

## *Commentary to the Austrian Model Investment Treaty*

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*Nathalie Bernasconi-Osterwalder and Lise Johnson*

*September 2011*

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## *I. Introduction and Background*

### History

For the past 50 years, countries have entered into treaties aiming to protect and promote foreign investments. The first such investment treaty was concluded in 1959 between Germany and Pakistan. Now there are nearly 3000 of these agreements, most of which were concluded over roughly the past 15 years. The most common form of an investment treaty is the bilateral investment treaty (BIT), but increasingly countries are negotiating investment protection provisions in their free trade agreements (FTAs), and regions have also begun adopting investment protection instruments. All attempts to negotiate at the broader multilateral level—first under the auspices of the Organisation for Economic Co-operation and Development (OECD) and later the World Trade Organization (WTO) have failed, however.

A key driver of these investment treaties has historically been the desire of developed, capital-exporting States to ensure that their nationals are financially and legally protected when investing in developing, capital-importing States. Consequently, the majority of investment treaties are between developed countries and developing countries or economies in transition.

While investment treaties do vary from agreement to agreement, they commonly share a number of key features. These are:

1. Preambles stating the parties' goals and objectives in concluding the treaties, which often focus on protecting and promoting foreign investment and enhancing economic cooperation between the States;
2. Broad definitions of covered "investors" and "investments" giving the treaties wide coverage;
3. Provisions imposing substantive obligations on the States receiving the foreign investment (the "host States") to (a) not discriminate against foreign investors in favour of domestic investors (the "national treatment" obligation) or in favour of other foreign investors (the "most favoured nation" or "MFN" treatment obligation); (b) pay compensation if they expropriate foreign investors' property; (c) accord foreign investors "fair and equitable" (FET) treatment; and (d) allow foreign investors to freely transfer capital in and out of the host country. Roughly 40 per cent of agreements also contain so-called "umbrella clauses" requiring host States to abide by any other commitment made or obligation owed to foreign investors;
4. Provisions allowing investors to bring claims directly against host States via international arbitration; and
5. An absence of provisions imposing any obligations on investors or the investors' States (the "home States").

Some agreements, particularly those concluded by the United States and Canada, also contain liberalization provisions, through which States seek to enhance the rights and abilities of their investors to enter host States' territories ("pre-establishment" rights). Traditionally, however, European agreements have focused more narrowly on securing protections for their investors once the investors have already established themselves in the host State ("post-establishment" rights). Pre-establishment rights and protections in European agreements are relatively rare.

Until the late 1990s, investment treaties stayed very much unnoticed outside of diplomatic circles. Often, concluding a BIT was seen by contracting States as a photo opportunity and had primarily a symbolic, rather than a legal function. No disputes were decided under any BITs until 1990—over 30 years after Germany and Pakistan signed the first such agreement. And it was not until the first cases were brought under the 1994 North American Free Trade Agreement (NAFTA) between Canada, the United States and Mexico—a free trade agreement that includes a chapter on investment protection—that governments, investors, and the broader public really began to realize that these treaties

are not mere friendly diplomatic instruments, but are actually treaties with real “teeth” that can expose host States to significant liability for their breach of obligations toward investors.

As the number of investment treaties began to increase in the late 1990s, and lawyers became aware of the tool that they had at hand to seek relief for losses suffered by their transnationally active clients, the number of disputes also increased accordingly. The number of investor–State disputes grew from just six known cases in 1995 to 226 known cases only 10 years later. That rapid growth has continued and even further accelerated: By the end of 2010, the total number of known treaty-based cases had risen to 390 (the exact number is unknown because many cases are never made public). Reflecting and likely to reinforce that trend, courses on investment arbitration, which address such issues as how to structure investments so as to take advantage of investor–State dispute resolution, are now taught in law schools and Masters programs. This field of study was almost unknown in academia just a decade ago.

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## Beginnings of Reform in Response to Claims Against Two Traditional Proponents of BITs—the United States and Canada

As the United States and Canada—countries which had thought of themselves primarily as capital-exporting States—began getting sued by foreign investors under the investment treaties they had negotiated, they realized that the obligations these treaties imposed on host States could be interpreted to seriously limit their own policy space. They concluded that they needed to protect and safeguard their rights to regulate and adapted their model and new investment treaties accordingly. For example, they added specifications and limitations to the most far-reaching substantive obligations relating to expropriation and FET in order to safeguard environmental and social policies. They have also included provisions clarifying that investment protection is intended by the treaty parties to further sustainable development and should not come at the expense of environmental protection and labour rights. The United States and Canada have also adopted new rules to ensure that arbitral disputes are conducted in a more transparent manner, with all non-confidential documents and hearings open to the public, and opportunities for submissions by non-parties.

By June of 2011, the United States and Canada have had 16 and 14 cases, respectively, brought against them by foreign investors.<sup>1</sup> The cases have almost all been brought by Canadian and American investors who, one might argue, have used investment treaties as a way of supplementing the rights that investors traditionally enjoy under the host States’ domestic laws, rather than addressing the lack of a well-functioning judicial system. As a response to these claims, the United States and Canada have taken steps to narrow and refine their agreements through interpretative notes, new model treaties, and modifications in treaty practice. These steps seem to have been relatively effective in preventing foreign investors’ from successfully using investment treaties to game the system and challenge legitimate domestic legal and regulatory conduct: The United States still has not lost an investor–State arbitration; and Canada has only lost two, though it should be noted that several claims have been settled, providing at least some relief to the claimant investors.<sup>2</sup>

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<sup>1</sup> These numbers are gleaned from information available on the U.S. State Department’s website on NAFTA investor–State arbitrations (<http://www.state.gov/s/l/c3439.htm>), and Canada’s website on investor–State arbitrations (<http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/gov.aspx?lang=en>).

<sup>2</sup> The claimant in *S.D. Myers v. Canada* won an award of roughly C\$6 million (plus interest and costs) (out of C\$20 million claimed); the claimant in *Pope & Talbot* won an award of US\$407,606 (plus interest and costs) (out of US\$508 million claimed). Canada has also settled at least two cases (*AbitibiBowater v. Canada*, and *Ethyl Corp. v. Canada*). Information about these disputes is available from website of Canada’s office of Foreign Affairs and International Trade, at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/gov.aspx?lang=en>.

## Developments in Europe

Most European States, in contrast to the United States and Canada, continue to use BIT models with vague language, allowing for potentially broad investor protection, and thereby imposing far-reaching obligations on the host country receiving the investment. The European models typically do not incorporate notions of sustainable development, and despite their name, do not contain any provisions actively promoting investment. Rather, they focus solely on the protection of the investor. Although European member States have already been sued at least 54 times under investment treaties, European States appear to continue to consider themselves largely immune to challenges of investors.

With the increasing number of investment treaties, and growing stocks of foreign investment in Europe, it is likely that challenges against European States will also increase. Making that conclusion even more likely, investors and law firms are becoming increasingly aware of the strategic and business opportunities that U.S. firms had discovered with NAFTA. We are already getting a glimpse of this new situation with the dispute initiated by the Swedish investor Vattenfall against Germany. In that dispute, the investor filed a claim seeking EUR1.4 billion plus interest and legal expenses as compensation for alleged harms arising out of environmental requirements government authorities imposed on Vattenfall's proposed major coal-fired power plant in the city of Hamburg. The investor brought its claim under investment protection provisions contained in the Energy Charter Treaty—a move that demonstrates investors will use international arbitration under investment treaties instead of, or in addition to, well functioning European legal systems because the treaties provide procedural and substantive rights and guarantees beyond those available at the national level.

Rather than proceed with arbitration, Germany has settled the claim. An award reflecting that the dispute has been settled has been made public on a private website (Germany has not officially made it public). The exact terms of the settlement, however, are still unknown despite the clear public interest in the outcome. There are, nevertheless, indications that the German government has agreed to loosen the environmental standard and to discharge Vattenfall of its obligation to build a cooling tower in order to settle the claim.

The Vattenfall claim against Germany illustrates that investment treaties are not simply benign instruments designed to protect entrepreneurial investors from egregious conduct in foreign countries where the rule of law is weak or lacking. It similarly illustrates how the world can no longer be neatly divided into capital-exporting States that want strong protections for their investors and capital-importing States that agree to provide such protections in order to attract investment. Developed countries are increasingly recipients of investment from other developed, and developing States, with investments from India and China, for instance, no longer a rarity in Europe. And while these factors are leading at least some European States to reconsider, revise and refine their traditional approaches to investment treaties, developments to adapt the treaties to modern realities nevertheless appear slow.

## The Picture in Austria

Austria is both a significant capital importer as well as a capital exporter; thus, it is crucial that Austria's policies with respect to investment treaties further its goals from both the perspective of the host and the home State.<sup>3</sup>

Austria concluded its first BIT with Romania in 1976; since that date it has negotiated an additional 67 agreements. Only eight of the agreements were signed in the decades prior to 1990; 26 were signed in the 1990s; and the remaining 34 have been signed from the year 2000 onward (6 in 2000; 16 in 2001; 3 in 2002; 3 in 2003; 2 in 2004; 1 in 2006; and 3 in 2010).<sup>4</sup> Fifty-nine of these agreements are currently in force.<sup>5</sup>

The majority of these agreements have followed the traditional European model, providing vague, potentially strong protections for investors that have invested in the host State, with little explicit consideration of the potential impacts on host States' rights, investors' obligations, or the broader relationship between investment and sustainable development. Perhaps, to some extent, this reflects the notion that the agreements were not seen as ones that invaded States' legitimate policy space, but were rather limited to preventing and providing remedies for rather egregious and discriminatory conduct. In other words, it could be that the BITs were intended to be a defensive tool to be used by foreign investors, not an offensive one. Nevertheless, as the agreements have been interpreted over the past 20 years to provide rather strong investor protections at the expense of other policy goals, States have taken steps to rebalance them.

As noted above, the United States and Canada have taken the lead on softening the texts so that they are not the offensive weapons against government regulation that some tribunals have interpreted them to be. And other States, among them Austria, have begun to similarly reshape their treaty practice.

Austria's treaty practice has evolved over time. A number of agreements concluded over roughly the past decade in particular inserted provisions that address some issues and concerns regarding protection and promotion of foreign investment that had arisen under the old-style agreements. Those newer provisions that began to appear toward the end of the 1990s were primarily refinements somewhat narrowing the scope of investors and investments covered under the agreements; inserting limitations to requirements for free transfers of payments; and slightly broadening the objectives of the agreements as stated in their preambles to incorporate references to labour rights.

In 2008, Austria adopted a model BIT (the "Model BIT") that formally incorporated and expanded upon those and some additional innovations. In certain respects, the Model BIT better clarifies the obligations of host State signatories and helps protect important policy space. Certain of the changes made can help prevent the costs of investment treaties for host countries from seriously overrunning their benefits. Nevertheless, as this note also explains, the Model BIT also entrenches (if not exacerbates) various problems.

Development and adoption of the Model BIT has had practical significance. In 2010, Austria concluded two BITs, one with Kosovo and one with Tajikistan, that very closely align with the model text. Deviations from the Model BIT, however, can and already have occurred. In 2010, Austria concluded a BIT with Kazakhstan that contains only some of the Model BIT's provisions with significant deviations.

<sup>3</sup> This information is taken from the web site of the Austrian National Bank, available at: [http://www.oenb.at/de/stat\\_melders/datenangebot/aussenwirtschaft/direktinvestitionen/direktinvestitionen.jsp](http://www.oenb.at/de/stat_melders/datenangebot/aussenwirtschaft/direktinvestitionen/direktinvestitionen.jsp)

<sup>4</sup> This information is taken from the website of the International Centre for Settlement of Investment Disputes' Database of Bilateral Investment Treaties, available at <http://icsid.worldbank.org/ICSID/FrontServlet>.

<sup>5</sup> This information is available from the website of the Austrian Federal Ministry of Economy, Family and Youth, through the link on External Trade, at <http://www.en.bmwfj.gv.at/ExternalTrade/InvestmentPolicy/Seiten/Bilateralinvestmentprotectionagreements.aspx>.

## II. Investment Treaties, their Interpretation, and the Austrian Model BIT in Comparison

### The Austrian Model BIT

The Austrian model is no drastic departure from the “traditional” old-style Europe investment treaty. It does, however, include a number of innovations aimed at ensuring that the host State retains a certain amount of regulatory space that is more constrained in the older investment treaties signed by Austria.

The model agreement remains rather short, providing little detail and guidance to the tribunals who will interpret the instrument. By comparison, the U.S. or the Canadian model texts are each approximately three times the length of Austrian model, and also contemplate addition of schedules and annexes to be tailored specifically for actual agreements with other contracting parties (though the schedules are mostly included to address issues relating to pre-establishment matters—a feature not included in the Austrian Model BIT, which is post-establishment only).<sup>6</sup>

The format and content of the Model BIT resembles that described above. It includes standard host State obligations that apply to investments after they have been established in the host country, such as those on (a) national and MFN treatment; (b) expropriation; (c) FET; (d) free transfers; and (e) the umbrella clause. The Model BIT allows investors to initiate investor-State arbitration without ensuring public access to information about outcomes and developments, and is rather silent with respect to investor and home State obligations.

Within and in addition to some of those traditional elements, however, the Model BIT incorporates some more modern features. In particular:

1. The preamble explains that the objective of the agreement is broader than just the protection of investment and the promotion of increased capital flows per se. It signals that investment protection and promotion is a tool of promoting sustainable economic development that is consistent with and even furthers environmental protection, labour rights, corporate social responsibility and other important policy objectives.
2. While the model's definitions of covered “investors” and “investments” are both broad in some respects, the text includes provisions that limit the terms in others. Some of those limitations incorporated in the model (e.g., the “denial of benefits” provision and language requiring investments to be made in “accordance with the law”) were rather common in BITs previously concluded by Austria; but new language in the Model BIT clarifying and narrowing the scope of protected “investments” in particular stands out as an important innovation.
3. The model's article on expropriation (Article 7) provides a carve-out from the notion of expropriation for measures designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment. Although the model includes a caveat to its carve-out, this is overall a useful safeguard for health and environmental measures, thereby avoiding (in large part) a situation where the State has to “pay to regulate.”
4. The model also incorporates exceptions to the requirement to allow free transfers of capital for certain legal and policy purposes. But as is described further below, it is unclear that those exceptions go far enough to adequately protect host States' legitimate interests in situations where it may be important to regulate transfers for economic crises and serious balance of payments concerns.

<sup>6</sup> The term “pre-establishment” refers to the phase prior to the time an investment has actually been “established” in the host country. “Post-establishment” matters are those that relate to the time after the investment has been “established.” When an investment has actually been “established” may in some cases be a difficult question as preparatory work (e.g., engagement of consultants, lawyers, feasibility studies, and travel) may all be taken before an actual enterprise is actually created and operating. Indeed, in some cases, the entity may never become operational.



