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Kyla Tienhaara

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feature 1

Does the Green Economy Need Investor–State Dispute Settlement?

Kyla Tienhaara

Environmentalists have traditionally been among the staunchest critics of investor–state dispute settlement (ISDS). For those familiar with the litany of ISDS cases that have involved challenges to environmental regulations—ranging from bans on pesticides to efforts to save endangered species—the opposition to ISDS on the part of environmental non-governmental organizations and scholars is not difficult to understand. However, in recent years a different kind of "environmental" ISDS case has emerged, as renewable energy companies have become major players in investment arbitration.

In tandem with the rise in renewable energy disputes, an increasing amount of commentary suggests that environmentalists should embrace ISDS because it "should help mobilise the huge investments required to transform the energy sector to cleaner forms of generation and to meet the needs of those many countries that suffer from energy poverty."[1] It has been argued that the "environment needs more investment protection—not less."[2]

These assertions are based on three key assumptions: (i) political risk is a major impediment to investment in renewable energy; (ii) ISDS is an effective counter-measure to deal with political risk; (iii) agreeing to ISDS will help states to attract foreign direct investment (FDI) in renewable energy.

1. Is political risk a major impediment to investment in renewables?

The assumption that political risk is a major impediment to investment in renewable energy appears reasonable at the outset. Financial risk tops the list of concerns by executives in the renewable energy sector, but political or regulatory risk—the risk of a change in public policy on renewables—is not far behind.[3]

One of the key reasons cited for this is the current dependence of renewable energy investors on incentive schemes like feed-in-tariffs (FITs), which guarantee renewable energy producers a set price for their energy over a fixed period of time. FITs are meant to reduce financial risk, and do provide increased security, but are not immune from political risk. In fact, Talus argues that relying on subsidies makes renewable energy investors particularly vulnerable to policy change.[4] Changes in government or unexpected cost escalations can undermine support for schemes. Furthermore, as Stokes points out, unlike other government subsidies (for example, fossil fuel subsidies), FITs are highly visible and therefore more easily targeted when a country's fiscal situation deteriorates.[5] This is what happened in several European countries following the Global Financial Crisis. The investment climate for renewables has also been unstable in other countries, such as Australia.

However, political risk of this particular variety is becoming much less of an impediment to renewable energy for the simple reason that politics is being overtaken by economics. Mendonca et al. noted in 2010 that the costs of renewable energy would eventually fall below the price of conventionally produced electricity and that once this "tipping point" had been reached "FITs [would] have done their job, and [would] only be needed on a limited basis, if at all."[6] By 2015, the tipping point had been reached by several renewable technologies. A number of recent reports indicate that onshore wind can now provide electricity competitively compared to fossil fuel–fired power generation without financial support in some parts of the world.[7] And solar photovoltaic, generally considered the most expensive form of renewable energy, is quickly catching up with wind. This data suggests that, although incentive schemes like FITs have played an important role, they are increasingly unnecessary to create a business case for investment in renewables. When government support is no longer needed in the sector, the case for ISDS as a protection against changes in subsidies will evaporate.

One could, of course, argue that renewable energy companies face other types of political risk aside from changes to subsidy schemes. For example, local opposition to development (often characterized as "Not In My Back Yard" behaviour) is a significant obstacle for wind energy investors in some jurisdictions. Whether ISDS presents an effective way of dealing with the risk of local opposition will be addressed in the next section.

2. Is ISDS an effective counter-measure against political risk?

The assumption that ISDS is an effective counter-measure to deal with political risk is grounded in the notion that ISDS acts both as a deterrent to states and as an insurance policy for investors. If a state changes the "rules of the game" after an investment has been made, the investor can seek monetary compensation in ISDS. The very threat of such action may in some cases be sufficient to deter a state from making

changes in the first place. Deterrence is arguably more important from a green economy perspective, as the insurance function can be achieved through other means (for example, political risk insurance). Additionally, the insurance function only benefits the green economy if money awarded in ISDS is re-invested into other renewable energy projects, something that is not guaranteed to occur. Finally, while deterrence benefits all renewable investors, ISDS only plays an insurance role for a select group of investors, specifically large foreign investors that have the resources to launch a case and have standing under a treaty (or the ability to restructure their investment to gain such standing). Domestic courts, on the other hand, are generally accessible to all. As Aisbett et al. have shown, providing compensation to only one set of investors results in an "implicit subsidy" and can generate "excessive entry."[8]

Let us take the example of Spain. In 2008, the Spanish government began to make a series of changes to the country's FIT that were detrimental to investors.[9] The changes were, in part, a response to the Global Financial Crisis.[10] However, another critical factor was the dramatic fall in hardware costs for solar modules (about a 60 per cent drop between 2008 and 2011). This drop in costs led to a surge of investment that stretched the capacity of FITs and other support schemes in several countries.[11] This factor could have been accommodated if the Spanish FIT had been well designed, but it was both over-generous and inflexible.[12] As a result, the system "overcompensated solar photovoltaic and failed to reduce compensation in response to the technology's rapidly declining costs."[12]

When Spain moved to scale back the FIT, foreign investors turned to arbitration under the Energy Charter Treaty (ECT). By late November 2015, there were 27 known ISDS cases pending against Spain under the ECT involving "legal reforms affecting the renewable energy sector."[13] Small-scale domestic investors and private citizens affected by the changes in Spain's FIT do not have standing in international arbitration. The only domestic firms able to pursue arbitration are large multinationals such as Abengoa and Isolux, which are using their foreign affiliates to gain standing. Importantly, some of the companies involved in the ISDS cases only started investing in Spain after 2009 and continued increasing their portfolios throughout 2010 and 2011, when the country was in crisis and some changes to the FIT had already been made; some of them have continued to invest even after bringing an ISDS case.[14] This suggests that some in the select group of investors that can access ISDS view it not only as an insurance policy, but also as an additional source of profit.

Whether the experience of Spain will deter other countries from changing their renewable energy incentive schemes is an open question. At least one author has mooted the idea that ISDS might have an environmentally beneficial "chilling effect" (as opposed to the chilling of environmental regulations usually at the focus of discussions on regulatory chill).[15] Proponents of ISDS generally suggest that there is no evidence that ISDS produces chilling effects (of any persuasion) and that it is "impossible" to obtain such evidence.[16] Other scholars (including the author) believe that it is a phenomenon worth continued study[17] but one that is beyond the scope of this article.

However, it is questionable whether chilling changes to renewable energy schemes would, in every case, be positive from a green economy perspective. If a scheme was well designed and was going to be amended or removed for ideological reasons (for example, if a "climate sceptic" government came into power as happened in Australia in 2013), chilling would certainly be beneficial. But if instead the changes to a scheme were simply aimed at correcting flaws and reducing excessive profits, it is hard to justify chilling from a green economy perspective (which is concerned with the success of the sector as a whole, not the bottom line of individual companies).

Chilling effects could also, in theory, reduce the likelihood of governments changing investment conditions to appease local opponents of renewable energy. However, in practice this seems unlikely. Governments are more likely to respond to local opposition at the planning stage, rather than after an investment has been made, and most investment treaties do not cover the pre-establishment phase. However, even if this phase is covered, there are substantial obstacles faced by investors that want to bring a claim. This is evident in the NAFTA Chapter 11 case brought by American company Windstream against Canada in 2012. The company is challenging the imposition of a provincial moratorium on offshore wind projects, which it argues was put in place to placate local opponents to wind energy in an election year. Although the case has yet to be decided, it demonstrates that arbitration is not a clear-cut strategy for dealing with the problem of local opposition. Substantiating allegations of political or electoral expediency can be very difficult, even if access to government documents is available through freedom of information legislation.

In any event, from a green economy perspective there are much more desirable ways to deal with local opposition to wind projects than legal action. Research suggests that financial benefit arrangements, including community profit-sharing, or direct involvement of communities in wind farm projects are likely to quell or at least limit opposition in many cases.[18]

3. Does ISDS reduce political risk and promote investment in renewables?

The final assumption of ISDS proponents is based on a logical combination of the first two assumptions: if political risk is a major barrier to investment and if agreeing to ISDS under a treaty reduces this risk, then it

should follow that investment flows will increase to those states that sign investment treaties with ISDS. However, there is no strong evidence that this plays out in practice. Numerous econometric studies examine whether there is a causal link between the existence of an investment treaty and increased flows of FDI. The results have been mixed. Many early studies that demonstrated a positive effect have been criticized on methodological grounds.[19] Some recent studies have addressed some, but not all, of the methodological issues and have found that treaties have little to no impact.[20]

Most quantitative studies are based on highly aggregate investment data, which makes it difficult to assess their relevance to specific sectors, such as renewable energy. While more research in this area is warranted, existing evidence does not indicate that renewable energy is a "special case." For example, a 2014 ClimateScope report that mapped the "frontiers" of clean energy investment found Brazil (a country that has never ratified a bilateral investment treaty) to be the second most attractive developing country for renewable energy investment (out of 55 countries studied).[21]

Conclusions

There is currently no evidence that ISDS can make a positive contribution to the green economy. The key lesson that should be learned from the experience of Spain is that FITs need to be designed very carefully to allow for flexibility when market conditions change. Well-designed FITs are in the best interest of both governments and the industry, because the alternative is a boom and bust scenario in which everyone loses (except the arbitration industry). Similarly, an assessment of *Windstream* does not lead one to conclude that ISDS is a critical tool for combatting local opposition to wind farms. It is also worth noting that both Canada and Spain have strong domestic court systems that are well equipped to deal with investor claims at much lower expense to the public purse.

