



Smart Flexibility Clauses in International Investment Agreements

by Anne van Aaken



The Quest for Commodities: Chinese Investment in Farmland by Carin Smaller, Qiu Wei and Liu Yalan

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The Draft Investment Chapter of the Canada-EU Comprehensive Economic and Trade Agreement: A Step Backwards for the EU and Canada? by Nathalie Bernasconi-Osterwalder

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Also in this issue: The Rompetrol Group N.V. v Romania; Ambiente Ufficio S.p.A. and others v. Argentine Republic; Inmaris Perestroika Sailing Maritime Services GmbH and others v. Ukraine; Tulip Real Estate and Development Netherlands B.V. v. Republic of Turkey

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Smart Flexibility Clauses in International Investment Agreements

Anne van Aaken

feature 1



A major challenge for investment treaty designers and adjudicators is to separate opportunistic behavior by host states that should be sanctioned under international law from bona fide public policy measures that should not. This article suggests that International Investment Agreements (IIAs) need to be both 'smarter' and more 'flexible' to better make that distinction. It draws on economic contract theory as a basic framework, and political economy theory for fine-tuning.

Economic Contract Theory

Complete contracts (or treaties) are impossible to draft since it is impossible to foresee and describe adequately the contractual outcome for all possible states of the future.¹ Contract theory distinguishes between three types of uncertainty:

1. Uncertainty about the future (unforeseeability)
2. Uncertainty about the actions of other players (asymmetrical information)
3. Uncertainty about the meaning and scope of contractual provisions (i.e. textual ambiguity and legal indeterminateness)

Information asymmetries between the parties pose the biggest problem: each party has exclusive information about itself, giving rise to potential opportunism. Contract theory analyzes the resulting problems: adverse selection, moral hazard, and verification. These problems arise equally in investment law. Contract theory also highlights the possibilities of solving them by separating behavior that should be allowed intra-contractually from behavior that should lead to punishment in order for the contract to be *ex post* efficient.² This separation serves as background for efficiently drafting flexibility clauses in IIAs.

Unanticipated contingencies, had they been known *ex ante*, would have changed the initial content of the contract. Regret occurs when unforeseen circumstances are not provided for in the (incomplete) contract, thus (erroneously) mandating performance, whereas the (ideal) 'complete contingent contract' would have excused such performance. Mandating performance or damages for a regulatory measure taken in good faith and without a discriminatory basis as, for example, in *CMS v. Argentina*,³ would be *ex post* inefficient. It's for that reason that contracts usually try to distinguish between opportunistic behavior taken in bad faith and unforeseen contingencies taken in good faith, and mandate different legal consequences accordingly.⁴ Regret contingency is different from opportunism in that the former is *ex post* welfare-enhancing for both parties, whereas opportunism is only welfare-enhancing for one party. It follows that the former should be permitted in the contract whereas the latter should not. This, however, is not the case in investment law: good faith regulations or good faith reactions to crises have led tribunals to order damage payments.

“ Smart flexibility clauses can be defined as clauses that take into account unforeseen contingencies. ”

Political Economy Theory

Political economy can give guidance on instances of opportunistic behavior. It has been successfully applied to trade-policy formation,⁵ but not yet to investment law. However, there are similarities: as Gene M. Grossman and Elhanan Helpman note, “(t)he domestic industry has the same incentive to lobby for barriers to investment as it has to lobby for impediments to trade.”⁶ Thus, being the result of maximizing political support, instead of maximizing welfare, some regulation will be opportunistic.⁷ Their approach allows us to look for typical opportunistic behavior, such as protectionist and discriminatory measures that seek to maximize either the support of the relevant national industry⁸ or one's own finances (i.e., corruption) via expropriation.