5. Another innovation is that the model contains clauses on labour (Article 5) and on the environment (Article 4) in its body text. As will be seen below, these provisions have uncertain legal impact, if any. Nevertheless, they indicate some awareness of the impacts investment promotion and protection can have on those issues. These types of provisions may become relevant to interpreting an investment treaty if, for instance, there is a conflict between strong investor protections and a State's environmental policies.

For the rest, the model hardly differs from the earlier versions. With respect to the substantive content of host State obligations, the Model BIT retains a vague FET clause and does not tie its scope explicitly to the customary international law on the minimum standard of treatment, as do many recent treaties, including those of the United States and Canada.

The Model BIT also includes a broad most favoured nation clause and does not limit its scope of application, thereby allowing investors to import substantive and procedural rights from other, more favourable, treaties.

Notably, the Model BIT includes an umbrella clause and even seems to broaden the obligations imposed by that provision beyond the text of umbrella clause provisions contained in other Austrian BITs.

With respect to issues of investor-State dispute settlement, the model does not include any innovations to address some of the problems inherent to the arbitration system it subscribes to: it does not address the issue of transparency, try to tackle the issue of conflicts of interests of arbitrators and counsel, nor contemplate mechanisms for ensuring greater consistency of arbitral decisions, such as development of an appeals mechanism.

To elaborate on these aspects of the Model BIT further, this note lays a foundation by examining how other existing investment treaties have addressed the five different issues of (1) scope, (2) host States' obligations, (3) provisions on labour, the environment, and sustainable development, (4) investor-State dispute settlement, and (5) home State and investor obligations. It looks at how tribunals deciding investor-State disputes have interpreted the relevant provisions relevant to those categories, and at what the investment treaties consequently mean for host States. This note then looks at how the Austrian Model BIT compares with existing treaty practice, noting areas in which the Model BIT seems to recognize and correct problems that have arisen with older investment treaties, and also highlighting where concerns remain.

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## Scope

The scope of an investment treaty determines which investors and investments are protected under the treaty and to whom and for what duration host States owe obligations. As is discussed further below, key factors affecting the scope of an investment treaty include: the definitions "investment" and "investor;" and the question of whether obligations not included in the investment treaty are brought under the realm of the treaty through so-called "umbrella clauses." Examining these features in the Austrian Model BIT indicates that its scope—and the potential liabilities it entails for host States—is very broad, and is not markedly different from Austria's older investment treaties.

## Defining “Investment”

One approach to defining investment in investment treaties has been to use an expansive, asset-based formulation which provides coverage to “any kind of asset” “owned or controlled,” “directly or indirectly” by a foreign investor. That definition is usually followed by a non-exhaustive list of the forms such assets may take. The list commonly includes a wide range of assets and interests, such as movable and immovable property, shares or stock in a company, futures, options, derivatives, contract rights, goodwill and intellectual property rights including trademarks and copyrights. Some definitions of “investments” also specify that they include entities whether owned or controlled by the government or private entities, and whether or not operated for profit.

One problem with this approach is that, as tribunals have interpreted the agreements, the phrase “any kind of asset” means to a large extent what it says, i.e. that is any kind of asset, ranging from money in a bank account, to a holiday home, to a company’s “goodwill” may be an investment under the treaty. Even contracts for the sale of goods manufactured by the investor in its home country, or services performed by the investor in its home country, and then sold to consumers in the host country, may potentially qualify as an investment.<sup>7</sup> Although these types of assets may make little or no contribution to the host State’s economy or (sustainable) development, they can benefit from the heightened rights and protections offered by the investment agreement.

Another issue with these broad definitions of “investments” is that they may unintentionally and/or undesirably grant privately owned investments the same rights and opportunities as government-owned or -operated entities. When an agreement includes government-owned or -operated entities within the definition of “investments,” and then requires host countries to treat foreign “investments” no less favourably than domestic “investments,” it may prevent host countries from favouring their domestic government-owned or -operated entities through subsidies, grants of monopoly rights, or other forms of government supports. Even if the government entity has been created to reliably and cheaply provide a public service, not to generate a profit, that public service/non-profit nature of the entity will not necessarily give it any special or protected status under the investment treaty (See Box 1).

### BOX 1: STATE ENTERPRISES AS INVESTMENTS

This issue of state enterprises falling within the definition of a “investment” arose in the context of the NAFTA dispute, *UPS v. Canada*. There, the US investor/claimant argued that Canada breached the NAFTA because it treated its government-owned and -controlled mail processing and distribution enterprise, Canada Post, more favourably than the private US investor in violation of the national treatment obligation. In order for its claim to survive, the US claimant had to establish that Canada Post—a state enterprise designed to serve the important public policy function of providing Canadians nationwide, reliable and affordable mail services—was an “investment,” and that Canada improperly discriminated against that domestic “investment” in favour of the US investment.

The tribunal had no problem determining that Canada Post was an “investment” of a domestic investor (Canada), and that improper discrimination against foreign investments in favour of Canada Post would violate the NAFTA. A majority of the tribunal, nevertheless, rejected the claimant’s claims on several grounds, including that Canada’s allegedly improper discrimination in favour of Canada Post were measures protected by exceptions in the NAFTA for government procurement and protection of “cultural industries.” (One of the arbitrators wrote a separate opinion stating his position that the exceptions did not apply). Notably, many BITs do not contain such exceptions. *UPS of America v. Canada*, Award, 24 May 2007, paras. 45-72.

<sup>7</sup> See, e.g., *SGS Societe Generale de Surveillance v. Pakistan*, ICSID Case No. ARB/01/13, Decision on Objection to Jurisdiction, August 6, 2003; *v. Philippines*, ICSID Case No. ARB/02/6, Decision on Objections to Jurisdiction, January 24, 2004. These cases involved contracts for services performed in large part outside of the territory of the host state. The tribunals found that there were “investments” over which they could take jurisdiction.

Absent explicit language in the agreements refining the definition of “investments,” tribunals appear to interpret the term broadly. In the context of deciding whether there is an “investment” (and, consequently, whether they have jurisdiction over the dispute), tribunals have displayed a tendency to be strict textualists, rejecting States’ arguments that reasonable limits should be read into the treaty to limit the scope of covered “investments.”

This can be seen in a number of cases against Argentina arising from measures the country took during and in response to its financial crisis. In these cases, a common issue was whether minority and/or indirect shareholders could bring an investment treaty claim seeking relief for losses they suffered as a result of damage to the *company* in which they held shares (as opposed to damage to their rights as shareholders such as expropriation or cancellation of the shares themselves). In these cases, which included *CMS v. Argentina*,<sup>8</sup> *Azurix v. Argentina*,<sup>9</sup> *Enron v. Argentina*,<sup>10</sup> and *Siemens v. Argentina*,<sup>11</sup> Argentina argued in relevant part that if the tribunals allowed minority and/or indirect shareholders to bring claims for relief based on damage to the company, host countries could be faced with a multitude of claims from different shareholders as well as claims by the company itself. Argentina argued that this result would be absurd and unreasonable, and was contrary to the general rule of international law, which did not recognize such broad shareholder rights. Tribunals, however, rejected those arguments in favour of a broad definition of “investments.” And in doing so, they hung their decisions on the observation that there was nothing in the actual text of the governing treaties that imposed such a limitation.

The various decisions of investment treaty tribunals interpreting the scope of covered “investments,” and the uncertainty that is inherent in the broad provisions commonly used in investment treaties, have led a number of States to either create alternatives to the expansive asset-based formulation or to narrow its scope. Some approaches include provisions:

- requiring that investments must represent lasting or significant interests in a foreign enterprise, or be made in order to obtain economic benefit;<sup>12</sup>
- requiring that foreign investments be made in compliance with host States’ laws;<sup>13</sup>

<sup>8</sup> *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, & Decision on Annulment, Sept. 25, 2007.

<sup>9</sup> *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Decision on Jurisdiction, 8 Dec. 2003, & Decision on Annulment, Sept. 1, 2009.

<sup>10</sup> *Enron Corp. and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, January 14, 2004, & Decision on Annulment.

<sup>11</sup> ICSID Case No. ARB/02/8, Decision on Jurisdiction, Aug. 3, 2004.

<sup>12</sup> Article 1 of the United States’ most recently concluded BIT—the BIT with Uruguay which was signed November 4, 2005 and entered into force November 1, 2006—for example, states that to be covered by the agreement, the asset must have “the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.” See also Australia–Chile FTA, Ch. 10, art 10.1(j) (requiring “investments” to have those same characteristics) (negotiations concluded in 2008 but the agreement is not yet in force). The investment chapter of the FTA between Canada and Peru, which entered into force 1 August 2009, similarly states that “real estate or other property, tangible or intangible” will only be an investment if it was “acquired in the expectation or used for the purpose of economic benefit or other businesses purposes.” Canada–Peru FTA, Ch. 8, Art. 847. The Canada–Peru FTA further specifies that although a loan to and debt security of an enterprise may qualify as an investment, to do so the original maturity of the loan or debt security must be at least three years. Canada–Peru FTA, Ch. 8, Art. 847. A different approach is one that requires investments to represent a lasting interest and to exceed a certain threshold of participation. The Turkey–Lebanon BIT uses this approach and states that “investment” refers to “direct investment,” which in turn “means obtaining a lasting interest by the investor of one Contracting Party in an enterprise established or incorporated in the territory of the other Contracting Party, by having an ownership of an equity capital stake of 10% or more of the ordinary shares or voting power.” Turkey–Lebanon BIT, Art. 1 (signed May 12, 2004; entered into force June 4, 2006).

<sup>13</sup> An example of the former type of restriction can be found in the definition of an “investment” set forth in the BIT between the Republic of Korea and El Salvador, which states in relevant part, “‘Investment’ means every kind of asset or rights invested by investors of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party.” *Id.*, Art. 1 (signed July 6, 1998, entered into force May 25, 2002). It should be noted that to limit an investment treaty’s protections to investments made in accordance with the host country’s laws (i.e., to deny protection to investments illegally made such as investments made through bribery or fraud) countries can contain provisions to that effect in other parts of their investment treaties. See, e.g., *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, Aug. 2, 2006).

- indicating that the treaty’s list of assets covered as “investments” is a limited exhaustive list, not a broad illustrative one;<sup>14</sup> and
- carving out from the definition certain types of assets, such as certain intellectual property rights,<sup>15</sup> rights deriving from legal judgments,<sup>16</sup> and rights to money associated with the cross-border trade in goods and services.<sup>17</sup>

There are examples of how these provisions have effectively barred claims relating to investments that provided questionable benefits for the host country. In *Inceysa v. El Salvador*,<sup>18</sup> for instance, the governing BIT contained provisions stating that, in order to be protected, investments had to be made in accordance with the domestic law. El Salvador argued that (1) the asset that formed the basis of the investor’s claims had been secured through fraud and (2) was therefore not a legally made investment covered by the treaty. The tribunal agreed and rejected jurisdiction over the investor’s claim.<sup>19</sup>

Further, when rejecting jurisdiction over a number of the claimants’ claims in *Grand River Enterprises v. United States*, the tribunal emphasized that the governing investment agreement, NAFTA, used a “relatively restricted,” exhaustive definition of “investment.” According to the tribunal, the claimants’ business expenditures and activities did not fit within enumerated categories of assets protected by the agreement.<sup>20</sup>

### *The Austrian Model BIT’s Definition of Investment*

The Austrian Model BIT uses a broad, asset-based definition of “investment,” and includes an illustrative, rather than exhaustive, list of the types of assets that would be covered. It specifies that it protects investments “owned or controlled, directly or indirectly” by foreign investors (Art. (1)(2)). It also adds that its definition of “investments” includes entities “whether or not for profit, and whether private or government owned or controlled.” (Art. 1(3)). These types of provisions incorporated in the Model BIT arguably go beyond the coverage provided by many of Austria’s existing treaties. A number of BITs concluded by Austria, for instance, do not explicitly cover indirect investments, government-owned or -controlled entities, or non-profit enterprises.<sup>21</sup>

The text, however, also appears to include some limits on the scope of the term “investment.” For one, in an article entitled “Scope and Application of the Agreement,” the Model BIT clarifies that it applies to “investments made in the territory of either Contracting Party in accordance with its legislation....” (Art. 27(1)).

<sup>14</sup> See, e.g., 2003 Canada Model Foreign Investment Protection Agreement (FIPA), Section A, Art. 1.

<sup>15</sup> The COMESA investment agreement limits its protection of intellectual property rights by stating “intellectual property rights, technical processes, know-how, goodwill and other benefits or advantages associated with a business operating in the territory of the COMESA Member States in which the investment was made.” (Art. 1(9)(d)).

<sup>16</sup> See, e.g., CAFTA, Art. 10.28, n.11 (stating that the “term ‘investment’ does not include an order or judgment entered in a judicial or administrative action”)

<sup>17</sup> See, e.g., NAFTA, Art. 1139(i); COMESA, Art. 1.

<sup>18</sup> *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, Aug. 2, 2006

<sup>19</sup> In this case, the phrase stating that investments had to be made “in accordance with” the host state’s law was not in the definition of covered “investments,” but was in two other provisions: one relating to the admission of investments; and the other relating to the scope of the agreement’s protection. Those two clauses, together with negotiating history reflecting the parties’ intent to limit covered “investments” to those legally made, led the tribunal to reject jurisdiction notwithstanding the fact that the limitation was not directly included within the definition of covered “investments.”

<sup>20</sup> *Grand River Enterprises v. United States*, Award, Jan. 12, 2011, para. 122.

<sup>21</sup> See Austria-Hong Kong BIT (signed Oct. 11, 1996; entered into force Oct. 1, 1997); Austria-Iran BIT (signed Feb. 15, 2001; entered into force July 11, 2004).

Second, the Austrian Model BIT specifies that “[i]nvestments are understood to have specific characteristics such as the commitment of capital or other resources, or the expectation of gain or profit, or the assumption of risk.” (Art. 1(2)). This could limit the definition of investment and therefore the special protection to “meaningful” investments, excluding those without substantial presence or economic contribution to the host State. The provision’s practical impact is somewhat unclear, however, due to the phrase “[i]nvestments are understood to have specific characteristics such as the commitment of capital or other resources, or the expectation of gain or profit, or the assumption of risk” (emphasis added). Does this mean that all assets listed are presumed to have such characteristics, or does it mean that each of the assets listed must in addition have such characteristic?