Most of those who advocate that ISDS can play an important role in the green economy are relying on an assumption that investment treaties will promote FDI in green sectors like renewable energy. Unfortunately, these advocates do not provide any empirical evidence to support this assumption. It has also been proposed that ISDS could produce beneficial chilling effects. However, even if it could be definitively shown that ISDS had chilled the amendment or removal of renewable energy incentive schemes, this would only be positive if such schemes were well designed in the first place and were amended or removed for ideological reasons: there is no environmental justification for providing "green" corporations with excessive profits. But even in these limited circumstances, any case for ISDS is rapidly diminishing as renewable energy subsidies become increasingly unnecessary. Those that propose that the environment needs "more investment protection" are recommending a very long-term solution (of questionable efficacy) to what is essentially a short-term problem.

Authors

Kyla Tienhaara is a Research Fellow at the Regulatory Institutions Network, Australian National University. This article is based on a chapter in: Kate Miles (Ed.), *Research Handbook on Environment and Investment Law*, Edward Elgar (forthcoming).

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feature 2

Conciliation and Arbitration Law: Times of Change in Investment Protection in Bolivia

Pablo Menacho Diederich

1. Neoliberal period: Legal structure of foreign investment protection

In the early 1990s, the Bolivian State underwent a *neoliberal period*. Such period was marked by (i) the setting up of a constitutional and legal structure aimed at protecting foreign investment, which affected Bolivia's regulatory framework and control authority, and (ii) a process of drastic reduction of state property, through the privatization of natural resources and the transfer of strategic state enterprises to transnational corporations.

In this context, Bolivia signed its first bilateral investment treaty (BIT), with Germany, on March 23, 1987, followed by other BITs with several countries up to 2004. The Bolivian State signed 22 BITs,[1] of which 21 were ratified. In 1990, Bolivia enacted the so-called Investment Law[2] and in the following year the country adhered to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards[3] (still in force). Afterwards, in 1994, the country ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention).[4]

2. The "process of change": Nationalization of natural resources, the new Constitution and its Article 320

On January 22, 2006 started the first constitutional mandate of President Evo Morales and, in turn, the so-called "process of change" in Bolivia. The government of President Morales brought about a series of transformations in the area of investment, domestic as well as foreign. The key milestones of such transformation were: (i) the process of nationalization of hydrocarbons;[5] and (ii) the Constituent Assembly, which gave origin to the current Political Constitution of the State (in Spanish, CPE).

In relation to the process of nationalization, it is worth noting that, after 10 years, the Bolivian State has reached amicably settled investment disputes, with only one award decided against the country, which was complied with in a period of four months. In this sense, Bolivia became the country with the largest number of nationalizations during the last years and which has faced the lowest number of disputes in this respect.[6]

As to the Bolivian constituent process, a high representativeness of social sectors has allowed for a new national vision, particularly regarding the state's role in economic affairs and, thus, sectorial policies regarding natural resources, and the treatment to foreign investments. In this framework, Article 320 was inserted in the CPE, which introduced new grounds for the treatment of foreign investment and its relationship with domestic investment.

Article 320 provides that:

> I. Bolivian investment shall take priority over foreign investment.
>
> II. Every foreign investment shall be subject to Bolivian jurisdiction, laws and authorities, and no one may invoke an exceptional situation or appeal to diplomatic claims to obtain a more favourable treatment.
>
> III. The economic relations with foreign states or enterprises shall be carried out under conditions of independence, mutual respect and equity. Foreign states or enterprises may not be granted conditions more favourable than those established for Bolivians.
>
> IV. The state acts independently in all of its decisions on internal economic policy, and shall not accept demands or conditions imposed on this policy by states, Bolivian or foreign banks or financial institutions, multilateral entities or transnational enterprises.
>
> V. The public policies shall promote internal consumption of products made in Bolivia.

This article has been subject to much debate because of its *atypical* drafting, in a current context in which a false image persists that foreign investment by itself encourages states' economic growth and allows for the development of host states.

Bolivia's experience has shown that attracting foreign investment does not by itself generate the expected development for host states and that, rather, it consists in a mechanism for financing and transferring resources from the *South* to the *North*. By contrast, in the case of Bolivia, the state's engagement as the promoter of an inclusive *plural economy* (involving the state, the private sector, cooperatives and forms of community production) and the growth of domestic demand, supported by policies for attracting foreign and for public investment, have boosted Bolivia's economic growth,[7] a fact that has been recognized by diverse international bodies and forums.[8]

Article 320 of the CPE brings back an important principle of Latin American countries, largely neglected under the hegemony of BITs: treatment of foreign capital cannot discriminate against domestic investors.[9] Equality between domestic and foreign investment in Bolivia materializes in the fact that both are subject to Bolivian jurisdiction, laws and authorities, with no possibility of invoking an exceptional situation. From Article 320 also results the current legal framework for investment, particularly the current Investment Promotion Law (in Spanish, LPI)[10] and the new Conciliation and Arbitration Law (in Spanish, LCyA).[11]

3. Conciliation and Arbitration Law

Law No. 708, of June 25, 2015, the so-called LCyA, was drafted by the Office of the Attorney-General

and the Bolivian Ministry of Justice. It resulted from a broad consensus among state institutions, public enterprises and the private sector. The law was enacted (i) to preserve the *public interest* and the *free will of the parties*, (ii) to provide legal security (predictability) to both the state and the investor (iii) in a framework of equality and equity for both.

The LCyA contains several legal concepts that were absent in the previous Arbitration and Conciliation Law No. 1770, such as:

- *Conciliation:* a conciliation procedure was developed, according full legal effectiveness to settlement agreements resulting from the procedure;
- *Arbitration:* the number of issues excluded from arbitration was increased,[12] a description of the stages of the arbitral procedure was included,[13] the seat (*sede*) of arbitration was distinguished from the venue or place (*lugar*) of arbitration,[14] formal requirements for the submission of a request for arbitration were established,[15] the concept of an emergency arbitrator was created,[16] the possibility of challenging experts was included,[17] and a special arbitration regime was created for disputes concerning foreign investments to which the state is a party,[18] among others.

4. Special Regime: Investment disputes involving the state

Pursuant to the LCyA, all investment disputes involving the Bolivian State shall be governed by a special regime, whether for conciliation or for arbitration. Such disputes, to be subjected to this special regime, shall meet at least three conditions: (i) the dispute must arise from a contractual or extra-contractual relationship that has not been excluded from the scope of application of the LCyA; (ii) the state must be a party to the dispute; and (iii) the dispute must involve an investment, as defined in the LPI.

The characteristics of investment conciliation and arbitration pursuant to the LCyA are the following:

- Conciliation and arbitration shall be local and have their seat in the territory of the Plurinational State of Bolivia;
- Hearings, evidence production and other parts of the procedure may be conducted outside of Bolivian territory; and
- Conciliation and arbitration shall not limit or restrict the control and supervision responsibilities of regulatory entities and competent authorities.

In the special case of arbitration involving foreign investment, the characteristics are the following:

- The Arbitral Tribunal shall be formed by three arbitrators;
- The Arbitral Tribunal shall decide in accordance with the law and shall apply the Bolivian constitution, laws and norms to decide the merits of the dispute;
- The Arbitral Tribunal shall decide objections to jurisdiction and competence as a preliminary matter and in a separate decision;
- Furthermore, the appointing authority and the applicable rules for conciliation or arbitration shall be chosen by the parties.

5. Toward a new Bolivian investment treaty model

Now that the normative drafting process is finalized and the constitutional and legal framework for investment protection is established, the drafting a new model investment protection and promotion agreement is in the hands of the Ministry of Foreign Affairs. If the Bolivian State approves a new model, it must be drafted within the limits established by the new legal and constitutional framework, departing from the traditional paradigm of investment protection agreements, which contain a whole menu of rights[19] for foreign investors to choose from and no obligation whatsoever.