Smart Flexibility Clauses

Smart flexibility clauses can be defined as clauses

that take into account unforeseen contingencies, in order to distinguish between host state measures that are in the public interest, for which compensation is not required, and opportunistic measures, for which compensation is necessary. One dimension of smart flexibility concerns the textual scope of the clause (i.e., the substantive dimension). Flexibility clauses are to be found on a continuum and range from essential security clauses to exceptions for certain regulatory goals. A second dimension of flexibility is grounded in the strictness of scrutiny of those clauses; in other words, the scope provided to tribunals to review government actions. Again, these are to be found on a continuum and range from self-judging clauses to strict scrutiny by tribunals. Furthermore, there are institutional mechanisms to be considered for a separation of opportunistic and good faith behavior (i.e., the institutional dimension).

With a view to the substantive dimension, clauses can be drafted such that particular measures taken in good faith and non-discriminatory are explicitly excluded from a breach and thus allow for state measures taken with a view to sustainable development goals. They can also include guidance to the tribunal concerning the allowed scope of review, thus delegating more or less judgment to the tribunal.

The Substantive Dimension

Substantively, the concepts of 'good faith' and 'non-discrimination' are particularly important to smart flexibility clauses. Currently, it is contentious whether a good faith measure by a host state would breach an IIA, especially when fair and equitable treatment or indirect expropriation is discussed. Whereas bad faith would indicate a breach for all tribunals, it is unclear whether good faith spares a host state from violating a treaty. From a flexibility point of view, a measure taken in good faith should be more readily accepted as legitimate by tribunals. In these cases there is a need to isolate special circumstances in which damages would be warranted, such as a bona fide direct expropriation where compensation has not been paid, or an indirect expropriation where a special sacrifice was demanded by the claimant. A good faith measure tends to be the result of evolving factual and legal circumstances (for example, the ratification of an international human rights treaty or an enhanced environmental policy) rather than of opportunistic behavior by the government. Both the United States and Canadian Model BITs explicitly state that certain measures with a good faith purpose, such as a public welfare objective, and taken in a non-discriminatory fashion, are not compensable.⁹ Thus, smart flexibility clauses not only explicitly describe permissible measures, but also exclude non-discriminatory measures. Furthermore, they provide

the tribunal with the discretion to award damages in the rare circumstances in which a good faith measure would amount to a treaty breach.

Arguments on non-discriminatory measures are more principled. From an economic point of view, non-discrimination is the gold standard since it guarantees a level playing field for all investors (national and international). Discriminatory measures are therefore supposed to breach an IIA in almost all circumstances,¹⁰ since there is reasonable suspicion that the motivation behind the policy measure is protective. If investment is also, as trade, about competitive opportunities, discriminatory conduct of the state ought to be scrutinized, whereas non-discriminatory conduct should not lead to a finding of a violation of an IIA, except in rare circumstances. Discriminatory conduct in post-establishment settings is, in other words, a strong indicator of opportunistic behavior. However, intent plays an exculpatory role since even discriminatory conduct may be permissible if the intent is benevolent. That could, for example, be the case in times of financial crises with a limited budget to bail out banks: there, discriminatory bail-outs or state guarantees for national banks may be excused. Furthermore, good faith measures which are taken by the government in emergency situations in an attempt to solve the crisis should not be compensable if the same measures are applied to nationals. A strong hint would be a national emergency law that also imposes hardship on national industry and citizens.

“ The United States and Canadian Model BITs explicitly state that certain measures with a good faith purpose, such as a public welfare objective, and taken in a nondiscriminatory fashion, are not compensable. ”

The Review Dimension

With respect to scope of review, self-judging clauses provide states with the greatest flexibility, while preventing tribunals from differentiating between opportunistic and welfare enhancing good faith measures. They could therefore easily lead to abuse by self-interested politicians. They also

create a legal void for investors and may impede legal security since any review of the host state's conduct is discarded. However, full review seems inadequate given that oftentimes, particularly in emergency or national security cases, a margin of appreciation should be provided to the government. In addition, the tribunal may lack the expertise to properly assess the government's response to the crisis. In order to avoid opportunistic behavior, a good faith review suffices. This is what national administrative courts do when they control discretion of the administration: they control for good faith limits. In other words, the legality of the behavior of the government is checked, but if the behavior stays within good faith limits, expediency considerations are not scrutinized. If, for example, the government takes a land zoning measure, courts would scrutinize the legality of the procedure and whether the government has taken into account certain interests prescribed by law, but would not scrutinize the economic efficiency of the decision.