Finally, another basis for viewing the Model BIT as preventing coverage of companies with no substantial business presence in the host State is that it states in its “Definitions” article that “enterprises” are one form of covered investment, and then specifies that “enterprises” are entities “constituted or organised under the applicable law of a Contracting Party ... and carrying out substantive business there.” While these provisions together seem to prevent companies with only minimal activity in the host State from qualifying as an “investment,” it is unclear how they relate to the definition of an “investment.” This definition is illustrative rather than exclusive: a whole range of entities may fall within the definition of an “investment” without falling within the definition of an “enterprise” and its “substantial business activities” requirements (Art. 1(1)(2)).

In sum, the provision in the Model BIT indicating that covered “investments” have to be made in accordance with the host State law does not do much more to narrow the text’s coverage than provisions in previously concluded treaties had. Agreements signed by Austria from the 1980s onward have often included similar language.

The Model BIT’s provisions indicating that investments must relate to some type of actual contribution or business activity in the host State, however, represent an innovation compared to previous Austrian BITs: Before the model’s adoption, similar limitations were rarely if ever present in Austria’s BITs, even its more modern ones.<sup>22</sup>

## Defining “Investor”

Similar to definitions of “investments,” definitions of “investors” are often broad, stating that an “investor” is a national or enterprise of one contracting State that is seeking to make, is in the process of making or has made an investment in the other contracting State.<sup>23</sup>

Those broad definitions can widen the scope of the BIT in ways perhaps beyond those intended or desired by their State parties. In particular, broad definitions of investors can enable investors to manufacture or alter their nationality specifically in order to obtain rights and protections under particular investment treaties.<sup>24</sup>

<sup>22</sup> See Austria–Algeria BIT (signed June 17, 2003; entered into force Jan. 1, 2006); Austria–Namibia BIT (signed May 27, 2003); Austria–Yemen BIT (signed May 30, 2003; entered into force July 1, 2004); Austria–Ethiopia BIT (signed Nov. 12, 2004; entered into force Nov. 1, 2005).

<sup>23</sup> See, e.g., Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore, Ch. 6, Art. 6.1 (signed June 29, 2005, entered into force Aug. 1, 2005); U.S.–Uruguay BIT, Art. 1;

<sup>24</sup> See, e.g., *Phoenix Action Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Award, April 9, 2009. In this case, the tribunal rejected jurisdiction on the grounds that the investor created the investment in order to improperly obtain protections afforded by the treaty. It should be noted, however, that this case turned on the definition of an “investment,” not the definition of an “investor.”

With respect to that issue, some tribunals, such as the tribunals in *Phoenix v. Czech Republic*<sup>25</sup> and *Cementownia v. Turkey*<sup>26</sup>, have been unwilling to allow an investor to claim the benefits of a treaty where it was apparent that the investor only established a legal presence in the home State in order to be able to seek the enhanced protections offered by the agreement.

States have also begun more carefully identifying in their investment treaties who qualifies as covered “investors” by, for example, denying protections to so-called “mailbox companies” (i.e., companies that establish only a minimal presence such as a post office box in the home country).<sup>27</sup> Investment treaties may do this by including such limitations directly in their definitions of covered “investors”<sup>28</sup> (See Box 2).

**BOX 2: AFT V. SLOVAK REPUBLIC: DENYING PROTECTION TO “MAILBOX” COMPANIES**

One BIT’s relatively narrow definition of covered “investors” was recently at issue in an investment dispute, *AFT v. Slovak Republic*, and led the tribunal to reject jurisdiction over the claimant’s action. The relevant BIT was a treaty signed in 1990 between Switzerland and the Slovak Republic, and defined “investors” in relevant part as “legal entities legal entities ... which are constituted or otherwise duly organized under the law of that Contracting Party and have their seat, together with real economic activities, in the territory of that same Contracting Party” (Art. 1(1) (b)). As the tribunal described this provision, it was a “special (and rather uncommon) clause by which the two Contracting States intended to exclude from treaty protection ‘mailbox’ or ‘paper’ companies” (para. 224).

When rejecting the claimant’s claim, the tribunal found that a corporate seat is an “effective center of administration of business operations,” and that the claimant, which did not have proof of a Swiss phone number, rental agreement for office space in Switzerland, or bank account in the country, failed to establish it had such a seat in Switzerland, the alleged home country (paras. 217-218). The tribunal also stated that the claimant did not have proof of “real economic activities” in Switzerland because it was “unable to establish [the] number and type of its clients, type of its operations, kind of contracts it enters into, quantity and type of personnel, and composition of its managing bodies. It even admitted that it has no employee” (para. 219).

*Alps Finance and Trade AG v. Slovak Republic*, Award, March 5, 2011.

Some BITs also or instead include so-called “denial of benefits” provisions, which commonly state that a contracting party may deny the benefits of the treaty to investors who do not have sufficient business activities in the home State.<sup>29</sup> It is unclear, however, whether and when States must give investors some type of advance notice before relying on the “denial of benefits” clause to deny the investors treaty protection. That issue is currently being litigated in at least one case, *Pacific Rim v. El Salvador*.<sup>30</sup> If tribunals interpret those “denial of benefits” provisions as requiring advance notice to investors, the provisions may be of little practical utility to States seeking to limit the scope of covered “investors.”

Another concern that can arise with broad definitions of the term “investors”—at least for the host State—relates to issues of competitiveness. Broad definitions of “investors” may explicitly or implicitly cover entities owned or controlled by the home State. These entities, in turn, may receive significant subsidies or other assistance that insulates

<sup>25</sup> ICSID Case No. ARB/06/5, Award, April 15, 2009

<sup>26</sup> ICSID Case No. ARB(AF)/06/2, Award, September 17, 2009.

<sup>27</sup> Some agreements, such as the Investment Agreement for the COMESA Common Investment Area state, for example, that for a “juridical person” to be a covered investor, it must be “duly constituted or otherwise organized under the applicable laws and regulations of a Member State... [A] juridical person owned or controlled by foreign nationals shall not qualify as a COMESA investor unless it maintains substantial business activity in the Member State in which it is duly constituted or organized.” Art. 1(4).

<sup>28</sup> *Id.*

<sup>29</sup> See, e.g., CAFTA, Art. 10.12.

<sup>30</sup> ICSID Case No. ARB/09/12.

and protects them from competition when going abroad. If a BIT requires equal treatment of domestic and foreign “investors,” therefore, it may effectively place private, unsubsidized domestic enterprises in competition with heavily subsidized and supported foreign State-owned entities and enterprises.

### *The Austrian Model BIT’s Definition of “Investors”*

The Austrian Model BIT contains a broad definition of “investors” covering natural and legal persons, the latter of which may take a wide range of corporate forms. Its Article 1(1) includes within the term “investor:”

- a. a natural person having the dominant and effective nationality of a Contracting Party in accordance with its applicable law, or
- b. an enterprise constituted or organised under the applicable law of a Contracting Party, making or having made an investment in the other Contracting Party’s territory.

The Model BIT then proceeds to define an “enterprise” in Article 1(3) as any entity “constituted or organized under the applicable law of a Contracting Party, whether or not private or government owned or controlled ... and carrying out substantive business there.”

Pursuant to the definition’s reference to those “making” an investment, the agreement arguably covers investors who have not yet established their investment in the host country. The agreement also explicitly covers government owned or controlled entities. These aspects of the definition of “investors” seem to sanction an expansive conception of the term, explicitly sweeping within its scope individuals and entities that may otherwise not have clearly been covered.

Yet while broad in those respects, the model’s requirements that natural persons have their “dominant and effective nationality” in a home country, and that enterprises carry out “substantive business” there, are both important requirements that seem to carve out from the term “mailbox” companies and investors who have manipulated their nationality or place of business specifically in order to claim the benefits of the treaty.

Further, the Austrian Model BIT also contains a “denial of benefits” clause in Article 10 that allows the contracting States to deny the protections of the agreement to investors (1) who are owned or controlled by residents of a State not party to the treaty, and (2) who do not have substantial business activities in the territory of the party where they are incorporated.<sup>31</sup> The provision does not explicitly require the host country to notify the investor before relying on this provision.

These provisions in the Austrian Model BIT prevent individuals and entities from “treaty shopping”—i.e., taking such steps as altering their residency, citizenship, or place of incorporation in order to claim the benefits of a particular BIT. This can prevent abuses of investor-State arbitration that have already been tried by various investors. It is a desirable addition to the model, but, in terms of Austrian practice, not especially novel. Agreements concluded by Austria over the past couple of decades have commonly included language restricting the definitions of “investors” in similar ways.<sup>32</sup> “Denial of benefits” clauses can also be found in Austrian agreements concluded at least as early as 2000.<sup>33</sup>

<sup>31</sup> Article 12 states:

A Contracting Party may deny the benefits of this Agreement to an investor of the other Contracting Party and to its investments, if investors of a Non-Contracting Party own or control the first mentioned investor and that investor has no substantial business activity in the territory of the Contracting Party under whose law it is constituted or organised.

<sup>32</sup> See, e.g., Austria-Malaysia BIT (signed Apr. 12, 1985; entered into force Jan. 1, 1987); Austria-Korea BIT (signed Mar. 14, 1991; entered into force Nov. 1, 1991).

<sup>33</sup> See, e.g., Austria-Uzbekistan BIT, Art. 10 (signed June 2, 2000; entered into force Aug. 18, 2001); Austria-Slovenia BIT, Art. 10 (signed Mar. 7, 2001; entered into force Feb. 1, 2002).



## Umbrella Clauses and Broad Dispute Settlement Clauses

A third aspect of investment treaties that impacts their scope is the presence or absence of so-called “umbrella clauses,” which have been included in investment treaties from early on. These clauses elevate the host States’ contractual and other undertakings toward foreign investors to treaty obligations.

A 2004 survey found that of the roughly 2,500 BITs then in existence, approximately 40 per cent contained such provisions expressed in a variety of different formats.<sup>34</sup> The provisions can be grouped in two broad categories.

First, sometimes treaties state that the host State must observe any obligation it has assumed with regard to the covered investments. This means that host States must comply both (1) with obligations explicitly agreed to in the treaty, such as obligations not to discriminate against foreign investors, which are discussed in more detail below; and (2) with any other obligations as well, including promises the host governments have made in specific contracts with the investor, or obligations the host governments have under domestic law. As a result, these clauses can bring host States’ contractual and other domestic law duties under the “umbrella” of the relevant investment treaty. Contract-based and other domestic law claims are, in effect, elevated to treaty-based claims. This can have the consequence that the obligations that would otherwise have to be settled in domestic courts or in some other pre-determined way can be brought directly to international arbitration under the treaty.

Second, broad dispute settlement provisions can also operate as umbrella clauses. For example, several treaties state that the agreement’s dispute settlement mechanisms apply to *any* dispute arising out of or related to covered investments. Again, these provisions may have the effect that not only disputes regarding obligations under the treaty can be brought directly to international tribunals but any dispute relating to the investment.

Tribunals have approached the interpretation of umbrella provisions in very different and, at times, conflicting ways. Some tribunals, such as the tribunals in *SGS v. Pakistan*<sup>35</sup> and *Siemens v. Argentina*,<sup>36</sup> have rebuffed broad interpretations of the provisions. In *SGS v. Pakistan*, the tribunal was unwilling to conclude that umbrella clauses are “so far-reaching in scope, ... automatic and unqualified and sweeping in their operation, [and] so burdensome in their potential impact upon” a contracting State that they would elevate all contractual breaches or breaches of commitments under the host State’s domestic law to a violation of the treaty.<sup>37</sup>

In *Siemens v. Argentina*, the tribunal departed from the decision in *SGS v. Pakistan* by stating that the umbrella clause meant what it said: that failure to comply with any obligation owed to the investor would amount to a breach of the BIT.<sup>38</sup> Nevertheless, it rejected the claimant’s umbrella clause claim on the ground that the claimant was not a signatory of the contract whose alleged breach the claimant argued was actionable as a breach of the umbrella clause. The tribunal explained that if a claimant wanted to use the umbrella clause to bring an investor–State claim based on a breach of contract, the claimant had to be an actual party to that contract.

<sup>34</sup> Gill, Gearing & Birt, *Contractual Claims and Bilateral Investment Treaties: A Comparative Review of the SGS Cases* (2004) 21:5 J. INT. ARB 397 at n. 31.

<sup>35</sup> ICSID Case No. ARB/01/13, Decision on Jurisdiction, Aug. 6, 2003.

<sup>36</sup> ICSID Case No. ARB/02/8, Decision on Jurisdiction, Aug. 3, 2004, & Award, Feb. 6, 2007.

<sup>37</sup> *Id.*, para. 167.

<sup>38</sup> *Siemens v. Argentina*, paras. 204-206.



Some tribunals have also limited the potential impact of umbrella clause provisions by suggesting that purely commercial contract disputes between the State or State entity and the investor will not amount to a breach of the umbrella clause. These tribunals, which have included the tribunals in *Pan American Energy v. Argentina*<sup>39</sup> and *Joy Mining Machinery Ltd. v. Egypt*,<sup>40</sup> have indicated that for the contract breaches to support an umbrella clause claim, the dispute or breach must have arisen as a result of the State's exercise of its sovereign authority.

There are, however, decisions such as *SGS v. Philippines*,<sup>41</sup> *Eureko v. Poland*,<sup>42</sup> and *Enron v. Argentina*,<sup>43</sup> in which tribunals have gone the other way on each of those issues, interpreting umbrella clauses expansively. As a consequence, the clauses' impacts are largely unpredictable. There is no way to know how they will be interpreted by a particular tribunal.

The only certain way to avoid the risk that, through tribunals' interpretations of the umbrella clauses, the scope of the treaties they have entered into are expanded beyond the State parties' expectations is to avoid incorporating umbrella clauses and to narrowly formulate dispute resolution provisions. Many investment treaties do not use umbrella clauses, and due to evolving case law and the uncertainty inherent in these types of clauses, a number of agreements that do include them attempt to expressly limit their scope.<sup>44</sup>

### *The Austrian Model BIT and the Umbrella Clause*

The Austrian Model BIT contains an expansive umbrella clause. It states:

Each Contracting Party shall observe any obligation it may have entered into with regard to specific investments by investors of the other Contracting Party.

This means, inter alia, that the breach of a contract between the investor and the host State or one of its entities will amount to a violation of this treaty (Art. 11(1)).

The first sentence is broad in that it refers to *any* obligation with respect to the investment. This would sweep within the treaty's protection any contractual commitment given by the host State. It may also include obligations under international and domestic law as well, though this is less clear. On the one hand, the language referring to obligations the host State "may have entered into with regard to specific investments" could arguably exclude obligations under

<sup>39</sup> *Pan American Energy LLC v. Argentina*, ICSID Case No. ARB/03/13, Decision on Preliminary Objections, July 27, 2006.

<sup>40</sup> *Joy Mining Machinery Ltd. v. Egypt*, ICSID Case No. ARB/03/11, Award, August 6, 2004.