While the first steps to promote times of change in foreign investment protection have been taken by several countries, including Bolivia, these steps result from much debate that, not too long ago, seemed to be following lost paths, and which, at a time, faced the threat of an alleged disinvestment. However, the constant stumbling of the international system of investment protection, which still has not found an appropriate response to the need of legal security and certainty, much needed for the preservation of private interests as well as the *public interest*, requires much more attention on the part of states, especially those over which will fall the burden of their own unreasonable decisions.

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14 *Id.*, Articles 54 and 55.

15 *Id.*, Article 86.

16 *Id.*, Article 67.

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19 Such as: National Treatment, Most Favoured Nation, Fair and Equitable Treatment, Non Discrimination, Free Transfer, Prohibition of Performance Requirements, Dispute Settlement, among others.

feature 3

Safeguarding Sustainable Development: Financing for Development and the International Investment Regime

Peter Chowla

Discussion of international investment governance has changed in character in recent years. While some specialists examined the potential negative sustainable development implications of international investment agreements (IIAs), in official forums the focus of previous decades was often on how to best protect and encourage foreign direct investment (FDI). Now, especially because of ongoing negotiations of mega-regional trade and investment agreements, the issue has moved into mainstream political debate.

Heads of state of the United Nations came together in late September 2015 to formally adopt the 2030 Agenda for Sustainable Development,[1] including a set of 17 Sustainable Development Goals (SDGs). These goals, which comprehensively address the economic, environmental, and social dimensions of sustainable development, set out a new vision for the world.

To achieve that vision, international financial systems will have to play their part. Intergovernmental negotiations concluded in July 2015 at the Third International Conference on Financing for Development (FfD Conference) in Addis Ababa, Ethiopia, indicate that governments are looking for new directions, including in the international investment regime.

Investment policy and sustainable development

Developing countries need investment to achieve higher standards of living and to adopt sustainable practices. However, policy coherence is a fundamental challenge.

Global savings and investment are large; capital markets intermediate trillions of dollars annually.[2] Still, areas of public priority such as universal basic services and infrastructure witness underinvestment. While large economies often can mobilize domestic, smaller and poorer economies usually cannot, relying on cross-border finance. Despite investment climate reforms, most countries still receive meagre foreign investment. Sustainable development will also require significant regulatory and policy changes to shape socially responsive and environmentally sensitive economies.

The current international investment regime has come under scrutiny for its failure to produce outcomes consistently coherent with sustainable development. Channelling investment into the priorities highlighted by the SDGs will be difficult. Some policy-makers feel that IIAs and investment promotion have a role to play, particularly to help least developed countries realize greater investment. IIAs may impact locational choice of investment,[3] though the evidence is weak on them having a large effect.[4] Yet, they also may constrain countries' ability to emphasize priority sectors by proactively screening investments. And IIAs have been faulted for regulatory chill and reducing needed policy space in a number of areas. Particularly worrisome has been investor–state dispute settlement, which has both regulatory and fiscal effects.

Sustainable and resilient infrastructure investment is not a concern just at the United Nations. The G20 under the Turkish presidency in 2015 has prioritized investment, including attracting institutional investors (such as pension funds) into cross-border financing of infrastructure. Sensitive, expensive, and risky infrastructure projects may be subject to regulatory changes, demands for contract renegotiation, or political changes of heart about private sector participation.[5] The development of complex financial structures to attract international investment into such projects could strain the international investment regime even more, as regulatory and political changes could be subject to challenge by overseas investors under IIA clauses.

Reconciling the important goals of investment promotion/protection and sustainable development will require much work. Still, with political will, there are possibilities for achieving greater coherence between the desires of investors and the needs of the public.

Ground-breaking commitment

The First FfD Conference, held in Monterey, Mexico, in 2002, was the first UN-sponsored summit-level meeting to address key financial and related issues pertaining to global development, and was organized with the participation of the International Monetary Fund (IMF), the UN Conference on Trade and Development (UNCTAD), the UN Development Programme, the World Bank, and the World Trade Organization. The Monterrey Consensus outcome document's reference to cross-border investment and IIAs is typical of its era: "Private international capital flows, particularly foreign direct investment, […] are vital complements to national and international development efforts."[6] It called for special efforts in "such priority areas as economic policy and regulatory frameworks for promoting and protecting investments" and noted that "mechanisms, such as public/private partnerships and investment agreements, can be important."[7]

The Second FfD Conference in Doha, Qatar, in 2008 again mentioned the importance of investment promotion: "Bilateral investment treaties may promote private flows by increasing legal stability and predictability to investors."[8] While the Doha Declaration encouraged countries to make sure such agreements "take into account regional and multilateral cooperation,"[12] there was no recognition of potential conflicts with development objectives.

However, by 2015, governments realized that IIAs and other policy objectives need to be consistent. During the preparatory process for the Third FfD Conference, the co-facilitators of the negotiations (the Ambassadors of Guyana and Norway) released a background paper identifying challenges:[9]

> [T]here has been a proliferation of bilateral, regional and interregional trade and investment agreements. Concerns on social impacts (including gender) and financial stability and environmental sustainability have not been taken fully into account in some of those agreements, raising questions about their compatibility with sustainable development objectives. While trade and investment practices are increasingly integrated, the policy environment remains highly fragmented.

Within a few months, the co-facilitators released their first draft of the Addis Ababa Action Agenda (the Agenda), the outcome document from the conference, for negotiation by member states. It made some major proposals:[10]

> We will carry out negotiation and implementation of trade and investment agreements in a transparent manner to ensure that trade and investment treaties do not constrain domestic policies to reduce inequality, protect the environment or ensure adequate tax revenues. We will strengthen safeguards in investment treaties, especially by proper review of investor-state-dispute-settlement (ISDS) clauses, to ensure the right to regulate is retained in areas critical for sustainable development, including health, the environment, employment, infrastructure (including electricity and transport), public safety, macro prudential regulations and financial stability.

This draft language proved more ambitious than many countries could agree. In the end, the **Agenda** states:[11]

> The goal of protecting and encouraging investment should not affect our ability to pursue public policy objectives. We will endeavour to craft trade and investment agreements with appropriate safeguards so as not to constrain domestic policies and regulation in the public interest. We will implement such agreements in a transparent manner.

This specific paragraph on IIAs comes in the context of the introductory section which states: "We will respect each country's policy space and leadership to implement policies for poverty eradication and sustainable development, while remaining consistent with relevant international rules and commitments."[12]

The language on IIAs represents a ground-breaking intergovernmental commitment: all of the countries of the world, in a consensus fashion at the highest level, recognized the need for IIAs not to constrain other public policies. The presence at the conference of 24 heads of state or their deputies and more than 100 ministers plus high-level officials from 174 countries lends extra weight to the outcome.

Implementing the commitment

The crafting of "appropriate safeguards" is a vital component of how the Agenda should be implemented. All new IIAs should now include safeguards for regulation in the public interest. In line with this thinking, UNCTAD has a work program on IIA reform with a mandate specifically endorsed by the Agenda; its updated **Investment Policy Framework for Sustainable Development** provides guidance for policy-makers on the options available[13] and the ***2015 World Investment Report*** provides an action-oriented roadmap for reform, with options for national, regional, and multilateral policy-making.[14]

Additionally, reforms of existing IIAs are warranted. By June 2015, at least 50 countries or regions had revised or were already reviewing their model agreements and strategies.[15] Review of past treaties, while laborious, is not impossible given political will. Reviews of IIAs could focus on vital reforms, such as right-to-regulate clauses, reforming investment dispute settlement, and strengthening investment promotion and facilitation functions.

The intergovernmental nature of the Addis Ababa commitment bodes well for further reform. Previously, investment policies, business regulation, and treaty negotiation might have been handled in silos. Yet clearly cross-ministerial coordination is needed, as is global coherence among social, environmental, and economic aims. Investment is clearly a priority for finance ministries, and is being brought to heads of state and government through the G20 and FfD. IIAs should no longer be a domain for trade ministers only.

Follow-up is a core part of the Agenda, and the United Nations will now hold a weeklong Forum on Financing for Development every year to discuss its implementation. The next meeting will be held in New York in April 2016. This is an important opportunity for further intergovernmental discussion on IIA reform.

Authors

Peter Chowla is an Economic Affairs Officer in the Financing for Development Office of the United Nations. The author would like to thank Elisabeth Tuerk and Shari Spiegel for their comments and suggestions. The views expressed in this article are those of the author and do not necessarily reflect the views of the United Nations.

Notes

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feature 4

Negotiations Kick Off on a Binding Treaty on Business and Human Rights

Joe Zhang

UN Photo by Jean-Marc Ferré

The inaugural session of the Open-ended Intergovernmental Working Group for the Elaboration of an International Legally Binding Instrument on Transnational Corporations and Other Business Enterprises (TNCOBEs) with respect to Human Rights (the Working Group) marks the beginning of a process to negotiate a binding treaty on business and human rights.