Institutional Mechanisms

Finally, institutional mechanisms can help distinguish between opportunistic behavior and desired behavior by delegating certain questions to expert bodies. For example, the 2012 United States Model BIT contains an institutional innovation concerning procedures for prudential measures related to the financial market. Similar procedures may also be applicable to other constellations. Here, states take back the delegation from the tribunal to solve certain questions – such as emergency measures in financial crises—and delegate them to specialized experts, normally non-political agencies of the state parties. This has the potential to mitigate opportunistic behavior by governments. When both agencies agree that a measure taken by the host state was prudential, a tribunal will likely have difficulties in finding opportunistic behavior. When considering the introduction of such procedures in their IIAs, states should decide whether they: 1) allow them to apply only above a certain threshold of damage claims (cost-benefit analysis); 2) bind tribunals by the views issued by the state parties' agencies; and 3) include expert consultation as a general principle.

Conclusion

Smart flexibility clauses such as those incorporated in the US and Canadian Model BITs might help solve a fundamental problem of drafting and applying investment law: the distinction between opportunistic (and thus compensable), or good faith (and thus non-compensable) behavior of host states. Drawing on economic theory helps to illuminate the underlying problem structure and may serve as a guide to treaty-makers and tribunals alike. The best option is to include smart flexibility clauses in IIAs but this will take a long time. In the meanwhile, tribunals could draw on

economic contract theory as a background for help in distinguishing opportunistic behavior from permissible reactions to unforeseen contingencies.

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Notes

1 Robert E. Scott and Paul B. Stephan, *The Limits of Leviathan. Contract Theory and the Enforcement of International Law*. Cambridge: Cambridge University Press (2006), p. 76. Jean Tirole, *Incomplete Contracts: Where do We Stand?*, 67 *Econometrica* 741 (1999), defines on page 743 an incomplete contract as one that "does not exhaust the contracting possibilities envisioned in the complete contract".

2 Contract theorists distinguish between observable and verifiable information. The former can be observed by the two parties but it may still be that the information is not verifiable in the sense that the observing party is unable to establish the fact sufficiently to convince a neutral third party at a reasonable cost. For details, see Scott and Stephan, *supra* note 2, p. 71-72.

3 CMS Gas Transmission Company v. Argentina, May 12th, 2005 – ICSID Case No. Arb/01/8.

4 If damages awarded are higher than expectation damages, "efficient breach" is discouraged and as they may lead to inefficient behavior by the host state. For a discussion of contracts covered by BITs, see Fabrizio Marrella and Irmgard Marboe, "Efficient Breach" and *Economic Analysis of International Investment Law*, 4 *Transnational Dispute Settlement*, Online Journal 6 (2007).

5 Gene M. Grossman and Elhanan Helpman, *Protection for Sale*, 84 *American Economic Review* 833 (1994); Gene M. Grossman and Elhanan Helpman, *Trade Wars and Trade Talks*, 103 *Journal of Political Economy* 675 (1995).

6 Gene M. Grossman and Elhanan Helpman, *Foreign Investment with Endogenous Protection*, in Robert C. Feenstra, Gene M. Grossman and Douglas A. Irwin (eds), *The Political Economy of Trade Policy: Papers in Honor of Jagdish Bhagwati*. Cambridge, Mass.: MIT Press (1996), p. 199, p. 216. See also Anne van Aaken and Tobias Lehmann, *Sustainable Development and International Investment Law: An Harmonious View from Economics*, in Roberto Echandi and Pierre Sauvé (eds), *Prospects in International Investment Law and Policy*, Cambridge: Cambridge University Press 2013, pp. 317.

7 The assumption in the Grossman/Helpman model is that governments always act so as to maximize political support/probability of reelection: it assumes that signing an international economic treaty was equivalent to maximizing political support. Hence, it is crucial whether signing the treaty would still have maximized political support ex ante if the exclusion of some measure (e.g. protectionism of some specific industry) had been on the table during the treaty negotiations. If not, then it amounts to opportunistic behavior ex post.