<sup>41</sup> ICSID Case No. ARB/02/6, Decision on Jurisdiction, Jan. 29, 2004.

<sup>42</sup> Partial Award, Aug. 19, 2005.

<sup>43</sup> ICSID Case No. ARB/01/3, Award, May 22, 2007, & Decision on Application for Annulment of the Argentine Republic, July 30, 2010.

<sup>44</sup> More modern U.S. BITs and FTAs, for example, have adopted an approach whereby they protect contractual rights granted in "investment agreements" rather than more expansively using umbrella clauses to protect "any obligation" owed to the investor. As can be seen in the U.S.-Uruguay BIT, an "investment agreement" is defined as a:

written agreement between a national authority of a Party and a covered investment or an investor of the other Party, on which the covered investment or the investor relies in establishing or acquiring a covered investment other than the written agreement itself, that grants rights to the covered investment or investor:

(a) with respect to natural resources that a national authority controls, such as for their exploration, extraction, refining, transportation, distribution, or sale; (b) to supply services to the public on behalf of the Party, such as power generation or distribution, water treatment or distribution, or telecommunications; or (c) to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines, that are not for the exclusive or predominant use and benefit of the government (Art. 1).

The agreement contains an explanatory note on the meaning of a "written agreement" stating in relevant part that the term does not "(a) a unilateral act of an administrative or judicial authority, such as a permit, license, or authorization issued by a Party solely in its regulatory capacity, or a decree, order, or judgment, standing alone; [or] (b) an administrative or judicial consent decree or order...." (n.5). There is also an explanatory note on the meaning of a "national authority." It states, "For purposes of this definition, 'national authority' means an authority at the central level of government" (n.6).

generally applicable laws and treaties. On the other hand, the “inter alia” language in the next sentence referring to contract breaches as just one possible way through which the umbrella clause can be violated seems to suggest that other legal obligations are also covered by this provision.

The second sentence of the umbrella clause provision notably expands the obligation even further beyond its already significant scope. For one, it explicitly equates *any* breach of a contract (not just material, serious or “non-commercial” breaches) with a violation of the treaty. Moreover, it is seemingly expansive in that specifies that it would require the host State to defend and possibly pay damages for any alleged breach of a contract (or other obligation) by any *State entity*. The types of entities that could trigger this potential liability for the host State are diverse and numerous. They could include, for instance, a sub-national entity such as a city government that contracted with the investor for provision of certain public services; it could also include a government agency that regulates labour, environmental, financial or other policy areas; and it could include quasi-commercial enterprises or State-funded entities such as hospitals, or companies that provide postal services.

This language making the State liable for its “entities’ ” contractual breaches appears to be a new feature—one adopted in the Model BIT but previously not present in Austria’s investment treaties (The 2010 agreements with Kosovo and Tajikistan also incorporate this development. The agreement with Kazakhstan does not).

The policy choice reflected in the model thus seems to be one in favour of a broad and strong umbrella clause. Another area where this is reflected is in the model’s design of the relationship between the umbrella clause and investor–State arbitration (an issue discussed further below). In short, in at least one treaty concluded by Austria, the contracting parties included an umbrella clause, but stated that investors could only use investor–State arbitration to allege a violation of non-treaty obligations covered by that clause if “normal, local, judicial remed[ies] were not available.”<sup>45</sup> The Model BIT does not adopt this limitation. Violations of non-treaty obligations can be brought directly to investor–State arbitration.

In sum, the umbrella clause included in the Austrian Model BIT is particularly expansive, and can have significant ramifications for host States, potentially subjecting them to liability for wide ranging actions or omissions of national and sub-national government branches, and government-owned and -controlled entities.

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## Host Country Obligations

Contracting parties agree in investment treaties to grant foreign investors various rights, and to comply with corresponding obligations. Provisions found in most treaties are those protecting foreign investors against discrimination in favour of the host country’s nationals (national treatment protection) or nationals of third countries (most favoured nation or MFN protection). Other common provisions include (1) expropriation clauses barring host States from expropriating an investment without paying compensation; (2) clauses requiring host States to accord investors FET; and (3) clauses guaranteeing foreign investors and investments rights to freely transfer funds out of the host country.

As referred to above, beginning in the 1990s, investors have increasingly initiated arbitration actions arguing that host States (both developed and developing) violated their obligations to foreign investors under governing investment treaties. Among their claims, investors have alleged that host countries breached their duties by taking various regulatory, administrative and other actions including making public statements regarding investors’ operation

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<sup>45</sup> Austria-India BIT, Art. 8(2) (signed Nov. 8, 1999; entered into force Mar. 1, 2001).

of important public services; requiring mining companies to take certain steps to rehabilitate the environment; and rejecting an investment on the grounds that it would negatively impact the preservation and character of an historic old town. These suits and others have highlighted the scope of governments' potential liability to investors under broad treaty provisions, and have raised and exacerbated concerns that investment treaties may undesirably restrict governments' efforts to implement legitimate environmental, social welfare and other policy goals. Some of the important issues raised by these investment treaty obligations, and countries' modifications to their texts in response, are described in more detail below.

## Non-discrimination: MFN and National Treatment

The great majority of investment treaties contain obligations to provide foreign investors MFN treatment and national treatment. MFN treatment means that the host State is to treat the investor of the home State no less favourably than it treats investors from other countries. National treatment means that the host State is to treat the foreign investor from the home State no less favourably than it treats domestic investors. These non-discrimination obligations both raise two main concerns.

First, both the MFN and national treatment obligations can potentially limit host States' authority to draw important distinctions between different investors or investments even when those distinctions are not based on the investors' or investments' nationality. The claims asserted in the Notice of Intent to Commence Arbitration filed by the U.S. investor, The Renco Group, Inc. ("Renco") against Peru illustrates this issue.<sup>46</sup> There, Renco alleges that the government improperly discriminated against it by imposing environmental cleanup obligations on it and its affiliates that were allegedly stricter than obligations imposed on other entities. Effectively, Renco argues that disparate treatment of different entities constitutes improper discrimination under the treaty. Governments, however, may have a number of valid reasons for treating individuals or entities differently. When enforcing laws and policies, for example, resource constraints preventing action against all offenders, the desire to "set examples" or target the worst offenders, and legitimate changes in policies may all be reasons why a government agency will pursue enforcement against one entity before (or without) pursuing similar action against another. If, as argued by Renco, such selective enforcement is deemed to constitute improper discrimination, the MFN and national treatment provisions may too tightly tie governments' hands.

Notably, a number of tribunals have held that an investor-claimant need not establish that the government *intended* to discriminate against it *on account of its nationality* in order for a breach of the non-discrimination obligation to be found.<sup>47</sup> Thus, using the potential Renco claim as an example, even if the government's efforts to enforce the investor's environmental cleanup obligations were taken as a result of the investor's conduct and the level of pollution, rather than the investor's nationality, such fact would not necessarily offer any protection to the government.

Second, MFN and national treatment obligations also raise concerns because, in some circumstances, governments may have legitimate reasons for wanting to discriminate between investors and investments precisely because of their nationality. States, for instance, may want to accord investors/investments from one State more favourable treatment than investors/investments from another State (e.g., treating fellow members of the EU more favourably than non-

<sup>46</sup> This Notice of Intent to Commence Arbitration is available at [http://ita.law.uvic.ca/documents/RencoGroupVPeru\\_NOI.pdf](http://ita.law.uvic.ca/documents/RencoGroupVPeru_NOI.pdf). The investor's discrimination claims argue that the government discriminated against it in favour of a domestic entity, and therefore allege a breach of the national treatment obligation. Nevertheless, these same claims could be made under the MFN clause if the entity allegedly receiving the more favourable treatment were a foreign investor from a third state.

<sup>47</sup> *Siemens v. Argentina*, Award, Feb. 6, 2007, para. 321; *Occidental Exploration and Production Co. v. Ecuador*, Award, July 1, 2004, para. 177; *S.D. Myers v. Canada*, Award, Nov. 13, 2000, paras. 252-54.

EU members, or according special treatment to least-developed countries). The MFN obligation will bar this if it is not limited through exceptions and reservations. Similarly, States may have important policy reasons for wanting to accord domestic investors more favourable treatment than foreign investors. Possible examples are numerous, and include providing special benefits or assistance to traditionally disadvantaged groups or minorities; providing support to infant industries to help further domestic industrial policies; and safeguarding control over national security and other strategic interests.

States have taken various steps in order to rein in the impacts of the MFN and national treatment obligations in these areas. For one, in order to protect their rights to treat investors/investments differently based on legitimate policy considerations that are unrelated to the investors'/investments' nationalities, some States have focused on the notion of "like circumstances." Countries have included in their BITs language clarifying that discrimination is only prohibited when it is between "like" investments/investors. Such text reflects the principle that countries may legitimately accord different treatment to investors or investments that are in dissimilar circumstances. Although the concept of "likeness" is difficult to define and often engenders litigation,<sup>48</sup> arbitral decisions such as that rendered in *Parkerings v. Lithuania* illustrate that this principle can be key for ensuring that governments are able to implement measures distinguishing between investors and investments in appropriate cases, such as when different investment projects pose different threats to environmental protection.<sup>49</sup> Arbitral decisions also indicate that the principle may be read into the treaty even when "like circumstances" language is not included in the text.<sup>50</sup> Nevertheless, being prudent, many treaties include language making clear that discrimination is only prohibited between investors or investments in "like" or "similar" "circumstances" or "situations."<sup>51</sup> Additionally, some treaties then provide language guiding tribunals in determining when situations or circumstances will be "like."<sup>52</sup>

Some States have also inserted more explicit reservations and limitations into their treaties to preserve their rights to take measures that will intentionally or foreseeably discriminate against foreign investors/investments. Recognizing the potential impacts of the national treatment provision on domestic policy goals, for example, some States have included in their agreements exceptions to that obligation. Those exceptions may be designed to protect particular aims and objectives (e.g., exceptions allowing more favourable treatment of indigenous or other minority groups), sectors or sub-sectors (e.g., provision of security services), and/or particular measures (e.g., exceptions for "non-conforming measures" existing at the time the agreement enters into force). The exceptions may also be designed to account for practical realities, such as the difficulty of ensuring sub-national political entities act consistently with the agreement. Thus, some provisions carve out measures taken by local governments from the national treatment obligation.

<sup>48</sup> See, e.g., the pending dispute in *Pacific Rim Cayman v. El Salvador*, ICSID Case No. ARB/09/12; *Methanex Corp. v. United States*, Final Award, August 3, 2005; *S.D. Myers v. Canada*, Partial Award, November 13, 2000.

<sup>49</sup> See, e.g., *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Arb. Case No. ARB/05/8, Award, Sept. 11, 2007, paras. 392-396 (looking at environmental, cultural, economic and legal aspects of the investments when determining whether investors were in "like circumstances").

<sup>50</sup> *Id.*

<sup>51</sup> See, e.g., 2004 U.S. Model BIT, art 4(1) ("Each Party shall accord to investors of the other Party treatment no less favourable than that it accords, in *like circumstances*, to investors of any non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory") (emphasis added).

<sup>52</sup> The COMESA investment agreement's article on national treatment contains useful language clarifying when investors and investments are in "like circumstances." These include circumstances relating to (a) effects on third persons and the local community; (b) effects on the environment; (c) the sector concerned; (d) the aim of the measure; (e) the regulatory process normally applicable; and (f) other factors directly relevant to the measure and investment/investor concerned (Art. 17(2)).

Similarly, States have inserted reservations and limitations shielding their rights to discriminate between foreign investors/investments from different States. Illustrating this, agreements commonly state the MFN provision does not allow foreign investors to benefit from preferential treatment granted to investors of third States pursuant to economic integration agreements such free trade areas, customs unions, common markets, or economic communities.<sup>53</sup>

Finally, countries may respond to these issues by deciding to entirely exclude the MFN or national treatment obligations from their treaties. The investment chapters in the India–Korea Comprehensive Economic Partnership Agreement (CEPA)<sup>54</sup> and India-Singapore CEPA,<sup>55</sup> for example, completely omit the MFN provision.

### *MFN-Specific Issues*

In addition to those two sets of concerns that the MFN and national treatment obligations both raise, each also independently triggers its own set of issues. Many raised by the national treatment obligation relate to matters of market access and the extent to which it grants investors “pre-establishment” rights. That topic is addressed below in section 2.3.2. Issues raised separately by the MFN provision arise from the extent it may be effectively ratcheting-up investors’ treaty protections and States’ treaty obligations by allowing investors to “import” commitments from other agreements to which the host State is a party.<sup>56</sup> In practical terms, this means that a hard-fought negotiation of a BIT, or a change in treaty practice and policy, could be made largely irrelevant because an investor could rely on the more favourable provision in another treaty, thereby bypassing the provisions of the applicable BIT. Some case law and certain academics are of the view that not only substantive guarantees could be imported, but also procedural issues, such as the provisions on investor-State dispute settlement.<sup>57</sup>

More specifically, some decisions to date in fact suggest that an investor whose rights against the host State are governed by one BIT with an MFN provision (the “basic BIT”) can search the universe of BITs (or potentially other treaties) the host State is party to, identify more favourable clauses and protections in those other agreements, and use the MFN provision to replace or supplement the protections the basic treaty alone would have provided the investor. Disconcertingly, the decisions also suggest that when “importing” these enhanced rights, the investors can unhinge them from their associated limitations and exceptions. This arguably enables investors to create a “super treaty” of strong protections that no country has been actually willing to conclude, but that the investors can craft by piecing together a patchwork of only the most favourable provisions of existing agreements.

Not only does this selective “importation” threaten to alter the balances countries intended to strike in their treaty negotiations; it also can prevent countries from being able to reform and revise their treaty practice. If, for instance, a country decided in 2010 to narrow or omit umbrella clauses from its treaties going forward, investors covered under

<sup>53</sup> See, e.g., China-Peru FTA, art. 131(4).

<sup>54</sup> This agreement, which entered into effect January 1, 2010, is available at <http://commerce.nic.in/trade/INDIA%20KOREA%20CEPA%202009.pdf>.

<sup>55</sup> Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore, ch. 6, June 29, 2005 (entered into force Aug. 1, 2005). Taking the place of an MFN provision, the agreement states in Article 6.17(1), “Review of Commitments.”

If, after this Agreement enters into force, a Party enters into any agreement on investment with a non-Party, it shall give consideration to a request by the other Party for the incorporation herein of treatment no less favourable than that provided under the aforesaid agreement. Any such incorporation should maintain the overall balance of commitments undertaken by each Party under this Agreement.

<sup>56</sup> See, e.g., *Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, Jan. 25, 2000.

<sup>57</sup> See, e.g., *Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, Jan. 25, 2000; *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, Feb. 3, 2004.

those post-2010 treaties could seek to use their MFN provisions to import umbrella clause protections contained in pre-2010 BITs.