The session took place four years after the UN Human Rights Council endorsed the UN Guiding Principles on Business and Human Rights (UNGPs), which have been widely praised as a global standard in terms of linking human rights to business activities. The UNGPs set out a three-pillar framework: the state duty to protect human rights, the corporate responsibility to respect human rights, and access to remedy for victims of business-related abuses. Over the years, however, concerns have been raised in regard to the third pillar of the UNGPs, especially on the limitations of the remedies available due to the voluntary nature of the initiative. Against this background, Ecuador and South Africa jointly presented a proposal to the Human Rights Council to elaborate a binding instrument to address this and related issues, which led to the adoption of the Resolution A/HRC/RES/26/9 (the Resolution).[1] The Resolution established the Working Group and set forth the work program of its first two sessions, namely "conducting constructive deliberations on the content, scope, nature and form of the future international instrument." These deliberations will be considered when substantive negotiations kick off at the third session.

The progress of the Working Group's first session was promising, especially considering that the Resolution itself was adopted by a modest majority vote of the Human Rights Council, supporters mostly being developing countries.[2] Although some states refused to participate in the process and some walked out in the middle of it, participating states, international organizations, national human rights institutions, and a wide array of civil society organizations carried out constructive debates and identified a number of key issues essential to the contour of the potential instrument.

Why negotiate a binding treaty?

Participants agree that the UNGPs' contributions in the area of business and human rights are undeniable. At the same time, the implementation of the UNGPs is inherently limited by their non-binding nature. Some participants argued that, once a state commits to implement the recommendations listed in the UNGPs, such commitment could be translated into a binding legal instrument enforceable at national and international levels. But most participants agreed that, in order to fill in the legal gap between what is recommended by UNGPs and what is not yet required under domestic and international law, it is both necessary and logical, as an extension of the UNGPs, to adopt the multilateral approach and to develop a complementary internationally binding instrument. For example, some participants suggested, as a starting point, such binding instrument could create an international responsibility for state acts or omissions that result in business related human rights violations.

What is the relationship between "business and human rights" and "corporate social responsibilities?"

Participants noted that the concepts of "business and human rights" (BHR) and "corporate social responsibilities" (CSRs) are often confused, as they both involve business activities. However, to some participants, the two are inherently different: while CSRs are voluntary and charitable in nature, human rights are mandatory and do not allow rights selection. In addition, in most cases, CSRs are only carried out through dealings with external parties—communities, customers, business partners, etc. Human rights obligations, on the other hand, cover a much broader scope and apply to enterprise conduct affecting not only individuals outside of the enterprise but also intra-company relationships. Further, compliance with international human rights law requires monitoring and verification—something lacks in most enterprises, including those reporting to be implementing CSR commitments. Many participants contrasted this with the distinct nature of BHR, which supports the view that a binding treaty is necessary: although the UNGPs have provided a good starting point for enterprises to respect human rights in their operations, a legally binding international instrument would help establish a level playing field in terms of the access to remedy for victims of corporate human rights abuse.

What enterprises should be covered?

The mandate of the Working Group limits the scope of the future instrument to transnational corporations and business enterprises with an international character, and expressly excludes "local businesses registered in terms of relevant domestic law."[3] Some noted this confined mandate reflected the compromise the members of Human Rights Council made in order to adopt the Resolution. But some also suggested this mandate might not be as restricted as it seems. First, at an operational level, nowadays many transnational business activities are carried out by various local companies registered under different domestic laws. Excluding these locally-established operators from the coverage of the proposed instrument would obviously negate the purpose of such instrument, so it seems to be logical to infer that these local companies would also be covered under the binding instrument due to such international character. In addition, today's reality of a

global supply chain and complex corporate structure and contractual arrangements has also arguably saturated many businesses with a hint of international character.

In order to define these TNCOBEs, that is, the enterprises covered by the proposed instrument, some suggested the Working Group should adopt some of the approaches taken in the context of international investment law. Others considered that an important factor would be the entity's power of influencing socio-political decision-making relative to other stakeholders. Still others proposed focusing on the impact of the operations and activities rather than the form of the entity. In any event, all participants agreed the definition of the TNCOBEs is a complex issue and needs to be carefully dealt with in the negotiations.

Which rights should be covered?

The United Nations and its member states have long recognized the interrelated, interdependent and indivisible nature of human rights.[4] Even so, during the discussion questions were raised regarding whether some rights could be more important than others, which might warrant the proposed instrument to include some but not others. For example, should the scope of the binding instrument be limited to certain flagrant and systematic violations or should the scope be extended to all human rights violations? Participants seemed to prefer an inclusive approach. A more important issue, however, as some participants noted, is what should be the appropriate liabilities imposed on a violator for the breach of any specific human rights. In particular, they asked whether the instrument could impose disciplinary, administrative, civil or criminal liabilities for those violations; what the standards should be for those who acted in complicity or conspiracy; and whether private individuals might also be held liable for violations committed by enterprises. In this context, participants also asked whether a future binding instrument could establish the supremacy of human rights law over other bodies of international law.

The state's duty to protect: How far does it reach?

The UNGPs have identified the state's duty to protect human rights as its first pillar. In this context the participants discussed how far this obligation reached and should reach.

What role should states play to ensure that companies domiciled in their territory do not commit or contribute to human rights abuses abroad? Does the duty to protect human rights incorporate a proactive due diligence obligation on the part of the state? Does the duty require providing access to judicial and non-judicial mechanisms for victims in the territory of the state where corporate entities are domiciled? All these issues were raised at this first session and need to be further debated in future negotiations.

Should TNCOBEs be directly liable under the proposed instrument?

Participants agreed that businesses must respect human rights and should be held accountable for violations due to their acts or omissions. Yet questions remain as to whether these obligations should be enforced through national legislations only, in which case the proposed instrument would only impose an obligation on its parties to enact national legislation, or whether the binding instrument should establish international liability of TNCOBEs. The legitimacy of imposing liability on private entities through a public international law instrument was a concern raised but later rebutted based on precedents such as the Maritime Labour Convention, which clearly created liability under international law for private ship-owners. Several participants also proposed an international standing body to receive and address cases of corporate human rights abuse.

What mechanisms are necessary for effective access to meaningful remedies?

There was a consensus among the participants that providing victims with effective access to meaningful remedies is at the core of the proposed instrument. In fact, this is both the starting point and the ultimate goal for deliberating such an instrument, to complement the third pillar of the UNGPs. But to achieve such goal is a challenging task. UN-sponsored studies indicate that, in many situations, the existence of "patchy, unpredictable, often ineffective and fragile" domestic remedies for human rights protection is the first hurdle.[5] In order to overcome the challenges, in addition to necessary domestic legal reforms, participants also recognized the critical role of international cooperation. Some suggested that the future instrument should establish an institutional framework to facilitate domestic legal reforms and to foster such international cooperation among the parties, especially in the areas of enforcement of judgment and capacity-building activities.

The way ahead is long but promises to be rewarding

As noted by some participants in their final remarks, this intergovernmental process is complex, sensitive and challenging. It was noted that it will take time for parties to bridge the gaps and to find some common ground, but the result will be rewarding and warrant such efforts. In order to achieve any positive result, participants agree that the efforts of diplomats alone will not be enough. Contributions from other stakeholders, such as communities, private businesses and civil society organizations, are also essential. At the end of the first session, the Working Group committed to engage in informal consultations with various stakeholders before its second session, to be held in 2016.

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In favour: Algeria, Benin, Burkina Faso, China, Congo, Côte d'Ivoire, Cuba, Ethiopia, India, Indonesia, Kazakhstan, Kenya, Morocco, Namibia, Pakistan, Philippines, Russian Federation, South Africa, Venezuela (Bolivarian Republic of), Viet Nam.

Against: Austria, Czech Republic, Estonia, France, Germany, Ireland, Italy, Japan, Montenegro, Republic of Korea, Romania, the former Yugoslav Republic of Macedonia, United Kingdom of Great Britain and Northern Ireland, United States of America.

Abstaining: Argentina, Botswana, Brazil, Chile, Costa Rica, Gabon, Kuwait, Maldives, Mexico, Peru, Saudi Arabia, Sierra Leone, United Arab Emirates.

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news in brief

UN Independent Expert Alfred de Zayas recommends abolishing current ISDS regime

In a report circulated on August 5, 2015, UN Independent Expert on the promotion of a democratic and equitable international order, Alfred-Maurice de Zayas, recommended that states abolish the existing investor–state dispute settlement (ISDS) system. The full text of the report is contained in UN document A/70/285.

The expert suggests replacing the ISDS regime with an international investment court, state–state settlement before the International Court of Justice, or litigation before domestic courts following due process standards established under international human rights law. Existing investment agreements would have to be modified or terminated accordingly.

