

# Research on the Host Country's Regulatory Power in the Situation of the Novel Coronavirus Pneumonia outbreak

Longge Su

Xinjiang University, Urumqi 830046, China.

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**Abstract:** In the process of combating the Newcastle pneumonia epidemic, shutdown measures taken by countries may harm the legitimate interests of foreign investors, and when foreign investors use the international investment dispute settlement (ISDS) mechanism to arbitrate with the host country, the purpose of international investment agreements (IIAs), which tends to protect the interests of investors, tends to be constantly expanded and used to the neglect of the host country's regulatory power. This is due both to the lack of clarity of certain provisions and to the inherent flaws of the ISDS mechanism. China should actively study the new changes in international investment rules, so that China can more favorably balance the interests of investors and host countries in the process of negotiating international investment agreements, and effectively safeguard the right of national regulation.

**Keywords:** National Regulatory Power; International Investment Dispute Settlement Mechanism; New Crown Epidemic

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## 1. Introduction

Since its outbreak in early 2020, the new crown epidemic has swept through more than 200 countries and regions in the world. The rapid global spread of the epidemic has caused a tremendous impact on the world economy. As the new coronavirus spreads overwhelmingly widely, countries around the world have successively taken various measures to prevent the spread of the epidemic, which may negatively affect international investment and even seriously harm the interests of foreign investors. The U.S. government initiated the Wartime Production Act under the Defense Production Act of 1950, forcing companies such as General Motors to shift production to mass production of manufactured goods related to the New Crown epidemic emergency, such as respirators. <sup>[1]</sup>This initiative may violate investor protection provisions in international investment agreements (IIAs), which allowed foreign investors to bring international investment arbitrations under IIAs against the host country where the measures were taken. To name only a few, certain Spanish investors affected by a new regulation issued by Mexico on May 15 regarding national power system to enable its state-owned electricity company to ensure the reliability of the electricity system in the event of reduced demand for electricity due to the New Crown pandemic intend to initiate arbitration proceedings based on the Mexico-Spain bilateral investment treaty.<sup>[2]</sup> Because most older protocols did not provide exceptions to respect the host country's right to regulate, there is little the host country can do to defend the investor's claim through the exception clause. In the face of sudden new crown epidemics, existing investment law rules still suffer from multiple dilemmas and deficiencies such as insufficient coverage, unclear legal nature and consequences, insufficient harmonization, and difficulties in invoking them. Therefore, this paper summarizes the rules of balancing the host country's regulatory power in international investment agreements, and provides constructive suggestions for the balance of rights between foreign investors and host countries, so that China can be in a proactive position in the international game and create a good and sustainable new international investment environment.

## **2. Overview of theories related to the regulatory power of the host country**

### **2.1 Overview of regulatory power**

Regulatory power refers to a country's freedom to control its political, economic, legal and other aspects within its territory. Regulatory power is autonomy of a country, and a country may choose to exercise its regulatory power to control domestic political and economic spheres in order to better protect the public interest and stabilize the economic market. The right to regulate in international investment law is a requisite part of maintaining national economic sovereignty and is a fundamental right of host countries to safeguard their public interests in the field of international investment. Economic sovereignty is the right of the host country to autonomously formulate economic development policies and protect the wholesome and orderly development of the national economy in accordance with its national conditions.

### **2.2 The way of regulation rights in current IIAs**

Different countries present the host country's regulatory rights in different forms and incorporate them into the IIAs they sign, so that the rights and obligations of the host country and foreign investors in IIAs are balanced, not only to protect the private interests of foreign investors, but also to reserve space for the regulatory policies of the host country.

There are three main ways to provide regulatory rights in current IIAs. First, the preamble of the agreement stipulates the regulatory rights or regulatory interests of the host country. Although this approach has the principle content and reflects the purpose and objective of the agreement, the preamble barely plays the role of supplementary explanation to the substantive provisions, and the regulatory rights of the host country still cannot be implemented and exercised in concrete terms. The second is limiting the right of the host state to exercise regulatory freedom to specific provisions while leaving other provisions unaffected. However, this inevitably makes it more difficult to apply the treatment clause and interpret the exception clause, requiring arbitrators to improve their ability to interpret the law; third, the host country's regulatory rights are directly provided for in the substantive provisions of the agreement, including granting immunity from prosecution to the host country, and defining the scope of application of the host country's regulatory rights in a closed enumeration, but the host country's regulatory rights are often limited to specific categories such as environment, health and labor.

## **3. Challenges to regulatory power**

### **3.1 The expansion of foreign investors' right to sue and the existence of abusive lawsuits**

Since the third-party risk fund bears the risk of losing the investor's investment arbitration request and all the legal costs related to the arbitration request, it reduces international investment arbitration to a profit-seeking tool of capital, which to a certain extent promotes the phenomenon of abusive litigation in the field of investment arbitration, increases the burden of responding to litigation on the respondent host country and weakens the impartiality and credibility of international investment arbitration tribunals.

### **3.2 Extended application of the treatment clause**

The lack of clarity regarding the standards and scope of public health protection provisions in investment agreements has led to an expansion of the discretion of arbitral tribunals, further constraining the application of the host country's public health regulatory authority.

### **3.3 Absence and ambiguity of exception clauses**

Some provisions in IIAs are vague, providing more room for discretion to arbitral tribunals. This leads to the arbitral tribunal often interpreting these vague legal concepts in favor of investors, making it easier for the host country's measures to be found to be in violation of the provisions of the relevant international agreements.