As was noted above, to avoid such uses of the MFN provision, one possible approach is to avoid the clause altogether. Another possible strategy is to include the provision, but then specify relevant exceptions or limitations to it. Examples of limitations used in existing treaties to prevent unintended “ratcheting-up” of the agreements include those indicating that the MFN provision cannot be used to (a) import more favourable provisions relating to certain rights and obligations such as dispute settlement procedures,<sup>58</sup> (b) import rights from specific agreements,<sup>59</sup> or (c) import protections from treaties concluded before a certain date.<sup>60</sup>

### *The MFN and National Treatment Obligations in the Austrian Model BIT*

The Austrian Model BIT contains a provision providing both MFN and national treatment protection for investors and investments after the investments have been established in the host country. It states in Article 3(3):

Each Contracting Party shall accord to investors of the other Contracting Party and to their investments or returns treatment no less favourable than that it accords to its own investors and their investments or to investors of any third country and their investments or returns with respect to the management, operation, maintenance, use, enjoyment, sale and liquidation as well as dispute settlement of their investments or returns, whichever is more favourable to the investor.

With respect to the issue of distinguishing between investors/investments for reasons *other than* their nationality, the text does not include “like circumstances” language. As noted above, tribunals’ decisions to date indicate that the absence of this language is not necessarily fatal for the contracting States’ rights to differentiate between investors and investments based on legitimate policy grounds. Nevertheless, the model’s failure to include it arguably represents a missed opportunity to clarify the issue.

The Model BIT does set forth three exceptions to the MFN and national treatment obligations (as well as other treaty provisions). These exceptions state that the obligations should not be interpreted:

- a. as to prevent a Contracting Party from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security; or
- b. as to prevent a Contracting Party from fulfilling its obligations as a member of an economic integration agreement such as a free trade area, customs union, common market, economic community, monetary union, e.g. the European Union, or as to oblige a Contracting Party to extend to the investors of the other Contracting Party and to their investments or returns the present or future benefit of any treatment, preference or privilege by virtue of its membership in such an agreement or any multilateral agreement on investment; or
- c. as to oblige a Contracting Party to extend to the investors of the other Contracting Party and to their investments or returns the present or future benefit of any treatment, preference or privilege resulting from obligations of a Contracting Party under an international agreement, international arrangement or domestic legislation regarding taxation.

<sup>58</sup> See, e.g., Colombia-Switzerland BIT, Ad Art. 4, para. 2 (signed May 17, 2006); Free Trade Agreement between New Zealand and China, Ch. 11, art 139 (signed Apr. 7, 2008; entered into force Oct. 1, 2008)

<sup>59</sup> See Canadian Model FIPA, Art. 9(3) (“Article 4 [MFN] shall not apply to treatment accorded by a Party pursuant to agreements, or with respect to sectors, set out in its schedule to Annex III.”)

<sup>60</sup> See *id.*

Thus, in certain circumstances a host government will be able to discriminate against foreign investors/investments. Such circumstances could include three types of measures or actions of the host government: first, actions to fulfill its obligations under the UN Charter: this could ensure that government measures taken to protect affected communities from actions of investors cannot be construed to amount to a violation of the investment treaty—even if this involved differential, more favourable treatment of investors.

Second, the Austrian model provides an exception with respect to certain obligations under economic agreements, including the European Union. Third, there is an exception with respect to preferences granted by virtue of membership of economic integration agreements or of a multilateral agreement on investment.” This exception means that privileges emanating from other BITs may be imported in case of a dispute. If the investment treaty is integrated in an FTA, the situation may be different since there is a reference to “economic integration agreements such as free trade areas.” Fourth, the Model BIT provides an exception for privileges accorded under international agreements regarding taxation, as well as under domestic tax legislation.

### **Market Access**

A growing number of investment treaties provide foreign investors/investments rights to enter the host State market. This is primarily done through the national treatment obligation and the MFN treatment obligation. For example, the U.S. Model BIT stipulates:

Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the *establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory* [emphasis added].

These provisions mean that if and to the extent a sector is open to national investors or investors from one foreign country, it must also be opened to foreign investors from other States. These clauses restrict host countries’ traditionally held sovereign rights to limit entry of foreign investors/investments. Even if a country is open to foreign investment, the provisions can prevent the host country from applying screening mechanisms to determine when and under what conditions foreign investors may enter and invest in the country.

Countries, however, may have a wide set of reasons for wanting to maintain control over entry and establishment of foreign investors/investments. Consequently, some countries that extend their national treatment and MFN provisions to the pre-establishment phase limit them in certain ways, including by narrowing their scope through positive or negative lists of sectors covered or excluded.

### **Market Access and the Austrian Model BIT**

European investment treaty models, like the Austrian Model BIT, typically do not extend their national treatment or MFN provisions to the pre-establishment phase. This is primarily because, until today, market access issues were dealt with at the Community, rather than the member State level. Accordingly, in contrast to the language from the U.S. Model BIT quoted above, which accords national and MFN treatment to investors with respect to the “establishment, acquisition, [and] expansion” of their investment, the Austrian Model BIT only extends those protections against discrimination to investors and their investments with respect to post-establishment activities like the management and operation of the investment (Art. 3(3)).



It is, however, arguable that the Austrian Model BIT provides some degree of market access rights. This is due to the operation of three provisions: First, pursuant to the “Definitions” article of the Model BIT, an individual or entity need not have already made an investment in the host country in order to be considered an “investor” (Art. 1). Second, Article 2(1) of the text states that “[e]ach Contracting Party shall, according to its laws and regulations, promote and admit investments by investors of the other Contracting Party.” And third, Article 13 regarding dispute settlement explains that it “applies to disputes between a Contracting Party and an investor of the other Contracting Party concerning an alleged breach of an obligation of the former under this Agreement which causes loss or damage to the investor or his investment.”

Combining these three provisions, if a State were to reject a foreign investor’s efforts to establish an investment in the host country, it may be possible for the rejected investor to initiate an investor-State action arguing that the State in which it sought to invest violated Article 2(1) of the agreement by not admitting its investment in accordance with the State’s laws and regulations, and that it suffered damages in the form of lost income or lost opportunities as a result. The investor may therefore be able to challenge the host State’s decision through international arbitration instead of or in addition to challenging the decision before the host State’s own courts or tribunals.

In sum, while provisions in the Austrian Model BIT could make compliance with existing host State laws and regulations “justiciable” under the agreement for admission of investments, it does not grant foreign investors rights of establishment in the host country. It can be argued that this approach represents a compromise position between States that are pushing for liberalization through their investment treaties, and States that want to maintain control over entry and establishment of foreign investment. It maintains State flexibility and does not necessarily limit future policy space because the host government remains free to regulate. At the same time, it provides potential investors with a guarantee of sorts to be treated under the rule of law.

## Expropriation

Most investment treaties allow States to expropriate an investment only under certain circumstances and with payment of compensation. Generally, they provide that host States may not expropriate investments unless the expropriation is (1) required for a public purpose; (2) effected on a non-discriminatory basis and (3) in accordance with due process; and (4) is accompanied by prompt payment of adequate and effective compensation. Most treaties also specify that those rules apply to both direct expropriation (e.g., outright seizure of assets) and indirect expropriation (e.g., regulatory measures that harm, affect or interfere with the investment to such a degree that they effectively take the investors’ property even if the investors still technically retain ownership).

In investor-State disputes, investors have challenged a wide range of government actions and measures, ranging from taxation to environmental regulation, arguing that they amounted to indirect expropriations, and therefore required payment of compensation. Tribunals have approached the assessment of indirect expropriation in different ways. Some tribunals, like that in *Santa Elena v. Costa Rica*,<sup>61</sup> have applied the so-called “sole-effects” test. Under that test, tribunals look only at the effect of the measure on the investment, deeming irrelevant the intent of host States. Other tribunals, such as that in *Methanex v. United States*, have looked at the intent of the government and nature of the challenged measure(s). They have explained that non-discriminatory measures enacted in accordance with due process and in order to further public purposes (e.g., protection of the environment and human health) are not expropriatory measures in the first place and therefore do not require the government to pay any compensation for losses that might be suffered

<sup>61</sup> *Compañía del Desarrollo de Santa Elena S.A. v. The Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award, Feb. 17, 2000.



by the investor as a consequence.<sup>62</sup> Still other tribunals, including that in *Tecmed v. Mexico*,<sup>63</sup> have suggested that the importance and legitimacy of regulatory measures needed to be weighed against effects on the investment.

Due to the varying approaches that tribunals have taken, it is extremely difficult for host States and investors to accurately predict whether an applicable investment treaty will require compensation for impacts regulatory measures have on foreign investors. This legal uncertainty and the potentially far-reaching consequences on host governments' ability to enact environmental, social welfare or other important laws and regulations without having to "buy out" foreign investors has led some countries such as the United States to explicitly "carve out" bona fide regulatory measures (e.g., measures enacted for a legitimate purpose and not as a disguised attempt to harm the investor/investment) from the definition of "expropriations" in their investment treaties.<sup>64</sup> Similarly, ASEAN's 2009 Comprehensive Investment Agreement explicitly rules out the sole effect doctrine. It declares that "the fact that an action ... has an adverse effect on the economic value of an investment, standing alone, does not establish that expropriation has occurred," and continues:

Non-discriminatory measures of a Member State that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute an expropriation.<sup>65</sup>

These carve-outs and specifications help provide host States and investors certainty regarding governments' regulatory rights.

#### *Expropriation Provisions in the Austrian Model BIT*

The Austrian Model BIT contains an expropriation provision, and also includes language clarifying and narrowing the meaning of that obligation. It states:

Except in rare circumstances, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Contracting Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation (Art. 7(4)).

This formulation is the same as used in the Canadian FIPA. The reference to "except in rare circumstances" does bring back a certain amount of uncertainty, but the example added narrows this uncertainty down again, by referring to measures that cannot reasonably be viewed as having been adopted and applied in good faith.

This additional language in the Austrian model is an important departure from its pre-existing language. Indeed, prior to the recently concluded BITs with Kosovo and Tajikistan, such language was not included in Austria's BIT. The BIT with Kazakhstan, however, does not include this additional language. This could be very problematic, as this could be seen by a tribunal as a conscious rejection of an interpretation along the lines of its model agreement and other recent investment treaties.

<sup>62</sup> See, e.g., *Methanex v. United States*, Award, Aug. 3, 2005.

<sup>63</sup> *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003.

<sup>64</sup> See, e.g., U.S.-Uruguay BIT, Art. 6 & Annex B(4)(b) ("Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations.").

<sup>65</sup> Annex 2, Article 4, ASEAN Comprehensive Investment Agreement.

## Fair and Equitable Treatment

Many investment treaties oblige host States to accord FET to investors. The FET obligation has emerged to be a prominent feature in investors' actions against host States and has in numerous cases allowed investors to succeed where their expropriation, non-discrimination and other claims have failed. It has thus become a kind of "catch-all" clause. Host States have, for example, been found to violate it for a failure to act in a transparent manner in administrative decision making. Other violations have been found in the inconsistent actions of host State agencies vis-à-vis the investor, such as the encouragement and approval of the investment by one agency and the denial of the necessary zoning permits by another.

While these actions are surely not desirable, they are often issues that are resolved through domestic administrative or judicial proceedings that review government actions using particular levels of deference and providing avenues for judicial review and appeal. As referred to in the section on investor-State dispute settlement, however, treaty-based investor-State arbitration has allowed investors to challenge these government actions directly in investor-State arbitrations, where scrutiny of State conduct need not wait for domestic action to be final, review of the challenged conduct is often strict, and opportunities for judicial review and appeal of awards are severely limited, if not foreclosed. States therefore face significant challenges in defending themselves against investors' claims that they have violated their international law FET obligations and must pay investors damages not uncommonly reaching into the hundreds of millions of dollars.

An important element tribunals have considered in determining whether there was a violation of the fair and equitable treatment standard is the notion of the "legitimate expectations of the investor." As elaborated upon by the tribunal in *Tecmed v. Mexico*,<sup>66</sup> that standard requires the host State to provide to the investor "treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment."<sup>67</sup> The tribunal further stated:

The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.<sup>68</sup>

This interpretation imposes a very high burden on host States with respect to their treatment of foreign investors/ investments. Moreover, it is not an anomaly. Similarly high standards of conduct have also been described in other decisions. In *CMS v. Argentina*, for example, the tribunal stated that the FET obligation required host States to provide foreign investors a stable legal and business environment.<sup>69</sup> Similarly, in *Vivendi v. Argentina*, the tribunal stated that the FET obligation meant that the government could not "disparage [or] undercut a properly granted concession," and labelled that obligation a "'do no harm' standard."<sup>70</sup>

In order to avoid being judged by arbitral tribunals applying such unpredictable and overly stringent standards, States are increasingly taking certain precautionary measures. One is to avoid including the standard in the investment treaties. The investment chapter of the 2005 trade agreement between Singapore and India, for instance, omits the FET clause.

<sup>66</sup> *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States*, ICSID Arb. Case No. ARB(AF)/00/2.

<sup>67</sup> *Id.*, para. 154.

<sup>68</sup> *Id.*

<sup>69</sup> *CMS Gas Transmission Co. v. Argentina*, ICSID Case No. ARB/01/8, Award, Sept. 1, 2006, paras. 266-281.

<sup>70</sup> *Vivendi v. Argentina*, Award in Resubmitted Proceeding, ICSID Case No. ARB/97/3, August 20, 2007, para. 7.4.39)

Another approach—and one that has been adopted by a number of countries in their BITs and investment chapters of their FTAs—is to draft the FET standard or craft an interpretative note indicating that the FET requirement is synonymous with the customary international law minimum standard of treatment.<sup>71</sup> As it is commonly described, the minimum standard of treatment sets a basic floor below which States may not go. Even if they treat their own citizens worse than permitted by that minimum standard or floor, that fact does not excuse similar treatment of foreigners. States must treat foreigners equal to or better than required by that minimum standard.

What the minimum standard of treatment actually requires in practice is an unsettled matter. Some tribunals have determined that it bars conduct that is outrageous or egregious.<sup>72</sup> Others have concluded that the conduct required is somewhat more exacting. Nevertheless, by equating the FET obligation to the minimum standard of treatment of aliens under customary international law, States aim to ground that treaty obligation. The concern is that, if left untied, the standard can and has been interpreted as requiring States to comply with a higher, more demanding standard of conduct regarding their treatment of foreign investors/investments.

### *FET in the Austrian Model BIT*

The Austrian Model BIT includes an FET provision, but does not contain a reference to the customary international law minimum standard of treatment. This approach is consistent with Austria's practice in its previously concluded BITs, and is continued in the three 2010 agreements with Kosovo, Tajikistan, and Kazakhstan.