Zayas also recommends conducting human rights, health, and environmental impact assessments before and after concluding investment agreements. Furthermore, he calls on states to suppress economic crimes, banking speculation, and corruption, and to adopt a legally binding convention covering corporate social responsibilities.

Investment Court System proposed by European Commission

On September 16, 2015, the European Commission published its proposal on Investment Protection and Resolution of Investment Disputes and Investment Court System. While aimed primarily at the EU–U.S. negotiations for a Transatlantic Trade and Investment Partnership (TTIP), the proposal would replace the investor–state dispute settlement (ISDS) mechanism in all ongoing and future EU investment negotiations.

The system would be composed of a first instance tribunal and an appeal tribunal. Among the elements of the text are safeguards to states' right to regulate, transparency of proceedings, and high qualification requirements for judges. The system would also bar forum shopping, parallel proceedings, and frivolous claims. The Commission hopes to build trust in the dispute resolution system by embedding in its proposal the inputs received through the public consultation on ISDS.

After discussing with the European Council and Parliament, the Commission will present the proposed text to the United States. It has also committed to working with other countries on establishing a permanent International Investment Court to replace all ISDS mechanisms in trade and investment agreements, both within and outside the EU context.

Deal reached on Trans-Pacific Partnership

On October 5, 2015, trade ministers reached agreement on the Trans-Pacific Partnership (TPP). The trade and investment agreement includes 12 countries, representing 40 per cent of the global economy: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam. Published on November 5, the text is available at http://www.tpp.mfat.govt.nz/text.

Tariff reduction schedules had already been set for hundreds of items. The final round of negotiations started in Atlanta, United States, on September 30, and centered on the more politically charged issues. The negotiating partners finally reached agreement on issues involving sectors such as biologic drug developers, dairy farmers, and auto producers. Minimum standards were also agreed on regarding environmental, labour, intellectual property, and other matters.

As reported by ITN in May, Australia had indicated in one of these texts that the investor–state dispute settlement (ISDS) mechanism under TPP would not be available for use by Australian investors or against Australia, except under "certain conditions." The text seems to have given Australian Trade and Investment Minister Andrew Robb enough confidence to state that "Australia will be able to ensure that tobacco control measures are never open to challenge."

EU–U.S. negotiations: ISDS on hold and controversy on a leaked EU proposal for the sustainable development chapter; secrecy in TTIP negotiations still a concern

From October 19 to 23, 2015, EU and U.S. officials conducted the 11th round of TTIP negotiations in Miami, United States. The agreement, in negotiation since 2013, aims at liberalizing trade and investment between the two parties, which encompass 850 million people and over half of the world's economy.

Negotiators said "substantial progress" was made in Miami, particularly in reconciling positions on tariffs and regulatory cooperation. Investment protection standards have not yet been discussed. U.S. negotiators insist that the deal must include an ISDS mechanism, which remains controversial in public debate, particularly in Europe. The European Union's investment court proposal has not yet been brought to the negotiation table.

A draft EU proposal for the Trade and Sustainable Development Chapter was leaked on October 23 by The Guardian. The newspaper criticized the text for containing "only vaguely phrased and non-binding commitments," despite earlier promises by the European Union to "set high levels of environmental and labour protection."

Secrecy in the negotiations continues to be a concern. Publishing all key negotiating texts—in TTIP as well as other negotiations—is one of the pillars of the European Commission's new strategy, "Trade for all: A more responsible trade and investment policy," published in October 2015. European politicians expect reciprocity from their U.S. counterparts. In an interview on September 28, French Foreign Trade Minister Matthias Fekl threatened pulling France out of TTIP negotiations if U.S. negotiators fail to be more transparent.

Both parties are intensifying the pace of negotiations. U.S. officials are pushing to conclude the agreement before the end of President Barack Obama's term in January 2017, while EU officials foresee that negotiations may take longer. The next formal round of negotiations is scheduled for February 2016.

ICSID tribunal renders interim decision on Ecuador's environmental counterclaim in long-running dispute

Perenco Ecuador Limited v. Republic of Ecuador, ICSID Case No. ARB/08/6

Matthew Levine

Perenco Ecuador Limited (Perenco)—a French-owned oil and gas company—and the Republic of Ecuador have been involved in arbitration since 2008 under the France–Ecuador bilateral investment treaty (BIT) and certain concession contracts. An International Centre for Settlement of Investment Disputes (ICSID) arbitration tribunal has issued an *Interim Decision on the Environmental Counterclaim* (Interim Decision).

The Interim Decision includes an invitation for the parties to settle the issues in dispute. The ICSID tribunal criticized the testimony of both sides' experts and suggested that the parties use a tribunal-appointed expert. The tribunal declined to immediately decide the issues raised by the counterclaim, indicating instead a willingness to do so in a future, final decision.

Background

Perenco was constituted under the laws of the Bahamas. A controlling interest in Perenco is indirectly held by the estate of the late Hubert Perrodo, a French national. Perenco, along with a Texas-headquartered oil and gas company (Burlington Resources), which has subsequently been acquired by the international major ConocoPhillips, invested in the operation of two hydrocarbon blocks through Ecuadorian participation contracts.

Following a political transition in Ecuador, Perenco was subjected to progressive windfall taxes of 50 and 99 per cent. Following imposition of the second levy, Ecuador's national oil company Petroecuador took over operation of the blocks. In April 2008, Perenco filed with ICSID a request for arbitration against Ecuador and Petroecuador. Ecuador's December 2011 counter-memorial alleged that Perenco's activities had resulted in significant environmental damage (environmental counterclaim) and amounted to a failure to properly maintain the blocks' infrastructure in good working condition (infrastructure counterclaim).

In a September 2014 *Decision on Remaining Issues of Jurisdiction and on Liability*, the tribunal confirmed an earlier finding of jurisdiction under both the BIT and the participation contracts. It also found Ecuador liable to pay compensation to Perenco under these same instruments.

The 2014 decision noted that the parties had agreed to a separate briefing schedule and hearing on Ecuador's counterclaims. Ecuador alleged that Perenco had left behind an environmental catastrophe and sought approximately USD 2.5 billion in compensation for necessary remediation. Perenco argued that that its liability did not exceed USD 10 million. The tribunal has now issued the Interim Decision.

Parties' experts "effectively shooting at different targets"

After reviewing the evidence, the tribunal was satisfied that there was at least some contamination for which Perenco would likely be held liable. However, it also noted that each of the parties' expert witnesses was "attempting to achieve the best result for the party by whom they were instructed, and that they crossed the boundary between professional objective analysis and party representation." They were "effectively shooting at different targets and this has made the work of this Tribunal most difficult" (para. 581).

In this context, the tribunal found that the only equitable solution in relation to the contamination problems would be to have a new expert examine the existing samples; if the problems were deemed to warrant remediation in light of all relevant circumstances, Perenco, its predecessor Petroamazonas, or both could be found *prima facie* liable for remediation costs. Only once this and certain other procedures have been completed would the parties be in a position to reach a negotiated settlement or the tribunal in a position to make a final determination of any damages owed by Perenco to Ecuador.

Fault-based liability applies during initial investment period

Having reviewed the parties' written and oral submissions, as well as expert evidence, the tribunal arrived at a series of conclusions as to the manner in which the counterclaim was put and the state of the dispute.

With regards to any contamination in excess of regulatory standards shown to have occurred between September 4, 2002 (when Perenco acquired its interests in the blocks) and October 19, 2008 (when Ecuador's current Constitution was promulgated), the tribunal found that a fault-based regime must apply. However, liability for any excess contamination shown to have occurred after October 20, 2008 should be assessed on the basis of strict liability, in accordance with the 2008 Constitution's regime for environmental damage.

Tribunal resolves relationship between environmental regulations and "background values"

The tribunal considered the relationship between the 2008 Constitution and domestic environmental regulations as the first of two major questions, the resolution of which narrowed the need for any further analysis. It found that the 2008 Constitution was the state's supreme legal framework within which other regulations specific to hydrocarbon activities must operate.

Ecuador had argued that its hydrocarbons regulatory regime should give way to "background values" found in the Constitution, such as full remediation of contamination. After carefully considering the arguments and the evidence, the tribunal found that it could not accept this argument. While nothing

precluded Ecuador from promulgating regulations that would hold oilfield operators to more stringent environmental standards, the 2008 Constitution alone was not a substitute for such regulations.

In principle, the tribunal also noted the issue of whether the 2008 Constitution's strict liability regime could be applied to Perenco's pre-2008 activities. Having found that the 2008 Constitution could not in and of itself establish technical standards, the tribunal found that it must look to the specific regulations enacted "on the ground" by the Ecuadorian state both before and after 2008.