8 UNCTAD World Development Report, 2012 UNCTAD, *World Investment Report*, 2012, p. 101 describes the problem as follows: "Despite the fact that international policy forums at the highest level (e.g. the G-20) frequently make reference to 'investment protectionism', there is no universally agreed definition of the term. Different schools of thought take different approaches. Broadly, protectionist measures related to investment would include: (1) measures directed at foreign investors that explicitly or 'de facto' discriminate against them (i.e. treating them differently from domestic investors) and that are designed to prevent or discourage them from investing in, or staying in, the country. And (2) measures directed at domestic companies that require them to repatriate assets or operations to the home country or that discourage new investments abroad. In this context, 'measures' refer to national regulatory measures, but also include the application of *administrative procedures* or, even less tangible, *political pressure*."

9 See e.g. Art. 20 (2) (a) US Model BIT on Financial Services: "Nothing in this Treaty applies to non-discriminatory measures of general application taken by any public entity in pursuit of monetary and related credit policies or exchange rate policies." More known is Annex 2, 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." Canada includes those issues in Annex B 13 (1) of the Canadian Model BIT from 2004: "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 Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation."

10 There might be acceptable reasons for discriminating between third country investors (MFN): for example in sensitive sectors (like the financial market sector), where a specific treatment is only granted to investors of a country with the same level of supervision. The same rationale as in the GATS Annex on Financial Services applies.

The Quest for Commodities: Chinese Investment in Farmland

Carin Smaller, Qiu Wei and Liu Yalan

feature 2



Farmland and water are increasingly sought-after resources for a growing number of foreign investors. The private sector is looking to capitalise on rising agricultural commodity prices and global demand, as well as speculating on rising land prices. Governments are investing abroad to secure their country's food and energy needs in the context of volatile world market prices, scarce or depleted natural resources at home and the global hunt for water resources.

The World Bank found that in 2009 investors were reported to have acquired 45 million hectares of land, 32 million of it in Africa alone. In 2012, the Land Matrix project revised those figures, and now estimates that over the past 10 years investors have acquired 83.2 million hectares of land, mostly in Africa. The phenomenon has come to be referred to as the global 'land grab'.

China is often singled out as one of the big 'land grabbers', although it strongly refutes these claims. Chinese Foreign Ministry spokesman Hong Lei told the Xinhua state news agency in December 2011: "Instead of grabbing land in Africa, China has been providing as much technical assistance as it can to help develop agriculture there and enhance the continent's capability of using its natural resources and addressing issues such as climate change and food security... There is indeed neo-colonialism in Africa, but absolutely not from China."

We set out to verify whether reports about Chinese investments were accurate or not.¹ Unsurprisingly, our findings present a more complex picture of China's overseas ambitions. Importantly, the country has a strong domestic agricultural base and a sound food security policy that enables it to be largely food self-sufficient. However, there are a few agricultural products that China does not produce in sufficient quantities. For these, China depends on commodity traders. To reduce this dependence, China is investing abroad, including by acquiring farmland and water, purchasing directly from

producers and through joint venture operations. In terms of land and water investments, we found media reports on 86 large Chinese projects covering 9 million hectares of farmland in developing countries. We were able to confirm the existence of 55 projects covering 4.9 million hectares. Most projects have not yet started production, but at a minimum, contracts or memorandums of understanding have been signed. This article summarises the main findings from our report *Farmland and Water: China Invests Abroad*.

China's trade dependence

China needs massive quantities of agricultural commodities to supply its industries, which cannot be met by domestic production alone. In 2010, the country accounted for nine per cent of world agricultural imports; the main commodities are soybeans, cotton, palm oil, dairy products, hides, skins and wool.²

To secure these commodities, the state depends on US and European transnational agribusinesses, such as Archer Daniel Midlands, Bunge, Louis Dreyfuss and Cargill, who dominate the trade in soybeans and other agricultural commodities.