As noted above, arbitral tribunals tend to interpret FET provisions explicitly linked to the minimum standard of treatment differently from provisions not so linked. Austria's formal adoption of this "free-standing" obligation may therefore be interpreted by tribunals as a purposeful decision to commit to that higher standard. This, in turn, can expose the signatory host States to potentially significant liability for actions and inactions of the inner workings of their domestic political, administrative and legal machinery.

## Transfers

Provisions requiring host countries to guarantee the free transfer of payments related to investments are nearly universal in investment treaties as a key protection for foreign investors.

While early versions of these provisions in investment treaties required the host country to guarantee free transfers in and out of its territory with little or no exceptions, more modern agreements have refined the transfer articles so that they are not interpreted to prevent States from giving effect to or complying with certain legitimate national and international laws and policies. Exceptions found in existing agreements include those allowing host countries to restrict transfers in accordance with bankruptcy laws, in order to secure payment of civil or criminal fines, or to protect the stability of domestic currency. Indeed, the importance of such exceptions is especially apparent in light of the ongoing global financial crisis as provisions in investment treaties guaranteeing investors and investments transfer rights might unduly restrict governments' efforts to prevent, respond to and mitigate such serious economic meltdowns (or might expose governments to liability for taking those actions).<sup>73</sup>

<sup>71</sup> See, e.g., CAFTA, Art. 10.5(1); India-Korea FTA, Art. 10.4(1).

<sup>72</sup> See, e.g., *Glamis Gold v. United States*, Final Award, June 8, 2009.

<sup>73</sup> See, e.g., Kevin P. Gallagher, Reforming United States Trade and Investment Treaties for Financial Stability: The Case of Capital Controls. *Investment Treaty News*, Apr. 5, 2011, available at <http://www.iisd.org/itn/2011/04/05/reforming-united-states-trade-and-investment-treaties-for-financial-stability-the-case-of-capital-controls/>.

Many European States have concluded investment treaties guaranteeing free transfers with no exceptions. The European Court of Justice, however, has decided that this must change. In 2009 it ruled against Sweden, Austria and Finland for including free transfer of capital provisions in their BITs, holding that the provisions cannot be reconciled with European law.<sup>74</sup> More specifically, the Court determined that the BITs' provisions guaranteeing unrestricted transfers of capital were incompatible with several articles of the EC Treaty, which grant the Council the ability to restrict transfers of capital between EU member States and third States in certain circumstances, such as to take safeguard measures against serious economic difficulties, or in accordance with foreign and security policy. The Court concluded that these countries had to renegotiate all their BITs containing non-compliant provisions to render them consistent with EU law. This ruling effectively means that all other EU member States with similar provisions will likewise have to renegotiate their BITs.

### *The Austrian Model BIT on Transfers*

Formally adopting the approach taken in many of its BITs concluded since 2000, the Austrian Model BIT includes a free transfer of payment article that reflects the more modern approach of including some important flexibilities (Art. 9). It allows parties to restrict transfers pursuant to bankruptcy laws and regulations; to protect the rights of creditors; to regulate securities, futures, options and derivatives; to require records or reports of transfers; to prevent money laundering and terrorist financing; and to comply with civil and criminal proceedings and judgments (Art. 9(4)). The article contains no explicit flexibility to restrict transfers for balance of payments considerations or other situations of economic emergency, however.

The article on free transfers also provides that if an exception is taken for any of the permitted grounds, it must be applied in an "equitable, non-discriminatory and good faith" manner (Art. 9(4)). This provision would seem adequate to guard against pretextual, unfair, or abusive use of the exceptions. Yet the article then adds that measures restricting transfers of capital "shall not be used as a means of avoiding the Contracting Party's commitments or obligations under this Agreement" (Art. 9(4)). It is unclear that this second provision provides any protection against improper use of the exceptions that is not already provided by the requirement that measures be applied in an "equitable, non-discriminatory and good faith manner." Arguably, the role of this second limitation on use of the exceptions may be to strip the exceptions of their utility.

In addition to these exceptions that are specific to the transfer obligation, the Austrian Model BIT limits the transfer obligation with three general exceptions clauses applicable to the agreement as a whole (These exceptions are referred to above in the discussion of the non-discrimination obligation, and are also addressed separately below). One of those three, the general exception that protects signatory States' rights to fulfil their "obligations as a member of an economic integration agreement such as ... the European Union," appears designed to resolve the conflict between BITs and the EC Treaty identified by the European Court of Justice. Yet importantly, although this provision may enable *European* member States such as Austria to restrict transfers in circumstances provided for under EU law (e.g., to take safeguard measures against serious economic difficulties), it does not provide partner States who are not members of the EU with the same flexibility to restrict transfers for balance of payments considerations or other situations of economic emergency.

<sup>74</sup> Case C-205/06, *Commission v. Austria* [2009] ECR I-1301; Case C-249/06, *Commission v. Sweden* [2009] ECR I-1335; Case C-118/07, *Commission v. Finland*, of November 19, 2009; available at <http://curia.europa.eu/jurisp/cgi-bin/form.pl?lang=en>.

## Provisions Specifically Addressing the Environment, Labour, and Sustainable Development

A growing number of agreements now contain provisions proclaiming the general principle that investment agreements and the foreign investments they protect should promote sustainable development; specifying that governments are not to relax and/or fail to enforce environmental and labour measures as an incentive to encourage investment; affirming that States have the right to implement laws and regulations aiming at environmental and labour protection; clarifying that the investment treaty does not excuse compliance with pre-existing international commitments to protect the environment and labour rights; and directing the contracting parties to cooperate in enhancing their efforts in these policy areas. These types of provisions are contained in preambular or introductory language, separate “side agreements,” and/or within the main text of the treaty.

### Provisions in the Preamble

The FTA signed by the United States and Colombia in 2006, for instance, states in the preamble that the parties should implement the “[a]greement in a manner ... [that] promote[s] sustainable development.”<sup>75</sup> Although such language in an agreement’s preamble will generally not impose any direct obligations on the contracting parties, nor narrow any obligations by way of exceptions or carve-outs, it has been shown to play an important role in the interpretation of treaty language. In investor-State arbitrations, tribunals have relied on provisions in the investment treaty’s preamble when interpreting the practical significance of States’ specific obligations under the agreement. In a number of cases, the preamble has been used by tribunals to tilt the impact of the agreement in favour of the foreign investors, giving a wide meaning to their rights and States’ corresponding obligations.<sup>76</sup> If provisions are included in the preamble that emphasize that investment should be used as a tool to further sustainable development, tribunals’ interpretations of the agreements may better ensure that the benefits of investment treaties for host countries do not outweigh their costs.

### Avoiding a Race to the Bottom

An increasing number of investment treaties now include provisions on the environment and/or labour. A frequent clause used is aimed at avoiding a “race to the bottom.” It usually reads as or akin to the following: “It is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor.”<sup>77</sup>

<sup>75</sup> U.S.-Colombia FTA (signed Nov. 22, 2006, not yet entered into force). See also, Canada-Colombia FTA (signed Nov. 21, 2008, not yet entered into force) (stating in the preamble that the countries resolve to “promote sustainable development”).

<sup>76</sup> See, e.g., *SGS v. Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction, January 24, 2004; *CMS v. Argentina*, ICSID Case No. ARB/01/8, Award, Sept. 1, 2006.

<sup>77</sup> See, e.g., Canada-Peru FTA, Ch. 10, Art. 809 (entered into force Aug. 1, 2009); Economic Partnership Agreement between the CARIFORUM States, of the One Part, and the European Community and its Member States, of the Other Part (signed Oct. 15, 2008) (considering, in the preamble, “the need to promote economic and social progress for their people in a manner consistent with sustainable development by respecting basic labour rights in line with the commitments they have under taken within the International Labour Organisation and by protecting the environment in line with the 2002 Johannesburg Declaration”). See, also e.g., Canada-Colombia FTA, Ch. 8, Art. 815; NAFTA, Ch. 11, Art. 1114(2); U.S.-Uruguay, arts. 12 & 13 (entered into force Nov. 1, 2006); Belgium-Luxembourg Economic Union-Colombia Investment Treaty, arts. 7 & 8 (signed February 4, 2009); Belgium-Luxembourg Economic Union-Ethiopia Investment Treaty, arts. 5 & 6 (signed 26 October 2006). These agreements also often include a mechanism for addressing and resolving issues where one state may be improperly encouraging investment. Canada-Peru FTA, Ch. 8, Art. 809. See also, NAFTA, Ch. 11, Art. 1114(2); U.S.-Uruguay BIT, arts. 12(1) & 13(1). Some FTAs Canada has concluded also contain an article titled “Corporate Social Responsibility” in their investment chapters. These articles state, in part, that the “Parties remind those enterprises” “operating within [their] territor[ies] or subject to [their] jurisdiction” of “the importance of incorporating ... corporate social responsibility standards” addressing “issues such as labour, the environment, human rights, community relations and anti-corruption” “in their internal policies.” See, e.g., Canada-Peru FTA, Ch. 8, Art. 810.

In addition to containing provisions discouraging States from weakening their environmental and labour standards in order to encourage investment, these articles or separate side agreements sometimes also contain provisions (1) strengthening the State parties' cooperation on promotion and protection of the environment and labour rights, and/or (2) allowing non-governmental organizations and other interested persons to raise allegations of violations of environmental commitments and labour laws.<sup>78</sup> The 2006 investment agreement between Belgium-Luxembourg and Ethiopia provides an example of the first type of provision. It states: "The Contracting Parties recognize that cooperation between them provides enhanced opportunities to improve environmental protection standards. Upon request by either Contracting Party, the other Contracting Party shall accept to hold expert consultations on any matter falling under the purpose of this Article."<sup>79</sup> The FTA between Colombia and the United States (which includes an investment chapter) provides an example of the latter type of provision, setting forth several procedures through which persons can file written submissions raising issues relating to contracting parties' implementation of their environmental commitments, and requiring responses to those submissions in appropriate cases.<sup>80</sup>

To date, these provisions have not played a major role in investor-State disputes, if invoked in the first place. Also, due to the limited experience, there is little evidence as to the effectiveness of the provisions providing for State-State consultations to address alleged "races to the bottom."<sup>81</sup> Additionally uncertain is what role provisions allowing the public to file complaints or make submissions have played. As these provisions are all relatively modern developments in treaty practice, it may take time for them to be understood and applied by States, investors and other stakeholders.

## Exceptions Clauses

An alternative or supplementary strategy to the two identified above (i.e., (1) incorporation of relevant language in the preamble, and (2) specific articles or side agreements on labour and the environment) is to include in the investment treaties exceptions that cover environmental and labour matters.

Notably, although general exceptions for environmental, labour and other policy considerations are a relatively common feature in agreements on trade in goods and services, they are curiously absent from a significant number of investment treaties. BITs, for the most part, have included only general exceptions that protect governments' rights to take measures for reasons of national security or "essential interests." These national security or "essential interest" exceptions have, however, figured prominently in many investor-State disputes and, in some of them, have successfully excused the host State from liability for measures taken.<sup>82</sup>

<sup>78</sup> These provisions are often not limited to the investment chapters of FTAs, but are applicable to both the trade and investment portions of the agreements and may be set forth in side agreements to the main text. See, e.g., U.S.-Peru FTA, Ch. 18.6 (entered into force Feb. 1, 2009); U.S.-Colombia FTA, Art. 18.6; Canada-Colombia FTA, Ch. 17, Art. 1703 and Agreement on the Environment between Canada and the Republic of Colombia (signed Nov. 21, 2008, not yet entered into force); New Zealand-China FTA, Art. 177 (entered into force Oct. 1, 2008).

<sup>79</sup> Art. 5(4).

<sup>80</sup> U.S.-Colombia FTA, Ch. 18, Arts. 18.7, 18.8 & 18.9.

<sup>81</sup> One recent example is the DR-CAFTA labor dispute resolution process initiated by the Office of the U.S. Trade Representative alleging that Guatemala has failed to effectively enforce Guatemalan labour laws regarding the right of association, the right of workers to organize and bargain collectively, and acceptable working conditions. This is the first labour case ever brought by the United States against a trade agreement partner. The United States brought this action after a coalition of union organizations filed a petition under the DR-CAFTA's complaint procedures, and consultations between the United States and Guatemala failed to resolve the issues. See: <http://www.ustr.gov/about-us/press-office/press-releases/2011/may/ustr-kirk-seeks-enforcement-labor-laws-guatemala> - and below.

<sup>82</sup> See, e.g., *Continental Casualty Co. v. Argentine Republic*, ICSID Case No. ARB/03/9, Award, Sept. 5, 2008; see also *Sempre Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on Annulment, June 29, 2010; *Enron Creditors Recovery Corp. and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Annulment, July 30, 2010.

As investment treaties have evolved and become more refined (likely in response to arbitral decisions and States' consequent concerns regarding their potentially broad exposure to liability under the agreements), a more comprehensive set of general exceptions or right to regulate clauses can increasingly be found in the texts.<sup>83</sup> One type of general exceptions clause used in investment treaties is based on GATT Article XX or GATS Article XIV.<sup>84</sup> The way these exceptions are transposed into investment treaties varies significantly from treaty to treaty. Some are formulated as "right to regulate" clauses, while others carry the heading "exceptions clauses." Their content, however, is basically the same.

An example can be found in Article 10 of the Canadian Model FIPA:

#### General Exceptions

1. *Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary:*
  - (a) *to protect human, animal or plant life or health;*
  - (b) *to ensure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement; or*
  - (c) *for the conservation of living or non-living exhaustible natural resources.*

Transposing language from trade law into investment law, however, does not always seem logical or effective for resolving possible tensions between investment protection and other legitimate policy goals. A number of problems and limitations with the Canadian language excerpted above illustrate this concern. For one, it is not clear whether the exceptions would offer any practical benefit for a State in relation to an expropriation claim. This is because investment treaties' expropriations provisions generally do not prevent States from adopting or enforcing measures that expropriate investors' property per se. Rather, they state that such expropriations must be lawfully done; and, importantly, they specify that, to be lawful, the expropriation must be accompanied by prompt payment of compensation (among other criteria). Thus, provisions simply stating that environmental and other public interest measures may be adopted and enforced may not protect States from claims that they nevertheless must pay compensation. If States wish to ensure that certain types of measures are not expropriations, and thus not compensable, they will have to say this explicitly in the provision relating to expropriation, as does the Austria Model BIT.

Another limitation in the Canadian exceptions clause is that it subjects all exceptions to the so-called "necessity test." GATT Article XX provides an exception for measures relating to the conservation of exhaustible natural resources (used most often in environmental protection cases), rather than measures *necessary for* the conservation of exhaustible

<sup>83</sup> In addition to the excerpts cited below and in associated footnotes, see also, e.g., Japan-Peru BIT, Art. 19(1).