Decision on infrastructure counterclaim reserved

Finally, the tribunal noted that it was most expedient and constructive to issue its decision on the environmental counterclaim first so as to permit the new expert to be selected, appointed, and instructed on his or her mandate, and only to then engage in the work that needs to be done. The tribunal further noted that it was likely to benefit from the evidence regarding Perenco's operation to be presented in a future hearing. It therefore reserved the infrastructure counterclaim to be addressed along with the overall quantum of damages.

Notes: The tribunal is composed of Judge Peter Tomka (President appointed by the Chairman of the ICSID Administrative Council, Slovak national), Neil Kaplan (claimant's appointee, British national), and Christopher Thomas (respondent's appointee, Canadian national). The *Interim Decision on the Environmental Counterclaim* of August 11, 2015 is available at http://www.italaw.com/sites/default/files/case-documents/italaw6315.pdf

First ICSID case brought by Chinese mainland investors dismissed on jurisdictional grounds

Ping An Life Insurance Company of China, Limited and Ping An Insurance (Group) Company of China, Limited v. Kingdom of Belgium, ICSID Case No. ARB/12/29

Joe Zhang

In an award dated April 30, 2015, a tribunal at the International Centre for Settlement of Investment Disputes (ICSID) dismissed what is believed to be the first claim at ICSID initiated by investors from mainland China.

Background

In 2007, the claimants—two insurance giants from mainland China—jointly became the largest shareholder of the Fortis group, a global banking and insurance group, regulated by Belgian, Dutch and Luxembourg authorities. In the aftermath of the 2008 financial crisis, Fortis was faced with a critical liquidity challenge. In order to rescue Fortis, the Belgian government implemented a series of measures that in effect nationalized the Belgian subsidiary of the group. Such restructuring resulted in a dilution of then-existing shareholders' (including the claimants') interest in Fortis. As the measures did not bring Fortis out of trouble, in early 2009 Belgium sold the Belgian subsidiary to BNP Paribas, which allegedly resulted in a significant loss to claimants of most of their investment in the Fortis group.

Two BITs

The claim relied on two bilateral investment treaties (BITs): the 1986 BIT between the Belgium–Luxembourg Economic Union (BLEU) and China, and the 2009 BLEU–China BIT that replaced the earlier one. Both BITs contain substantive obligations of protection and equitable treatment, and conditions for expropriation and nationalization. However, the dispute settlement provision of the 1986 BIT was much more restrictive than that of the 2009 BIT. In particular, the 1986 BIT granted exclusive domestic jurisdiction to "all disputes"; international arbitration could only be invoked to determine the amount of compensation for expropriation. By comparison, the 2009 BIT has a much broader dispute settlement clause, which provides that the investor may choose to submit any legal dispute between and investor of one state and the other state to ICSID for international arbitration.

> "Acknowledging the risk that certain disputes might fall into some 'black hole' or 'arbitration gap' between the two BITs, the tribunal found that the 2009 BIT did not cover the dispute at question."

In October 2009, two months before the entry into force of the 2009 BIT, the claimants sent a notice of dispute to the Belgian government citing the 1986 BIT. In 2012, the claimants communicated with the Belgian government to confirm that the October 2009 letter constituted a notice of dispute under the 2009 BIT and subsequently filed a formal request for arbitration with ICSID relying on the 2009 BIT's arbitration clause. The merits of the claim, however, were entirely based on the substantive obligations under the 1986 BIT and general principles of international law.

Discussions

Belgium raised a total of five jurisdictional objections. The tribunal did not address the remaining four objections once it decided the case in favour of Belgium on its first objection—*ratione temporis.*

Belgium argued that the dispute arose before the entry

into force of the 2009 BIT, which only covered breaches of that treaty or other existing treaties, and did not include the obligations under the 1986 BIT and general principles of international law on which claimants relied in formulating their claims.

After canvassing the previous ruling and awards rendered by international tribunals on the principle of non-retroactivity in international law, the tribunal noted that the issue of non-retroactivity is not relevant in this case as "the temporal application of jurisdictional provisions is a question separate from the retroactivity of substantive provisions" (para. 186); and "the application of a new dispute settlement mechanism to acts which may have been unlawful when they were committed is not in itself the retroactive application of law" (para. 218).

The tribunal then focused on the interpretation of the arbitration clause of the 2009 BIT, in particular, whether it covers disputes previously notified but not submitted to a formal judicial or arbitral process before it came into force. Relying on the following six indicators, the tribunal ultimately found the parties to the treaty did not intend for the 2009 BIT to cover these disputes.

First, the tribunal looked at the "plain meaning" of the arbitration provisions of the 2009 BIT and found it referred to future disputes rather than disputes that had already arisen, as the 2009 BIT used the language of "[w]hen a legal dispute *arises* […] either party to the disputes *shall notify* […]" instead of "*has arisen*" or "*shall have notified*" (para. 224).

Second, the tribunal found that nothing in the preamble of the 2009 BIT that could assist the claimants' position, and refused to fill such gap by "creative interpretation."

Third, the tribunal noted that the 2009 BIT expressly covered prior investments but not disputes arising before its entry into force.

Fourth, although the 2009 BIT made it clear that it does not apply to disputes already under judicial or arbitral process before its entry into force, the tribunal rejected the claimants' argument that this supports the inference that those prior disputes already notified but not yet under judicial or arbitral process would be covered.

Fifth, the fact that the 2009 BIT substituted and replaced the 1986 BIT does not justify the inference that these "notified but not matured" disputes would survive under the 2009 BIT.

Finally, the tribunal looked at the potential impact if the claim were allowed to proceed, and expressed its concern that claimants would be awarded access to a significantly broader dispute settlement mechanism simply by the coming into force of the 2009 BIT without any express consent by the contracting parties.

Final decisions

Regrettably acknowledging the risk that certain disputes, including the one at question, "might fall into some 'black hole' or 'arbitration gap' between the two BITs" (para. 207), the tribunal nevertheless found there was nothing in the 2009 BIT that could justify the extension of its coverage to settle these disputes. However, the tribunal did not rule out the possibility that the claimant could still seek other remedies, including initiating a new claim (either investor–state or state–state) under the 1986 BIT by the operation of its survival clause, or initiating a proceeding in Belgium's domestic courts.

The tribunal ordered the parties to share the expenses of the tribunal and ICSID, and each of the parties to bear its own legal fees and expenses.

Notes: The tribunal was composed of Lord (Lawrence) Collins of Mapesburty (President appointed by agreement of the co-arbitrators, British national), David A.R. Williams (claimants' appointee, New Zealand national), and Philippe Sands (respondent's appointee, British and French national). The award is available at http://www.italaw.com/sites/default/files/case-documents/italaw4285.pdf

Tribunal largely adopts independent expert's damages findings in USD 405 million award to previous owners of an Argentine public utility company

Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic, ICSID Case No. ARB/03/17; and AWG Group Ltd. v. The Argentine Republic, UNCITRAL

Marquita Davis

In a combined ICSID and UNCITRAL decision dated April 9, 2015, a unanimous tribunal awarded claimants Suez, Sociedad General de Aguas de Barcelona S.A. (AGBAR), Vivendi Universal S.A. (Vivendi), and AWG Group Ltd (AWG) a total of USD 405 million for Argentina's breach of its fair and equitable treatment (FET) obligation during the 2001 financial crisis.

Background and claims

The claimants owned and managed the Argentine company Aguas Argentinas S.A. (AASA), which had a 30-year concession contract with the Argentine government to provide public water and sewage services. In its 2010 Decision on Liability, the tribunal found that Argentina's emergency measures during its 2001 financial crisis led to the failure of AASA, but postponed the complex valuation of the losses sustained by the claimants.

The claimants initially alleged losses exceeding USD 1 billion, seeking damages relating to debt payments they

made to multilateral lenders, loss of equity interests in AASA, unpaid management fees, and unpaid dividend interests. In turn, Argentina argued the claimants sustained zero losses because AASA was going to fail for other reasons unconnected to Argentina's actions.

Double recovery dismissed by tribunal

Argentina also argued that there was a risk of double recovery, because AASA had a claim of ARS 2,487,600,000 (roughly USD 260 million) before Argentine courts. The tribunal determined that no actual double recovery had been established given that the Argentine court had not granted any recovery to AASA as of the date of the award.

International law standard of compensation: full compensation

Based on the three bilateral investment treaties (BITs) applicable in this case (the France–Argentina BIT, the Argentina–Spain BIT, and the Argentina–United Kingdom BIT), the tribunal determined that the legal standard of awarding compensation for Argentina's treaty violation was to be found in international law principles. Because the parties disagreed on what international law principles should be applied, the tribunal determined that it must look to customary international law.

The tribunal reasoned that Argentina's failure to accord claimants FET under the relevant treaties constituted international wrongful acts. As a result, Argentina was obligated to compensate the claimants for any injuries sustained from its failure to meet its international obligations and "place the Claimants 'in the situation which would, in all probability, have existed' if Argentina had not committed its illegal acts" (para. 27). The tribunal looked to the *Chorzów Factory Case* to determine that full compensation (*restitution in integrum*) was the appropriate customary international law standard.