China is concerned about the costs associated with purchasing from traders and the high volatility of agricultural prices. In an interview with *The China Daily*, the president of a state-owned Chinese agricultural company, Chongqing Grain Group, said "most Chinese companies import soybeans through the four largest grain dealers... However, if importers can purchase from the producers, 18 to 24 per cent of the profit could be saved." As a result, China has shifted to foreign direct investment. Acquiring farmland is one part of the strategy, but it is much broader, and includes joint ventures with local governments or local companies and contracts with local farmers.

The shift to foreign investment

A turning point was reached in 2001, when the country formally adopted its 'Go Global' strategy, the first major drive by the government to encourage investors to go abroad. In many ways it was China's 'coming out' and showed its desire to turn local enterprises into international players.

Since the launch of the strategy, overseas investment has increased dramatically. In 2001, annual flows of overseas direct investment totalled \$6 billion, and in 2010 \$68 billion (placing it fifth among other economies in terms of annual foreign direct investment outflows, but only representing five per cent of total global outflows).

In 2007, stocks of Chinese foreign direct investment (FDI) in agriculture were roughly \$1.2 billion, making it the third largest source, behind the United States and Canada.³ In 2010, China's Ministry of Commerce reported that stocks had grown to US\$2.6 billion.

Asian and Latin American markets

Asia is the top target for land-based investments. We found 29 projects covering 2.5 million hectares of land. But local resistance has sometimes forced China to find more socially and politically acceptable business models. So, it has also invested through contract farming and joint ventures, as well as aid and development cooperation, particularly with the Mekong River Basin countries, to help improve agricultural productivity. In Central Asia, there are three confirmed projects covering just over a million hectares.

We found five land-based projects covering 770,000 hectares in Latin America. Because of strict foreign ownership laws for land, Chinese investors have been buying directly from producers, particularly soybeans. In Brazil, for example, a mix of four private and state-owned Chinese enterprises is negotiating a \$7 billion agreement in the state of Goiás to produce six million tons of soybeans a year for export to China.

In addition, Chinese investors are expected to invest \$2 billion in a soybean crushing plant and storage facility and \$100 million to improve port facilities in Sao Francisco do Sul.⁴

African markets

In Africa, we found 18 land-based projects covering 380,000 hectares of land, some of which are part of China's aid and cooperation programme. Aid projects date back to the 1950s but have become increasingly profit-driven. Today, an important motivation for China's aid projects is helping to establish new markets for Chinese companies—not unlike the strategy used by many industrialised countries. For example, the Chinese state-owned enterprise China–Africa Cotton Development Limited has a joint venture in Malawi to produce, process and export cotton back to China. The project combines aid and commercial ventures and involves construction of a processing plant and purchasing cotton from local farmers.

Too big to succeed

Investment projects that involve tens of thousands of hectares of farmland are of real concern because of the growing evidence of seriously negative effects on local communities and the high rate of failure. In 2011, a World Bank report found that investors were generally targeting countries with weak land governance, resulting in transfers often neglecting land rights. They pointed to a culture of secrecy in which communities (and even government officials) are not consulted or informed about land deals until after they had been signed. They also found that investment projects failed to generate employment. There are a growing number of reports about large projects failing. And the World Bank recently conducted a survey of 179 agricultural investment projects, which found that 50 percent failed in financial terms because the concept was “fatally flawed”.⁵

Since then, a number of other intergovernmental organisations, academics, and NGOs have conducted research and made similar findings. While these do not specifically point the finger at China, any government or investor acquiring land abroad should proceed responsibly, ensuring compliance with domestic laws and international treaties and standards. A number of tools can be used to help design responsible, sustainable investment projects and assess their performance.

Conclusion

China is actively pursuing investment opportunities abroad and is now the world's third largest source of foreign investment stocks in agriculture. The agricultural sector has become a priority for Chinese overseas investments, and this is expected to increase in significance.

The shift to overseas investment is partly about reducing dependence on global commodity markets. As a result, China is implementing a complex investment strategy that includes acquiring farmland and water resources, purchasing directly from producers, and investing in joint ventures.