<sup>84</sup> See GATT, Article XX: General Exceptions (1994) ("Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures:

... (b) necessary to protect human, animal or plant life or health; ... (e) relating to the products of prison labour; ... (f) imposed for the protection of national treasures of artistic, historic or archaeological value; ... (g) relating to the conservation of exhaustible natural resources; ....').

Unlike GATT Article XX, GATS Article XIV does not contain an exemption for measures relating to the conservation of exhaustible natural resources.



natural resources. Arguably, the term “necessary” leads to a stricter test for the government invoking the environmental exception. Some treaties avoid this issue by not using the words “relating to” or “necessary” in their exceptions clauses. BITs stating, for example, that measures “designed and applied” for environmental and other identified policy goals stay away from those terms pregnant with meaning from decisions under the GATT.<sup>85</sup>

To date we have no publicly available investment treaty decision dealing with environmental exceptions/right to regulate clauses. Clearly, countries integrating such clauses into their investment treaties are trying to address a shortcoming in the current investment treaty model. However, it is unclear to what extent they can serve as effective safeguards for legitimate environmental or other valid policy measures. Nevertheless, though somewhat unpredictable, these types of clauses will likely be more meaningful for host governments than similar clauses that allow States to take environmental measures but additionally require that these be “consistent with the agreement,” a condition sometimes added that arguably nullifies the protections provided by the exception.

### The Austrian Model BIT, Sustainable Development, and Other Policy Goals

The Austrian Model BIT contains provisions on sustainable development, and environmental, human rights and labour concerns. It therefore forms part of the current trend in investment treaties to defuse possible tensions between, on the one hand, investment promotion and protection and, on the other, furtherance of those fundamental policy goals. Nevertheless, it may provide inadequate assurance for host States that the measures they take in furtherance of their sustainable development aims will not trigger claims and/or liability under the treaty.

More specifically, the Model BIT contains a number of provisions in the preamble linking the agreement to the notion that it should be compatible with and promote development that is sustainable and consistent with protection of human rights and the environment. The Austrian Model BIT also contains two articles specifically addressed to the issues of labour and the environment. Article 4 (“Investment and Environment”) states:

The Contracting Parties recognise that it is inappropriate to encourage an investment by weakening domestic environmental laws. If a Contracting Party considers that the other Contracting Party has offered such an encouragement, it may request consultations with the other Contracting Party and the two Contracting Parties shall consult with a view to avoiding any such encouragement.

Article 5 (“Investment and Labour”) similarly provides:

The Contracting Parties recognise that it is inappropriate to encourage an investment by weakening domestic labour laws.<sup>86</sup>

Article 5 goes on to define “labour laws” as:

statutes or regulations, that are directly related to the following internationally recognized labour rights:

<sup>85</sup> See, e.g., COMESA Investment Agreement, Art. 22(1)(b) & (c) (adopted May 2007 at the Twelfth Summit of COMESA Authority of Heads of State and Government).

<sup>86</sup> Art. 5(1).



- a. the right of association;
- b. the right to organise and to bargain collectively;
- c. a prohibition on the use of any form of forced or compulsory labour;
- d. labour protections for children and young people, including a minimum age for the employment of children and the prohibition and elimination of the worst forms of child labour[;]
- e. acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health[; and]
- f. elimination of discrimination in employment and occupation.<sup>87</sup>

These provisions affirm the important, yet relatively uncontroversial, notion that countries should not engage in “races to the bottom” by weakening their environmental and labour standards in order to attract investment; they also indicate that if one contracting State views the other contracting State as violating that principle, it can initiate State-State consultations regarding the matter.

While representing progress, there are some aspects of these provisions that are problematic. For one, while the environment article guards against weakening of “laws,” it provides no protection against the relaxation of environment standards that may occur in manners that are often less obvious or transparent, such as through weak enforcement or implementation of the laws, and other non-legislative actions like adoption of administrative regulations or policy decisions. Similarly, the labour article discourages weakening of “statutes or regulations,” but does not address those other measures through which standards may be diluted or nullified.

A second issue is that even though the two articles indicate disapproval with the idea of *weakening* standards in order to attract investment, they do not provide support for the crucial notion that efforts taken by States to *improve* their environmental and labour standards will be protected, even if they negatively impact foreign investors/investments.

A third problem is that the agreement does not include any mechanism through which interested or affected citizens may be able to bring to the contracting parties’ attention violations or abuses by foreign investors/investments.

Finally, the Austrian Model BIT does not contain any general exceptions designed to affirm and protect host States’ abilities to take measures to further such policy goals as protection of the environment and/or labour rights. The article on expropriation does contain a provision clarifying that, “[e]xcept in rare circumstances, ... non-discriminatory measures of a Contracting Party that are designed and applied to protect legitimate public welfare objectives, such as the health, safety and the environment, do not constitute an indirect expropriation” (Art. 7(4)). However, this addition in the expropriation article does not shield a country against claims under other clauses, which are not subject to any carve-out or exception. Consequently, the Austrian Model BIT’s lack of general exceptions for environmental, labour and public welfare measures may leave host States’ measures in these areas unnecessarily and undesirably exposed, especially with respect to the MFN and the national treatment clauses. Without an exceptions clause, flexibility would have to be addressed in the context of the MFN and the national treatment clauses themselves: these would need to guarantee and allow sufficient space for the government to distinguish varying situations (see discussion above on non-discrimination standards and the concept of “like circumstances”).

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<sup>87</sup> Art. 5(2)

## Investor–State Dispute Settlement

Most investment treaties now include provisions establishing a mechanism for settling disputes between investors and host States. These provisions allow investors to challenge the host State under the treaty before international tribunals. This is perhaps the single most important element of investment treaties, as these provisions mark the difference from other economic treaties. While the WTO, for instance, allows one State party to challenge another State party for violation of a WTO treaty, the WTO does not allow affected exporters or other private parties to bring a claim directly to the WTO dispute settlement body. By contrast, investment treaties do just that: they allow investors to challenge host States directly in international tribunals. Moreover, unlike human rights instruments, which also often allow private parties to bring claims against governments, investment treaties typically do not require the prior exhaustion of local remedies. An investor can therefore circumvent domestic courts altogether, bringing its claims against the host government directly to an international tribunal.

Supposedly as a response to an increase of investor–State cases and also a better understanding of the investor–State process, countries are taking new approaches in designing dispute settlement provisions in investment treaties. For example, some countries are now excluding disputes regarding particular host State rights and obligations from investor–State dispute settlement.<sup>88</sup> Others are indicating in their treaties that the State parties, not tribunals, have the exclusive or first right to resolve particular aspects of disputes between investors and States.<sup>89</sup> Still others are turning away from the investment arbitration system. The Australia–U.S. BIT, for instance, does not provide for that remedy. Australia has also recently decided not to include the remedy in its future investment treaties with other States. In April 2011, the Gillard Government issued a trade policy statement declaring, in part:

In the past, Australian Governments have sought the inclusion of investor–state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice. If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries.<sup>90</sup>

Several countries are also addressing procedural problems, such as the lack of transparency and arbitrator conflicts of interest.

The Austrian Model BIT does little to address some of the concerns that other countries have addressed. The following sections look at various approaches and innovations that countries have introduced to design and improve dispute settlement and notes how the Austrian Model BIT addresses each of the issues raised.

<sup>88</sup> See, e.g., Canada–Croatia BIT, Annex I(VI)(1) (“Decisions of a Contracting Party as to whether or not to permit establishment of a new business enterprise, or acquisition of an existing business enterprise or a share of such enterprise, by investors or prospective investors of the other Contracting Party shall not be subject to dispute settlement under Article XII of this Agreement.”).

<sup>89</sup> See, e.g., Japan–Peru FTA, art. 170; Canada–Croatia BIT, Annex I(VI)(2).

<sup>90</sup> Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity (April 2011), available at <http://www.dfat.gov.au/publications/trade/trading-our-way-to-more-jobs-and-prosperity.html#investor-state>.

## Exhaustion of Remedies, Waiting Periods, “Fork-in-the-Road” Provisions, and Limitations Periods

### *Exhaustion of Domestic Remedies*

In line with the commonly used approach in public international law, including human rights law, a few investment treaties, such as the Southern African Development Community’s Protocol on Finance and Investment (SADC FIP) include explicit requirements that investors exhaust their domestic remedies before initiating investor–State arbitration.

<sup>91</sup> A few treaties, while not requiring the exhaustion of all local remedies, do nevertheless require the exhaustion of administrative remedies.<sup>92</sup> By making exhaustion of remedies a prerequisite to the filing of an investment arbitration claim, countries promote the use of and reliance on domestic courts and administrative bodies, which can help develop a strong domestic rule of law. Further, ensuring that claims first funnel through courts and administrative bodies limits claims to only those based on host governments’ final actions and determinations (as opposed to mere policy statements or preliminary decisions).

Unless the governing treaty contains a requirement that investors exhaust their domestic remedies before bringing their claims, tribunals have commonly determined that no such requirement exists, allowing investors who are challenging the government’s conduct to bypass normal channels of administrative or judicial review.<sup>93</sup>

The Austrian Model BIT explicitly renounces the requirement that the investor should exhaust internal administrative or judicial remedies before initiating an arbitration claim (Art. 15(2)).

### *Waiting Periods and Mandatory Negotiations*

Some agreements, in addition to or instead of an exhaustion of remedies clause, contain mandatory waiting periods, consultations and/or negotiations. These can limit the number of claims filed against host States by facilitating the informal resolution of disputes. A number of agreements with these clauses, such as the 2009 China–Switzerland BIT and 2001 Canada–Croatia BIT, require investors to wait six months before bringing their claims to arbitration, providing a “cooling off” period during which time the parties can attempt to find a solution regarding the dispute.

Despite the inclusion of such provisions in the agreements, a number of arbitral tribunals have interpreted these provisions in ways that have watered down or effectively eliminated their impact. A number of tribunals, such as the tribunals in *Biwater v. Tanzania*,<sup>94</sup> *SGS v. Pakistan*<sup>95</sup> and *Occidental v. Ecuador*,<sup>96</sup> have, for instance, allowed investors to bring claims notwithstanding the respondent government’s objections that the mandatory waiting period had not yet expired. In order to ensure these “cooling off” periods are enforced, countries may wish to clearly state in their

<sup>91</sup> Art. 28.

<sup>92</sup> See, e.g., China–Switzerland BIT, Protocol, Ad Art. 11, para. 2 (“The People’s Republic of China, when acting as a Contracting Party involved in a dispute, may require the investor concerned to exhaust the domestic administrative review procedure specified by the laws and regulations of the People’s Republic of China before submission of the dispute to the arbitration procedures...”).

<sup>93</sup> See, e.g., *Helnan International Hotels v. Egypt*, Decision on Annulment, ICSID Case No. ARB/05/19, June 14, 2010, paras. 46–57. Some decisions that have concluded there is no obligation to exhaust domestic remedies have done so based on Article 26 of the ICSID Convention. That article states, “Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.” Absent such an explicit requirement in the applicable investment treaty, ICSID tribunals have been generally unwilling to imply that one exists.

<sup>94</sup> Award, July 2008.

<sup>95</sup> Decision on Jurisdiction, Sept. 2008.

<sup>96</sup> Decision on Jurisdiction, Sept. 2008.

investment treaties that compliance with the designated waiting period is a necessary prerequisite that must be satisfied in order for tribunals to take jurisdiction over disputes.

These clauses have also been ignored when investors used the MFN clause to claim that investors using other investment treaties did not have to respect similar waiting periods.

The Model BIT states that disputes shall “if possible, be settled by negotiation or consultation,” but only requires that the investor pursue this path for 60 days before it may formally bring an arbitration proceeding against the State. It is questionable that this short period of time is sufficient for any actual resolution to be achieved.

### *“Fork-in-the-Road” Provisions*

Some agreements contain “fork-in-the-road” clauses, stating that investors have the choice of bringing their claims before domestic courts or to an international tribunal, but that they may not pursue both avenues. These “fork-in-the-road” provisions can help prevent host States from having to concurrently litigate the same or similar issues in different forums, can prevent investors from taking “multiple bites at the apple,” and can prevent issuance of inconsistent judgments relating to the same set of facts. “Fork-in-the-road” clauses cannot be logically combined with exhaustion of domestic remedies clauses.

Adopting a broad reading of their jurisdiction, a number of tribunals, including those in *CMS v. Argentina* and *Toto Construzioni Generali v. Lebanon*<sup>97</sup> have, however, stated that the governing treaties’ “fork-in-the-road” provisions did not prevent the investors from pursuing their investor-State treaty-based arbitrations at the same time as, or following initiation of, separate proceedings against the governments in different forums. According to the tribunals, if an investor brought claims before domestic courts that the government’s conduct constituted a contract breach or other cause of action not based on the treaty, the investor could also concurrently or subsequently initiate a treaty-based arbitration against the State, arguing that the government’s contract breach and/or other wrongful conduct violated the governing BIT. Even if the allegedly wrongful conduct in both proceedings involved the same or overlapping set of facts, the “fork-in-the-road” clause would not prevent the investor from maintaining those separate actions.<sup>98</sup>

As reflected in these cases, tribunals have apparently watered down the practical significance of “fork-in-the-road” provisions. It is a seemingly rare event for a tribunal to reject a claim based on these clauses. Yet careful drafting of the “fork-in-the-road” provisions may help prevent such narrow interpretations of their role.

The Austrian Model BIT contains a provision stating that a foreign investor may not submit a dispute to investor-State arbitration if “a court in the first instance ... has rendered its final decision on the merits” of the dispute (Art. 15(1)). To some extent this provision may serve as a “fork-in-the-road” provision limiting foreign investors’ abilities to take advantage of multiple avenues of relief. Yet while its wording seems to prevent investors from proceeding to arbitration *after* receiving a final decision in domestic courts, it does not seem to prevent them from pursuing their claims simultaneously in the two forums as long as the arbitration was initiated before the domestic court rendered its final decision.

<sup>97</sup> ICSID Case No. ARB/07/12, Decision on Jurisdiction, Sept. 11, 2009.

<sup>98</sup> But see *Pantechniki v. Albania*, ICSID Case No. ARB/21, July 30, 2009. In this case, the tribunal (comprised of a sole arbitrator, Jan Paulsson) rejected jurisdiction over some of the claimant’s claims due to operation of the fork-in-the-road clause. It explained that the claimant could not simply recast what were truly contractual claims as violations of the treaty. Summarizing the claimant’s position, it stated:

The key is to assess whether the same dispute has been submitted to both national and international fora. The Claimant refers to many precedents but has not distilled significant principles from them. It is reduced to the mere assertion that claims based on Treaty provisions are inherently different from those it pursued as a contractor. This is argument by labelling - not by analysis.