> "According to the tribunal, compound interest was more effective than simple interest in putting claimants back in the position they 'currently would have been had the injury not taken place.'"

Damages valuated by independent financial expert

After having received input from both parties, the tribunal appointed independent financial expert Akash Deep to valuate the damages. Each party was allowed to submit comments on Deep's preliminary report to the tribunal. During a later hearing, parties were allowed to examine Deep and have financial experts testify on their behalf.

To determine the value of the investment, the tribunal asked Dr. Deep to first determine its value *without* the measures taken by Argentina, and then calculate its value *with* the measures taken by Argentina, and finally subtract the second value from the first and actualize that amount with an appropriate interest rate to put the claimants in the position they would have been had Argentina not breached its FET obligation. Dr. Deep created an economic model of AASA's operation that took into consideration various factors, including general economic conditions, labour conditions, operating costs, and changes in technology that would have impacted the profitability of AASA's concession.

The tribunal acknowledged that the valuation of claimants' losses would be imprecise, but stated that international law does not require that damages be calculated with absolute certainty. The damages calculation need only put the claimant in the position they "*in all probability*" (para. 30) would have been in had Argentina not breached its obligations.

Valuation period: from date of breach until expiration date of the concession contract

Argentina argued that the valuation period should only run from 2002 (when the violation occurred) until 2006 (when the concession was terminated). However, the tribunal agreed with the claimants and Dr. Deep that the valuation period should extend to 2023, the date of the concession's expiration according to the contract; otherwise, the shorter valuation period would "seriously undervalue" claimants' losses.

Compensation for amounts paid to extinguish debt guarantees

The four claimants were awarded compensation of USD 360,987,923 for the amounts they paid to multilateral lenders to extinguish the debt guarantees, including compound interest. The tribunal reasoned that compound interest was more effective than simple interest in putting claimants back in the position they "*currently* would have been had the injury not taken place" (para. 65). It also cited to recent international tribunals who have applied compound interest for damage calculations and standard financial and business practices that apply compound interests when calculating losses.

The tribunal also dismissed Argentina's argument that the claimants should have borne the risk of their choice to finance AASA with Dollar-denominated loans rather than Peso-denominated loans. Instead the tribunal reasoned that the fact that an investment presents a risk does not mean that it is not protected by a relevant treaty or applicable customary international law. The tribunal also awarded claimants USD 10.4 million for

unpaid fines incurred by AASA.

Compensation for management fees

Claimant Suez was awarded USD 26,084,421 in unpaid management fees under its management contract with AASA for the years 2018 to 2023; Dr. Deep determined that in this period the claimant would have had sufficient cash flow to pay management fees if Argentina had afforded AASA fair and equitable treatment. Argentina opposed awarding management fees because it considered them to result from a commercial agreement, not consisting in an investment covered under the relevant BIT; thus, according to Argentina, claims arising under the contract were not within the jurisdiction of the tribunal. The tribunal determined that the management contract was not an ordinary commercial agreement given that the concession agreement required that "at least one substantial investor serve as the Concession's operator" (para. 75).

However, the tribunal declined to award Suez earned but unpaid management fees for the years before 2001, when Argentina enacted its emergency measures. According to the tribunal, the Argentine government was not responsible for the non-payment of such management fees, and a reasonable regulator facing difficult circumstances during a financial crisis would not have provided for their payment.

Compensation for loss on equity in AASA

The claimants were awarded USD 17,466,706 for their loss on equity in AASA as determined by Dr. Deep, who averaged the results of two valuation methods: the Adjusted Present Value Method and the Flow to Equity Method. The tribunal did not award claimants the value of unpaid dividends because it considered them to be included in the value of the shareholders' equity in AASA.

Costs

Costs in the UNCITRAL and ICSID cases were decided separately.

Under UNCITRAL Arbitration Rules, costs are normally borne by the unsuccessful party, but the tribunal has discretion to consider specific factors of the case when apportioning costs. As the present case involved "many novel and complex issues of fact and law" (para. 113), the claimants only prevailed on one violation claimed (FET), and claimants recovered far less than they claimed, the tribunal decided that it was appropriate to depart from the general principle of the unsuccessful party paying costs. It ordered claimant AWG and Argentina to each bear their own costs and to split the costs of arbitration.

Under the ICSID case, claimants Suez, Vivendi, and AGBAR as well as respondent Argentina were also directed to bear their own costs and split the costs of arbitration for the above reasons.

The claimants committed not to seek double recovery for any loss awarded and paid in the present arbitration.

Notes: The tribunal was composed of Jeswald W. Salacuse (President appointed by ICSID, U.S. national), Gabrielle Kaufmann-Kohler (claimant's appointee, Swiss national), and Pedro Nikken (respondent's appointee, Venezuelan national). The award is available at http://www.italaw.com/sites/default/files/case-documents/italaw4365.pdf. The 2010 Decision on Liability is available at http://www.italaw.com/documents/SuezVivendiAWGDecisiononLiability.pdf

Energorynok had no ownership or control over energy-related economic activity; ECT case against Moldova dismissed

State Enterprise "Energorynok" (Ukraine) v. The Republic of Moldova, SCC Arbitration V (2012/175)

Martin Dietrich Brauch

A January 29, 2015 award by a tribunal under the Arbitration Institute of the Stockholm Chamber of Commerce has recently become public. The tribunal dismissed the claims by Ukrainian state enterprise Energorynok against Moldova under the Energy Charter Treaty (ECT) for lack of jurisdiction.

Background and claims

In February 1995, the energy ministries of Ukraine and Moldova concluded an Agreement on the Parallel Operation of the Energy Systems of Ukraine and Moldova (the APO), vesting its performance in two state enterprises: Ukrenergo for Ukraine, Moldtranselectro for Moldova.

An overflow of electricity of 50,000,000 kWh occurred from Ukraine to Moldova in October 1998; under the APO, this overflow trigged Moldova's obligation to compensate Ukraine in the amount of USD 1,662,297.81. Ukraine's credit for the overflow was transferred from Ukrenergo to the claimant, Ukrainian state enterprise Energorynok, established in May 2000.

After trying unsuccessfully to obtain payment from Moldtranselectro for five years, Energorynok initiated a lawsuit in 2002 against Moldova's energy ministry. This lawsuit resulted in a December 25, 2002 decision of the Economic Court in Kiev that ordered Moldova's energy ministry to pay Energorynok USD 1,745,412.71 and litigation costs.

As Energorynok's efforts to enforce the 2002 decision also failed, it initiated arbitration against Moldova under the ECT in December 2012. In particular, it argued that its claim to money under the 2002 decision was an investment under the ECT and that, by failing to enforce

the decision, Moldova expropriated Energorynok's investment and breached the fair and equitable treatment standard under the ECT. It sought compensation in the amount determined in the 2002 decision, plus interest, and arbitration fees and legal costs.

Moldova objects to jurisdiction; Energorynok insists it had "investment" under ECT.

According to the tribunal, Moldova objected to the tribunal's jurisdiction arguing that the 2002 Kiev court decision was "illegally and fraudulently obtained" and therefore did not deserve protection under the ECT, and that, even if this were not the case, Energorynok did not satisfy the criteria to bring an ECT claim (para. 77).

The tribunal reasoned that whether Energorynok had obtained the 2002 decision illegally and fraudulently was a question for the merits. Leaving that question to the side, it set out to look instead at whether it had jurisdiction, analyzing whether Energorynok had an "investment" under the ECT.

Relying on the definition of "investment" under ECT Article 1(6), Energorynok argued that its investment is a claim for money or the right to compensation for the overflow, and that this claim or right was an energy-related asset with an economic value. The claimant relied on *Petrobart v. Kyrgyz Republic*, which concluded that a contract, a court decision, and a claim to money concerning the sale of a gas condensate were "investments" under the ECT.

> "For a claim to money to qualify as an ECT 'investment,' the investor must also have ownership, control or a financial interest in the underlying energy-related economic activity out of which the claim arose."

Tribunal looks at Petrobart and Electrabel to clarify circular definition of "investment"

In interpreting whether Energorynok had an investment, the tribunal looked mostly to *Petrobart* and to *Electrabel v. Hungary*, another ECT case. Both tribunals noted the ambiguous and unclear language in ECT Article 1(6)(c). In referring to "claims to money and claims to performance pursuant to contract having an economic value and *associated with an Investment*," the provision defines "investment" by resorting to a reference to "investment"—a circular definition raising logical problems.

The *Petrobart* tribunal concluded that, since the gas condensate sold was an energy material qualified as an "investment," the claimant's right to be paid for this gas condensate was also covered under "investment." The *Electrabel* tribunal indicated that interpreting ECT Article 1(6)(c) depended on an overall assessment of the investment.