As with all initiatives involving land- and water-resources transfers to foreign investors, there is cause for concern about China's projects in developing countries. However, particularly in the poorest countries, investment in agriculture is desperately needed, and China can play a positive role. It is essential that foreign investment operates within a sound economic, legal and public policy framework and that the host country's investment policies will ensure that projects contribute to improving livelihoods, strengthening food security, creating jobs and using natural resources in a sustainable manner.

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Investment Treaties and the Search for Market Access in China

Axel Berger

feature 3



It is a commonplace by now to say that the global investment treaty system is at a crossroads. On the one hand, a number of countries are opting out by terminating bilateral investment treaties (BITs), withdrawing from the International Centre for Settlement of Investment Disputes or by negotiating investment treaties without controversial investor-state dispute settlement (ISDS) clauses. On the other hand, treaty-making is also changing. The days of the simple, one-purpose BITs seem to be counted. As the number of newly negotiated BITs has declined in recent years, more complex investment rules are increasingly integrated in preferential trade and investment agreements (PTIAs) among larger groups of countries. These treaties typically combine more balanced rules in the post-establishment phase with market access rules for investment. The Mega regionals currently under negotiation, such as the Transpacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP), or the Transatlantic Trade and Investment Partnership (TTIP), may prove to be the outstanding examples of this trend. However, the inclusion of market access commitments in investment agreements has proven divisive: capital-exporting countries and regions like the United States, Canada, the European Union and Japan are leading proponents, while capital-importing countries often remain resistant.

Where does China stand in this increasingly complex investment treaty system? Rapidly increasing outward foreign direct investment flows by Chinese companies have put China in the spotlight of international attention. At the same time, China has built up a dense network of now more than 130 BITs. If China continues negotiating new treaties at the same pace it will overtake Germany as the country with the largest number of BITs in the near future.¹ Of course, assessing China's international investment policy on the basis of the sheer quantity of treaties only takes us so far. More important is the question whether China is joining the trend towards comprehensive treaties that go beyond the investment protection rules found in mainstream BITs. In particular, what is China's position on extending the scope of

investment treaties by including controversial market access rules?²

Three generations of Chinese investment treaties

Chinese investment treaties can be categorized into three generations. The first generation of BITs, negotiated throughout the 1980s and 1990s, included various safeguards for the host country, most importantly ISDS clauses that were limited to disputes concerning the amount of compensation due in case of expropriation. China negotiated more than 70 of such first generation BITs.

The China-Barbados BIT in 1998 was the first of approximately 50 second generation treaties. This treaty can be considered a watershed of China's investment treaty making; for the first time, China consented to allow foreign investors to bring "any dispute concerning an investment" to international arbitration.³ China also gradually introduced a number of other treaty innovations such as less restrictive national treatment clauses.

In recent years the Chinese approach towards international investment-treaty-making has progressed and a third generation of Chinese BITs have come to the fore. These treaties aim to strike a better balance between the rights of the investor and the host state,⁴ drawing inspiration from the innovations introduced by the members of the North American Free Trade Agreement (NAFTA) in response to numerous ISDS claims. Against this background, Chinese experts speak of an "Americanization" of Chinese investment treaties.⁵ A number of concepts developed by NAFTA countries, such as references to the concept of the minimum standard of treatment, adoption of the term "in like circumstances" to specify the meaning of the national treatment clause and exceptions to the transfer clause, have been adopted by China in recent years.

A noteworthy aspect of China's investment treaty practice is that second and third generation treaties are negotiated in parallel. The reason behind this seemingly puzzling pattern is that China, unlike traditional capital exporting countries, is not insisting on its own model text as a basis of negotiations. Interviews by the author with investment treaty negotiators reveal that China is comfortable to negotiate on the basis of the partner countries model texts.