### Limitations Periods

Some agreements also contain limitations periods requiring investors to bring actions within a certain window of time after they knew, or should have known, of the conduct and damages giving rise to their claims. As explained by the tribunal in *Grand River Enterprises v. United States*, in order to determine whether and when an investor “should have” known of the allegedly wrongful conduct, it should be assumed that the foreign investor has made “reasonable inquiries about significant legal requirements potentially impacting on [its] activities” and “knows the rules” about developing and conducting business abroad.<sup>99</sup>

By requiring investors to file their claims in a timely way, limitations periods can provide an incentive for businesses to stay informed of regulatory developments in the countries in which they invest. Limitations provisions can also help host States gauge, account for, and address their potential liability for any given measure. Further, like waiting periods, consultation requirements, “fork-in-the-road” provisions, exhaustion requirements and limitations periods can help host States control the number of claims filed against them.

The Austrian Model BIT contains a limitations period. It requires any investor-State arbitration claim to be filed within five years of the date the investor first acquired or should have acquired knowledge of the events which gave rise to the dispute. Through this provision the host government signatories can avoid finding themselves liable for actions that had occurred long in the past. Yet the five-year limitations period in the Austrian Model BIT is more lenient on foreign investors than limitation periods that can be found in other agreements, which, for example, set a three-year period.<sup>100</sup>

### Available Remedies

Remedies investors have asked for include monetary compensation; restitution or return of property; punitive damages (i.e., an assessment of damages against the State designed not to compensate the investor for harms suffered, but to punish the State for wrongful conduct); declaratory relief (i.e., a declaration deciding a particular issue in dispute); and injunctive relief (i.e., an order telling the government to take, or refrain from taking, certain action).

With the exception of punitive damages, which are generally said not to be allowed in investor-State arbitrations, or only allowed in “exceptional circumstances,”<sup>101</sup> investors have been successful in securing all other forms of relief. “Compensatory” damage awards are commonly issued, and though the awards are frequently less than the amounts sought by investors in their claims, they are often staggering, even running into the hundreds of millions of dollars.<sup>102</sup>

While the financial impacts on the host State are not as directly apparent when a tribunal issues an award against it requiring injunctive relief, this form of relief is arguably more intrusive and objectionable from the respondent host State’s perspective because, in addition to having possible impacts on the host State’s budget, it consists of the tribunal directly dictating how the government must or must not act. Requests for this type of relief seem to be on the rise

<sup>99</sup> Decision on Jurisdiction, para. 66.

<sup>100</sup> See the three-year period found in the 2002 Korea-Japan BIT, the investment chapter of the 2009 China-Peru Free Trade Agreement, and the investment chapter of the 1992 North American Free Trade Agreement (NAFTA).

<sup>101</sup> See *Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Award, March 28, 2011.

<sup>102</sup> See, e.g., *CME v. Czech Republic*, Final Award, March 14, 2003 (ordering the respondent to pay the investor roughly US\$270 million in compensation, plus 10 per cent interest accruing from the date in which the investor served its notice of arbitration on the respondent until the respondent paid the award, and roughly US\$675,000 in arbitrators’ fees and costs); *Rumeli Telekom v. Kazakhstan*, ICSID Case No. ARB/05/16, Decision of Ad Hoc Annulment Committee, March 25, 2010 (upholding the tribunal’s award of US\$125 million, plus interest and costs, against the respondent state).

as investors seek new ways to use investment treaties to their advantage. In the currently pending case, *Chevron v. Ecuador*, for instance, the claimants have brought a controversial action in which it is asking, in part, for the tribunal to issue the following non-monetary relief:

6. Ordering Ecuador to use all measures necessary to prevent any judgment against Chevron in the Lago Agrio Litigation from becoming final, conclusive or enforceable.
7. Ordering Ecuador to use all measures necessary to enjoin enforcement of any judgment against Chevron rendered in the Lago Agrio Litigation, including enjoining the nominal Plaintiffs from obtaining any related attachments, levies or other enforcement devices.
8. Ordering Ecuador to make a written representation to any court in which the nominal Plaintiffs attempt to enforce a judgment from the Lago Agrio Litigation, stating that the judgment is not final, enforceable or conclusive[.]<sup>103</sup>

The “Lago Agrio Litigation” referred to in those claims for relief is a pending action brought in Ecuadorian courts by Ecuadorian plaintiffs seeking damages from Chevron as a result of harms the company allegedly caused to the environment and human health through its oil operations in the Ecuadorian Amazon.

Some investment agreements limit tribunals’ discretion to order particular forms of relief. Certain texts, for example, state that tribunals’ final awards may only order monetary relief or restitution of property, and may not order payment of punitive damages.<sup>104</sup>

With respect to the issue of available forms of relief, the Austrian Model BIT identifies the types of remedies that a tribunal may award. It specifies that three are permitted: (1) a declaration that the host State has breached its treaty obligations; (2) monetary compensation (including interest); and, when appropriate, (3) restitution. It then adds that if the parties to the dispute agree, the tribunal may order any other form of relief. These provisions clarify that injunctive relief (e.g., a tribunal ordering a country to change a domestic law), and punitive damages (i.e., damages designed to punish the country for conduct the tribunal deemed wrongful) are not to be awarded unless the respondent State and the investor claimant otherwise consent.

## Transparency and Arbitrator Conflicts of Interests

A peculiarity of investor–State arbitration is the very opaque manner in which it can be conducted. Unlike other international judicial processes, such as under the WTO or the International Court of Justice, an investor–State dispute can remain entirely unknown to the public from beginning to end, even if the State gets condemned to paying a vast amount of money to the investor. This lack of transparency runs contrary to widely accepted principles of good governance and sets back efforts to promote government and corporate accountability. The secrecy of the proceedings not only hinders (or bars) the public’s awareness and understanding of particular disputes, but also hinders its understanding of the implications of the broader investment law framework as those implications are in significant part shaped by the resolution of investment cases.

The lack of transparency in investor–State dispute settlement is primarily due to arbitration rules normally applied in the proceedings, which are usually either the set of rules developed under the World Bank’s International Centre for Settlement of Investment Disputes (ICSID), or the United Nations Commission on International Trade Law

<sup>103</sup> See Claimants’ Memorial on the Merits, Sept. 6, 2010, para. 547, filed in *Chevron Corp. & Texaco Petroleum Co. v. Ecuador*, PCA Case NO. 2009-23.

<sup>104</sup> See, e.g., US-CAFTA-DR, Art. 10.26.

(UNCITRAL). While ICSID rules provide for a greater degree of openness than those under UNCITRAL (because under ICSID Rules, both the commencement and the outcome of a case are registered and posted online), both sets of rules are essentially silent on whether, when, and how information relating to the proceedings should be disclosed. Given the rules' silence on transparency, tribunals often address the issues on an ad hoc, case-by-case basis. The decision in *Biwater v. Tanzania*<sup>105</sup> illustrates how the tribunal's wide discretion in this area might impact governments' rights and obligations regarding public disclosure: In that case, the tribunal imposed a gag order on the respondent State that restricted the government's ability to make statements and disclose information relating to the proceedings despite (and, notably, also due to) the significant public interest in the case, which related to water delivery services.

In light of the lack of transparency under most arbitration rules, and due to growing awareness of the public interest implications of investment disputes, States are increasingly taking steps to ensure openness of the proceedings by including provisions on the issue in their investment treaties. Examples include the United States and Canadian Model BITs, U.S., Canadian, Australian BITs and FTAs, and a major regional African investment treaty (the COMESA investment agreement).

The Austrian Model BIT does not include any provisions regarding the transparency of investment arbitration. It provides no assurance that awards or other important information relating to investor-State disputes will be available to the public. This sets it apart from a significant number of more modern investment agreements in which States have opted to firmly incorporate principles of transparency directly into their treaties. The Model BIT also lacks other features that could remedy current problems in investor-State arbitration, including provisions governing and preventing arbitrator conflicts of interests, and provisions contemplating an appellate mechanism designed to standardize and improve interpretation and application of treaty obligations.

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## Home State and Investor Obligations

Investment treaties typically impose obligations on host States, but not on the home State or the foreign investor.<sup>106</sup> Commentators and governments are increasingly calling for incorporating these provisions as a strategy for better ensuring that investment treaties contribute to sustainable development.<sup>107</sup> With respect to home State obligations, investment treaties could, for instance, include provisions requiring developed home States to promote foreign investment in developing host countries, and to cooperate with developing countries to transfer technology to and build capacity in those developing countries to host *and benefit from* foreign investment.

With respect to investor obligations, investment treaties could include provisions that specifically require investors to, among other goals, respect or promote policies on good corporate governance, consumer protection, environmental protection, and human rights. While such provisions are generally absent from most investment treaties, there are

<sup>105</sup> ICSID Case No. ARB/05/22, Award, July 24, 2008.

<sup>106</sup> The recent Investment Agreement for the COMESA Common Investment Area provides an example of what may be a new trend of agreements recognizing investor obligations. It includes an article titled "Investor Obligation" that states, "COMESA investors and their investments shall comply with all applicable domestic measures of the Member State in which their investment is made." *Id.*, Art. 13; see also Economic Partnership Agreement between the CARIFORUM States, of the One Part, and the European Community and its Member states, of the Other Part, Art. 72 (stating in part that state parties shall take steps to ensure that "[i]nvestors act in accordance with core labour standards" and "do not manage or operate their investments in a manner that circumvents international environmental or labour obligations....").

<sup>107</sup> See, e.g., UNCTAD, *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*, at 155 (2003) ("In future IIAs consideration should especially also go to home countries ... to encourage FDI flows to developing countries and help increase the benefits from them.")



some clauses in a number of existing agreements that arbitral tribunals have relied on to ensure investors comply with their obligations under host countries' domestic laws, the applicable investment treaty, or international law. Tribunals, for instance, have held that a provision stating that the investment treaty protects investments made "in accordance with [the host State's] legislation" means that the treaty does not protect illegal investments such as those made through bribery or fraud.<sup>108</sup> However, in the absence of these or more specific provisions, tribunals' willingness to recognize and enforce investors' obligations is unpredictable and uncertain, and can lead to inconsistent decisions. To avoid such uncertainty and inconsistency, and to ensure foreign investments made or maintained in violation of relevant laws and policies do not inappropriately receive protections under investment treaties, the agreements should explicitly incorporate investor obligations

The Austrian Model BIT, like the current majority of texts, addresses host State conduct, but is essentially silent on home State and investor obligations. Two caveats are that (1) there may be some minimal requirements of legality imposed on foreign investors through various provisions in the main body of the text; and (2) the preamble affirms and reinforces investor and home State obligations that may at least become useful in interpreting and applying the treaty.

Requirements that investments be legal derive from various provisions of the text: Article 2(1) of the Austrian Model BIT states that "[e]ach Contracting Party shall, according to its laws and regulations, promote and admit investments by investors of the other Contracting Party." Article 27(1) similarly states that the agreement applies "to investments made in the territory of either Contracting Party in accordance with its legislation by investors of the other contracting party." As discussed above, in a case initiated against El Salvador (*Inceysa v. El Salvador*)<sup>109</sup> similar wording contained in the treaty's article on protection of investments was interpreted as limiting the protections contained in the investment treaty to only those investments that were made legally (i.e., not investments made through fraud). It is not clear that other tribunals will follow *Inceysa's* interpretation of the "in accordance with its legislation" language because, in that case, the parties' treaty negotiations clearly reflected their intent to limit the entirety of the BIT's protections to investments legally made. Furthermore, it is not uncommon for different tribunals to read similar treaty language in very distinct ways. Nevertheless, if an *Inceysa*-type approach were applied to the Austrian Model BIT, Articles 2 and 27 of that agreement would seem to impose at least some obligations on foreign investors to establish their investments through legal, non-fraudulent conduct.

The preamble contains much broader principles relevant to home State and investor conduct. These include (1) a reference to the 2006 Ministerial Declaration of the UN Council of Full Employment and Decent Work; (2) a reference to international obligations and commitments concerning respect for human rights; (3) the commitment to achieve the investment treaty's objectives "in a manner consistent with the protection of health safety, and the environment, and the promotion of internationally recognised labour standards;" (4) affirmation of the importance of responsible corporate behaviour as reflected in the OECD Guidelines for Multinational Enterprises; (5) emphasis on the "necessity for all governments and civil actors alike to adhere" to international anti-corruption efforts; and (6) reference to the principles of the UN Global Compact. These references are important because, although standing alone as provisions in a preamble they seemingly impose no legal duty enforceable under the BIT, they facilitate interpretations of the BIT's substantive provisions that take into account obligations of investors, and home (and host) States under various sources of international guidelines and laws.

<sup>108</sup> See, e.g., *Inceysa Vallisoletana S.L. v. Republic of El Salvador*, ICSID Case No. ARB/03/26, Award, August 2, 2006.

<sup>109</sup> *Id.*



### *III. Conclusion*

The Austrian government has made a commendable effort to modernize its approach to international investment treaty negotiations. Its process to elaborate the text seems to have been a fairly inclusive one, including various ministries, as well as the Austrian social partners. The outcome of the process is an overall more balanced investment treaty model, though it continues to include various provisions with potential negative impacts on governments' ability to deal with complex and dynamic sets of issues that confront them, such as environmental regulation, health, welfare, and safety issues, competitiveness and industrial policy. Key areas of concern are the broad and unpredictable FET standard, the expansive umbrella clause, the lack of transparency and review in investor-State arbitration, and the potential lack of independence of arbitrators. While some efforts to better balance the text (e.g., the narrowed definition of "investments" and the police powers clarification to the expropriation obligation) have been adopted, more can and should be done. Moreover, it is unfortunate that these more modern approaches have not been integrated in all post-2008 agreements that Austria negotiated. Of course, all texts are products of a negotiation, but it may be necessary for Austria to draw a line and not negotiate away some of the crucial new elements of its 2008 Model BIT.

To be truly effective, work on Austria's investment treaties should not only address future treaties, but also the nearly 70 treaties Austria has already concluded. Correcting problems in existing treaties is a complicated, but not impossible task, as there are several options under international law available for States to clarify the meaning of their agreements or, if necessary, amend them. For provisions that are unduly vague, Austria can work with treaty parties to issue joint statements clarifying the signatory States' understanding of the clauses. Austria can also issue unilateral statements explaining its interpretation of the treaty's provisions. While not having the same clear legal force as a joint statement among the treaty parties, a unilateral statement by Austria can also be effective in shedding light on its understanding of the treaties (particularly if issued before and apart from the context of an investor-State dispute). Finally, Austria can also engage its treaty parties to formally amend existing agreements. Indeed, given that Austria must renegotiate provisions restricting transfers of capital, it may be an opportune time for it to revisit other aspects of its treaties.

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