## **3.4 ISDS operational mechanism hinders the host country from exercising its regulatory power**

### **3.4.1 The arbitration award shall be final and binding**

The complexity of investment dispute resolution between foreign investors and host countries places a high demand on the fairness of arbitration outcomes, and the existing system of finality lacks the possibility of further redress. With no avenues of redress for the host country under the finality regime, the mechanism may affect the exercise of the host country's regulatory power. Host countries will be prone to abstain from enacting relevant laws and regulations out of concern for unfavorable outcomes.<sup>[3]</sup>

### **3.4.2 Uniformity of adjudication standards**

Because some provisions in IIAs are vague and incoherent, they provide greater room for arbitral tribunals to exercise discretion. And since arbitral tribunals are not subordinate and mutually binding, they are independent of each other, and different tribunals have inconsistent views on the interpretation of provisions in the same agreement. Even if one arbitral tribunal makes a decision that favors the balance of the host country's regulatory power, it does not provide practical guidance to the next case, and it is difficult to measure the extent to which it has had an impact on subsequent arbitrations. Because tribunals are not bound by prior interpretations or rulings, this has led to a number of inconsistent awards based on the same facts.

## **4. Suggestions**

UNCTAD released the World Investment Report 2021: Global FDI falls 35% to \$1 trillion in 2020 due to the impact of the New Crown Pneumonia epidemic.<sup>[4]</sup> FDI flows to Asia grow by 4%, driven by economies such as China, accounting for half of total global FDI in 2020, making it the only region with positive growth. The old-style international investment agreements have been unable to adapt to today's international investment form, coupled with the economic layout optimization of tax measures, environmental protection measures taken by foreign investors using the ISDS mechanism to ICSID, the Chinese government is greatly increased the risk of being sued.

### **4.1 Set up special procedures to prevent investors from abusive lawsuits**

As international investment treaties give excessive protection to investors, investors often file arbitration requests without legal basis in order to obtain treaty benefits that do not belong to them or with the intention of influencing the public policy choices of the host country. Such abusive claims by investors can create litigation burdens for host countries, forcing them to reduce or abandon the protection of public interests and proper regulation of investor conduct. To prevent investors from abusing the arbitration process, a special procedure of "vexatious litigation" may be established. The arbitral tribunal can deny the investor's claim for reasonable and non-discriminatory regulatory actions taken by the host country in response to the Newcastle pneumonia epidemic and review the legal part at the early stage of the arbitration process, without the need for subsequent substantive hearings. The arbitral institution may reject the investor's unreasonable claims and review the legal portion directly at the beginning of the arbitration proceedings, without the need for a subsequent hearing on the merits.

### **4.2 Improve the accuracy of the treatment clause**

Such cases should be explicitly excluded from the application of the fair and equitable treatment clause in IIAs: measures taken by the host government that will be non-discriminatory and motivated by legitimate public interest objectives such as public health, safety, the environment, public morals or public order. In addition, the regulatory measures of the host country must not cause more damage to the investor than is necessary, otherwise it should be subject to appropriate liability.

### **4.3 Setting exception clauses**

Exception clauses are a flexible mechanism for achieving investment liberalization and protecting non-investment interests. In the long run, the international community should make it an important public health objective to establish more comprehensive and

enforceable general exceptions in IIAs, so that host countries can seriously perform their public health functions under IIAs. To date, however, many of the IIAs signed by China do not provide for public health exceptions, and only some of the more recent IIAs have incorporated different types of public health exceptions. The lack of public health exceptions has to some extent limited the exercise of China's public health regulatory authority, so China should amend the protocols as soon as possible, or negotiate regional agreements to replace the first generation of BITs.

## **4.4 Promote the reform of ISDS mechanism**

### **4.4.1 Leading into the appellate procedure**

The Chinese government formally submitted its "Submission on Possible Reforms to the Investor-State Dispute Settlement System" to the UN Commission on International Trade Law in July 2019, expressing China's support for the establishment of the appellate procedure and presenting China's views and proposals in this regard. This submission is highly practical and universally applicable, but requires a broad international consensus and the participation of more countries. The establishment of a permanent global appeal mechanism is conducive to promoting the improvement of the error correction and bias correction mechanism, further regulating the investment arbitration process, improving the consistency, predictability and correctness of awards, surpassing the legal expectations, reducing the abuse of investors' rights, and achieving the protection of the host country's regulatory rights. In addition, the mechanism can further improve the standardization and transparency of the procedures and reduce the abuse of rights by disputing parties.

### **4.4.2 Following precedents**

The crisis of legitimacy of the ISDS mechanism has been a major unresolved issue, of which the inconsistency of awards is a prominent one. The main reasons for the inconsistency of awards are the vague concepts and unclear boundaries of the BITs that initiate arbitration and the lack of uniform standards of interpretation. Meanwhile a scholar had conducted a survey and in their search for international commercial awards, there are no cases in which they cite precedents. <sup>[5]</sup> In the absence of precedent references, different arbitral tribunals can solely make decisions based on their own judgment. Thus, even cases with identical facts, parties, and investment rights may result in different awards due to different interpretations of the investment term by the arbitral tribunal.

Constructing a precedent system in the international investment arbitration mechanism is of great significance to ensure the fairness of the award. In international investment arbitration, ensuring that the same or similar issues receive the same or similar awards, which is an important basis for ensuring the legitimacy of the awards. At the same time, these public precedents allow both investors and host countries to foresee the outcome, which helps investors and host countries to better conduct their business, control potential risks, to a certain extent, avoid them. Thus, judicial decisions can serve as an aid in determining the rules of international law, and decisions based on exceptions related to public health will provide guidance for subsequent dispute resolution, thus further reducing uncertainty in arbitrations involving public health during the prevention and control of the Crown's latest outbreak, and safeguarding China's right to effective regulation of public interest in the country in a manner that protects the interests of overseas investors.

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