Energorynok failed to show ownership or control over energy-related economic activity

Applying these interpretations to the present case, the tribunal pointed out that the claimant, unlike *Electrabel*, was "not a shareholder in an entity directly or indirectly engaged in the underlying economic activities." Furthermore, it indicated that Energorynok, unlike *Petrobart*, did not have "full control over its own sales and deliveries," and was not "a full party to the sale and delivery contract" (para. 86).

The tribunal agreed with Energorynok that "ECT Article 1(6) requires the investor to own or control the asset" (para. 89). Yet the tribunal interpreted that, for the claim to money to qualify as an "investment" under Article 1(6)(c), the investor must also have ownership, control or a financial interest in the "investment" to which the claim was associated, that is, the underlying energy-related economic activity out of which the claim ultimately arose.

Indicating that Energorynok was not a party to the APO and, accordingly, had no right, obligation or role under the APO, the tribunal found that the claimant, even though owning or controlling a claim to money, did not have any ownership, control or interest in the "investment" to which the claim to money was associated—the transmission of electricity in Moldova. Accordingly, the tribunal found that Energorynok's claim to money did not constitute an "investment" under the ECT, and dismissed the case for lack of jurisdiction.

The parties were ordered to bear arbitration costs equally, and each of them was ordered to bear its own legal costs and other expenses.

Notes: The SCC tribunal was composed of Nancy B. Turck (Chairperson appointed by the Arbitration Institute of the SCC), Joseph Tirado (claimant's appointee), and Rolf Knieper (respondent's appointee). The award is available at http://www.italaw.com/sites/default/files/case-documents/italaw6299.pdf

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resources and events

Resources

The Law of Investment Treaties

By Jeswald Salacuse, Published by Oxford University Press, July 2015

The book examines the law of international investment treaties, specifically in relation to its origins, structure, content, and effect, as well as their impact on international investors and investments, and the governments that are parties to them. Since publication of the first edition, in 2010, this field of law has both experienced growth and generated controversy. The year 2011 saw the highest number of new treaty-based investment arbitration cases to date; in July 2014, *Yukos v. Russia* culminated with record awards of over US$50 billion. Controversy has primarily revolved around investor–state dispute settlement, thus far involving at least 98 states as respondents. Salacuse captures these developments, examining the significant growth in treaties, the trends that have followed, and their effect on the content and evolution of the law. The new edition includes an additional chapter on the consequences of treaty violations and the determination of damages in investor–state disputes. It also covers all treaties and free trade agreements negotiated since the first edition, and analyzes trends from treaty negotiation. Available at https://global.oup.com/academic/product/the-law-of-investment-treaties-9780198703976

Financing for Agriculture: How to boost opportunities in developing countries

By Marina Ruete, Published by the International Institute for Sustainable Development (IISD), September 2015

The policy brief explores the financial needs of agriculture in developing countries and the instruments available to address these needs. It examines the challenges in financing agricultural investments, the role of different actors, and the options for governments to enhance the legal and policy environment of the financial system to support agricultural development. It argues that a successful story of agriculture finance requires a combination of good laws, a specialized financial sector, and profitable businesses of small and large farmers and companies in the agriculture sector. The government can be proactive and promote or raise awareness of laws and regulations with financial instruments. Furthermore, regulation and programs to attract financing must be realistic with the characteristics of the sector and the viability and rate of return. Finally, financial regulations must go beyond economic development and consider, among others, food security, poverty reduction, and mainstreaming marginalized groups. Available at https://www.iisd.org/publications/financing-agriculture-how-boost-opportunities-developing-countries

Proportionality and Deference in Investor-State Arbitration: Balancing investment protection and regulatory autonomy

By Caroline Henckels, Published by Cambridge University Press, October 2015

The study examines how investment tribunals have balanced the interests of host states and foreign investors in determining state liability in disputes concerning the exercise of public power. It proposes a new methodology, combining the proportionality analysis with an institutionally sensitive approach to the standard of review, in order to lead to more consistent and coherent decisions and greater certainty, and to safeguard states' regulatory autonomy. Available at http://www.cambridge.org/academic/subjects/law/public-international-law/proportionality-and-deference-investor-state-arbitration-balancing-investment-protection-and-regulatory-autonomy

Yearbook on International Investment Law & Policy, 2013–2014

By Andrea K. Bjorklund, Published by Oxford University Press, September 2015

This annual publication provides an overview of recent trends and key issues in international investment law and policy. Topics covered include proportionality, standards of review in investment arbitration, legitimate expectations, investor protection and regulatory freedom, jurisprudential interaction between ICSID tribunals and the International Court of Justice, inconsistency in awards and the role of state interpretation, and state defences. Available at http://ukcatalogue.oup.com/product/9780190265779.do

NAFTA and Sustainable Development: The history, experience, and prospects for reform

By Hoi Kong & Kinvin Wroth (editors), Published by Cambridge University Press, August 2015

This book assesses the current state of environmental protection under the North American Free Trade Agreement (NAFTA) and the North American Agreement on Environmental Cooperation (NAAEC), outlining the scope and process of both agreements, their impact on specific environmental issues, and paths to reform. Available at http://www.cambridge.org/academic/subjects/law/environmental-law/nafta-and-sustainable-development-history-experience-and-prospects-reform

Transparency in International Investment Arbitration: A guide to the UNCITRAL Rules on Transparency in Treaty-Based Investor–State Arbitration

By Dimitrij Euler, Markus Gehring, & Maxi Scherer (editors), Published by Cambridge University Press, August 2015

This in-depth commentary analyses each paragraph of the UNCITRAL Transparency Rules, and explains the underlying debate for a broader context. Available at http://www.cambridge.org/academic/subjects/law/arbitration-dispute-resolution-and-mediation/transparency-international-investment-arbitration-guide-uncitral-rules-transparency-treaty-based-investor-state-arbitration

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Events 2015

November 10–11

10TH ANNUAL COLUMBIA INTERNATIONAL INVESTMENT CONFERENCE, Columbia Center on Sustainable Investment (CCSI) & UN Conference on Trade and Development (UNCTAD), New York, NY, United States, http://ccsi.columbia.edu/2015/11/10/10th-annual-columbia-international-investment-conference-investment-treaty-reform-reshaping-economic-governance-in-the-era-of-sustainable-development

November 16–18

9TH ANNUAL FORUM OF DEVELOPING COUNTRY INVESTMENT NEGOTIATORS, IISD, Government of Brazil & South Centre, Rio de Janeiro, Brazil, https://www.iisd.org/investment/dci

November 16–18

4TH ANNUAL UNITED NATIONS FORUM ON BUSINESS AND HUMAN RIGHTS, Office of the High Commissioner for Human Rights, Palais des Nations, Geneva, Switzerland, http://www.ohchr.org/EN/Issues/Business/Forum/Pages/2015ForumBHR.aspx

November 23–26

17TH AFRICA OIL, GAS AND MINES TRADE AND FINANCE CONFERENCE AND EXHIBITION: EXTRACTIVE INDUSTRIES AND SUSTAINABLE JOB CREATION, UNCTAD & Government of Sudan, Khartoum, Sudan, http://cubicglobe.com/ogtafrica/en

November 26

ICSID AT 50: THE EVOLUTION OF INTERNATIONAL INVESTMENT TREATIES AND DISPUTE RESOLUTION, International Centre for Settlement of Investment Disputes (ICSID) & Xi'an Jiaotong University, Xi'a, China, http://event.31huiyi.com/113990510

December 4–5

THE TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP (TTIP): A EU PERSPECTIVE ON GLOBAL ECONOMIC GOVERNANCE, Europa Institute and the Faculty of Governance & Global Affairs of Leiden University, Leiden, The Netherlands, http://law.leiden.edu/organisation/publiclaw/europainstitute/ttip/ttip/ttip-2015.html

December 11

32ND JOINT COLLOQUIUM ON INTERNATIONAL ARBITRATION: MODERNIZATION OF ARBITRATION – NEW APPROACHES TO CONTINUING CHALLENGES, ICSID, American Arbitration Association (AAA) International Centre for Dispute Resolution, International Chamber of Commerce (ICC) International Court of Arbitration, Washington, DC, United States, https://webapps.worldbank.org/apps/ICSIDWEB/Documents/32nd%20JointColloquium2015-Agenda.pdf

December 14–15

GREEN GROWTH AND SUSTAINABLE DEVELOPMENT FORUM 2015 – ENABLING THE NEXT INDUSTRIAL REVOLUTION: SYSTEMS INNOVATION FOR GREEN GROWTH, Organisation for Economic Co-operation and Development (OECD), Paris, France, http://www.oecd.org/greengrowth/ggsd-2015.htm

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