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Research Report

An outline for systematic reform of the investment law regime

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An outline for systematic reform of the investment law regime

by

Wenhua Shan *

A balanced multilateral or plurilateral framework on investment (MFI/PFI) would serve the interests of all stakeholders best.¹ As foreign direct investment (FDI) plays a critical role in world economic growth and development, an MFI/PFI should be geared toward investment liberalization, rather than investment restriction. This reflects the fact that countries around the world still are adopting more liberal investment measures than restrictive ones. Also, 31 additional international investment agreements (IIAs) were signed in 2014, whilst nearly 90 countries are involved in five mega-regional IIA negotiations (including the Transatlantic Trade and Investment Partnership and the Regional Comprehensive Economic Partnership).²

However, the investment regime must be balanced. This is particularly important because the original template for the IIA regime—generally followed till today—was biased in the sense that it emphasized investment protection and promotion, with little or no regard for preserving the regulatory space of host countries. Such an imbalance is the “birth defect” of the IIA regime that cannot be effectively redressed without a systematic and thorough reform.³

The negotiation of an MFI/PFI would provide a perfect opportunity for a systematic review and reform of the IIA regime “from root to rules.” The “root” refers to the underlying spirit of the investment regime: no longer should it be an offensive instrument (“sword”) focused on the interests of foreign investors with little or no regard to the regulatory space of host countries; rather, it should be a self-balanced system (“scale”) that evenly and proportionately serves the interests of both foreign investors and host countries.⁴ Such a philosophy should be reflected in the preamble and guide the crafting of every provision of a treaty, including its scope, investment liberalization, substantive protections, social clauses, and dispute settlement.

The **preamble** should emphasize not only the critical role of foreign investment in economic growth and development and the importance of a sound legal framework for

the promotion and protection of such investment, but also a host country's inherent right to regulate foreign investment. Mutual respect of the fundamental political, economical and legal systems of the contracting parties should also be highlighted as a basic principle underlying the treaty.

An MFI/PFI's **scope** should extend only to the protection of proper investments, excluding assets that do not possess such characteristics of investments as contribution of capital, assumption of risk or expectation of return. All covered investments should be equally protected without discrimination. It would further fragment the regime to create separate rules for certain categories of investment, such as state-owned enterprises, sovereign wealth funds or hedge funds.

Investment liberalization should be included in an MFI/PFI, since it reflects the worldwide trend of investment liberalization mentioned above, whilst providing a crucial incentive for countries to enter IIAs, particularly after investment rules have become balanced and neutral.

Most **substantive protections** have already been reformulated in recent IIAs, to achieve a better balance between the need of investment protection and the right to regulate.⁵ What is needed now is a more systematic approach consolidating all the patchy reform measures, to establish a coherent set of rules for substantive protection.

An MFI/PFI should address **social concerns**, such as environment and labor concerns, but realistically only on a complementary basis, as investment treaties should focus on “investment,” and should not take over the roles of other specialized instruments and agencies.

A matrix analytical framework could be used to ascertain which **dispute-settlement** method (investor-state dispute settlement (ISDS), state-state arbitration, local remedies) are best fit for each category of disputes.⁶ It is crucial to “publicize” (or “de-commercialize”) the ISDS mechanism by introducing fundamental public law principles such as accountability, openness, coherence, and independence.⁷ Measures adopted in some recent IIAs—such as a roster and codes of conduct for arbitrators, transparency rules, suggestions for an appeal mechanism and/or a permanent court—all point in this direction.⁸

The development of the international investment regime has reached a critical stage that calls for strategic thinking and systematic reform. A balanced regime should be the goal of such reform as it serves the best, long-term interests of all stakeholders. Whilst details need to be further worked out, such a regime would, over time, win support of the overwhelming majority of countries around the world.

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¹ Wenhua Shan, "The case for a multilateral or plurilateral framework on investment," *Columbia FDI Perspective*, No. 161, November 23, 2015.

² UNCTAD, *World Investment Report 2015* (Geneva: UNCTAD, 2015), p. 23.

³ See e.g., Giorgio Sacerdoti, ed., *General Interests of Host States in International Investment Law* (Cambridge: Cambridge University Press, 2014).

⁴ Many recent IIAs have already followed this reform path. See UNCTAD, "Taking stock of IIA reform," *IIA Issue Note*, No. 1, March 2016.

⁵ See e.g., Federico Ortino, "Substantive provisions in IIAs and future treaty-making: addressing three challenges," E15 Initiative, Geneva, June 2015, available at <http://e15initiative.org/publications/substantive-provisions-in-iias-and-future-treaty-making/>.

⁶ Wenhua Shan, "A matrix analysis on ISDS reform: preliminary considerations," December 2013, available at www.encharter.org/fileadmin/user_upload/Conferences/2013_Dec_5-6/4-3_Shan.pdf.

⁷ Gus van Harten, *Investment Treaty Arbitration and Public Law* (Oxford: OUP, 2007), p. 153.

⁸ Examples can be found in the dispute settlement sections in the China-Australia FTA, CETA, EU-Viet Nam FTA, and the EU proposal for TTIP.

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