute.
⇒ 95 countries were involved in one or more disputes. For five cases, the respondent country is unknown.
⇒ Venezuela had the most cases in 2012 (9), followed by Pakistan (4). Algeria, Egypt and Hungary had 3.
⇒ Investors from the United States (123 cases), the Netherlands (50), the UK (30) and Germany (27) initiated the most disputes.
⇒ Comparing IIAs, NAFTA has had the most cases (49) followed by the Argentina US BIT (17).

Source: UNCTAD 2012.

Chart 2: Trends in BITs and Other IIAs

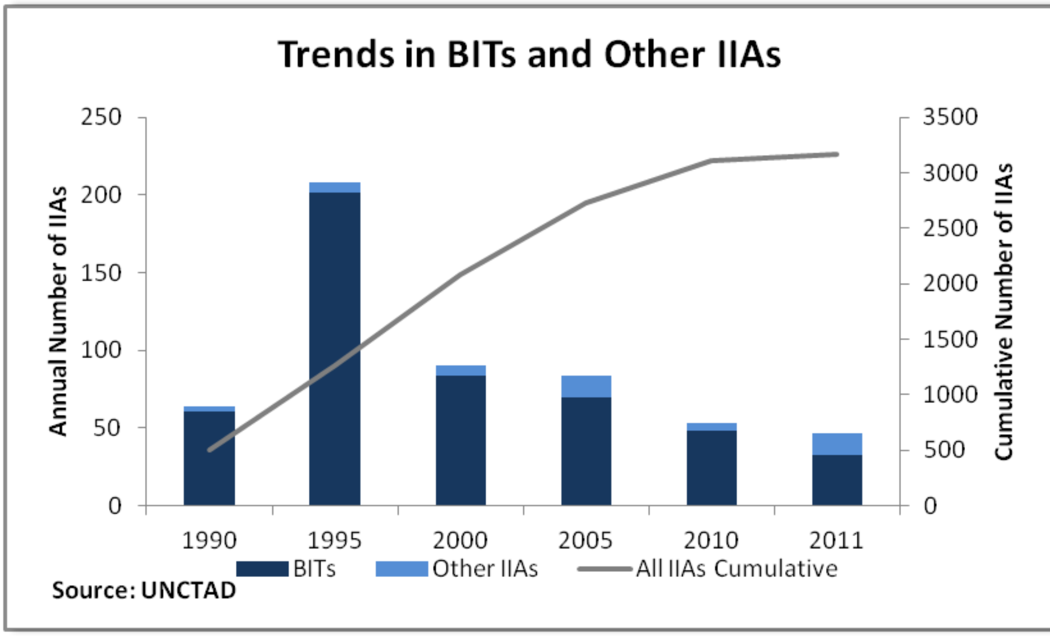


Chart 3: BRIC Outward FDI Stock, 2000 – 2011

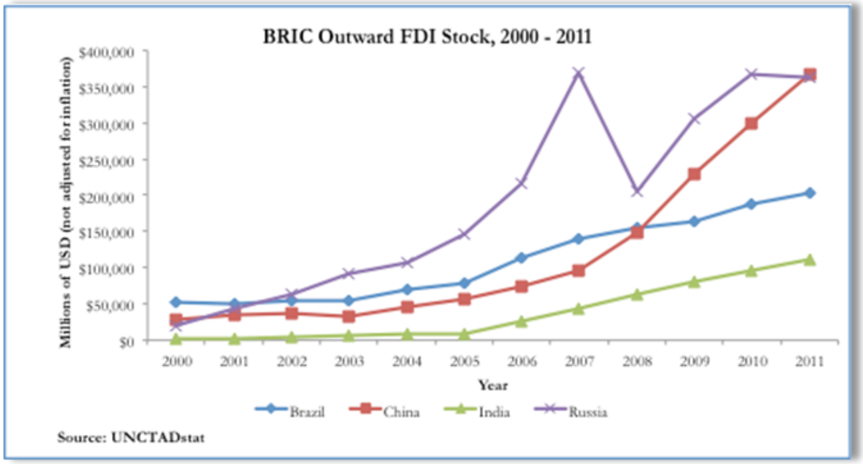


Chart 4: Examples of Treaty Shopping

Examples of Treaty Shopping Influencing Investment Tribunal Decisions				
Case	**BIT**	**Summary**	**Why is this Treaty Shopping?**	**Decision**
Aguas del Tunari v. Bolivia	Dutch-Bolivian BIT	Aguas del Tunari was a Bolivian company, in which a US parent owned a majority stake. The US parent incorporated a new Dutch holding company over Aguas del Tunari.	The US did not hold a BIT with Bolivia, so by incorporating a shell in the Netherlands the company could take advantage of strong investor protection in the Dutch-Bolivian BIT.	The tribunal ruled that this structure allowed the parent company of Aguas del Tunari to qualify for investor protection.
TSA Spectrum de Argentina S.A. v. Argentine Republic	Dutch-Argentine BIT	TSA Spectrum, an Argentine company investing in Argentinian radio spectrum, established a shell parent company in the Netherlands to acquire investor protection.	The Argentine investors believed the Dutch-Argentine BIT would provide them protection similar to the *Champions* tribunal.	The tribunal threw out the case, ruling that TSA was in practice an Argentine company, so could not bring a claim against Argentina because of Art. 25(2)(a).

Source: Stephan Schill, The Multilateralization of International Investment Law, Cambridge University Press, 2009

Chart 5: Notable Cases in International Arbitration

Notable Cases in International Arbitration				
Case	**Forum**	**Claimant View**	**Respondent View**	**Final Award**
Ping An Life Insurance Company of China, Limited and Ping An Insurance (Group) Company of China, Limited v. Kingdom of Belgium	ICSID	Ping An is the first mainland Chinese firm to pursue a claim through ICSID. As a result of Belgium's nationalization and sale of Fortis, Chinese investors lost significant investment in the bank.	To prevent the collapse of one of its largest banks at the height of the financial crisis, Beglium bailed out Fortis and sold its Belgian operation to BNP Paribas.	Pending
PV Investors v. Spain	UNITRAL	As a result of austerity policies, Spain revoked feed-in tariffs (a type of subsidy) for solar photovoltaic energy. The PV Investors claim that this action is tantamount to indirect expropriation.	Spain claims that this action was necessary, as the subsidies for green investment were too expensive to continue under their required austerity policy.	Pending
Achmea B.V. (formerly known as "Eureko B.V.") v. The Slovak Republic	PCA	Achmea claimed that Slovakia expropriated private insurers in order to return to a single-payer system. This violated Slovakia's obligations under the Dutch-Slovak BIT.	The Government of Slovakia maintained it is inappropriate for health insurers to make a profit, and they should instead spend revenue fully on treatment.	Award of €22 million to Achmea
Metalclad Corporation v. United Mexican States	NAFTA	First major NAFTA Chapter 11 case. Local municipal officials forbade a federally-approved landfill from operating. Metalclad claimed this was a form of indirect expropriation and violated fair and equitable treatment.	Mexican state and local governments claimed that Metalclad did not obtain the proper municipal-level construction permits, and that the facility was an environmental hazard.	Award of US$16.7 million to Metalclad

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