China and market access rules

In addition to its dense network of BITs, China has so far concluded 12 preferential trade agreements of which four include comprehensive rules on investment.⁶ In its PTIAs China follows a largely conservative approach that focuses on trade in goods, although investment rules have been included at the request of the partner country. With the exception of the Pakistan PTIA, which merely copies China's second generation BIT approach, the PTIAs signed with New Zealand, Peru and the ASEAN countries come under the third generation of China's

investment treaties. China, however, remains opposed to extending the coverage of the national treatment obligations to the establishment of investments, thus preserving its right to regulate the entry of foreign investments. At the most, China is willing to grant most-favoured nation treatment with the regard to market access, ensuring that its partner countries' investors benefit from more preferable treatment that China might grant third countries in the future. In addition to PTIAs, China has also resisted including market access rules in a recent BIT signed with Canada and the trilateral investment agreement signed with Japan and South Korea, thus departing from the usual approach adopted by these partner countries.

Upcoming negotiations

In light of the global trend towards more comprehensive investment agreements, China will most likely face more demands to include market access provisions in its BITs and PTIAs. That pressure originates from three areas:

1) *The negotiation channel*: China is currently negotiating a BIT with the US and is about to officially launch negotiations with the EU in autumn 2013. Both the US and the EU have stated that market access provisions would be an integral part of any future investment agreement they are willing to sign with China. Market access provisions will most likely also be tabled in the negotiations of a RCEP among ASEAN+6 nations. Given the economic importance of these countries, China will face strong pressure to include market access provisions.

2) *A changing international environment*: Important capital exporting countries are pushing for a combination of post-establishment investment protection and market access provisions. This becomes apparent by the stated aim of the US and the EU to draft the trade and investment rules of the 21st century in the context of the TTIP. The same can be said about the TPP. The noteworthy aspect about both negotiation processes is that China is excluded. Regardless of the question whether these negotiations are intentionally directed against China, these Mega Regionals will likely include investment rules that go beyond the level of investment protection included in Chinese agreements, thus exerting competitive pressure on China to provide foreign investors in China and Chinese investors abroad similar levels of protection.

3) *A changing domestic political economy*: The above described pressures on the international level must to be assessed against the background of the debate within China on a recalibration of the Chinese growth model towards higher levels of domestic consumption and innovation-driven economic development. Especially controversial is the discussion to what extent China needs more market-oriented structural reforms. The report "China 2030" published by the Development Research Center of the State Council, one of the most influential Chinese think tanks on economic policy issues, together with the World Bank, for instance, called

for a further liberalisation of investment restriction and especially highlighted the importance of market access provisions to be included in future Chinese investment treaties.⁷ Recent policy initiatives to streamline foreign exchange rules also point to the direction of further liberalisation of China's FDI regime.⁸

Given China's treaty-making history as well as the importance of the state in the Chinese economy, it seems unlikely that China will give up its opposition to market access rules in its BITs and PTIAs in the near future. Nonetheless, the external and internal pressures described above are immense and make it possible that the Chinese government will move further in the direction of liberalising the admission and approval process for FDI. However, even if China decides to unilaterally liberalise its investment regime, it is an open question whether the US and the EU, in particular, can use the momentum to successfully press for the inclusion market access provisions in a stand-alone investment agreement signed with China. Chinese investors already enjoy a relatively open and stable investment framework in the EU and the US. It seems questionable, therefore, whether the EU and the US are able to offer China anything meaningful in the context of a BIT. While the US and the EU are at the moment cautious about entering into negotiations for a comprehensive trade and investment agreements with China, such an agreement could provide the possibility to trade concessions across disciplines, thus providing for more leverage to push China into the direction of more market access.

Author

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Notes

1 Germany has practically stopped negotiating new BITs as a result of the transfer of competency for FDI to the level of the European Union. As new European investment treaties will replace existing member state BITs the number of German BITs will even decrease in the years to come.

2 See Axel Berger (2013): Investment rules in Chinese preferential trade and investment agreements: is China following the global trend towards comprehensive agreements?, Bonn: German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE) (Discussion Paper 7/2013), online: [http://www.die-gdi.de/CMS-Homepage/openwebcms3.nsf/%28ynDK_contentByKey%29/ANES-96KDZQ/\\$FILE/DP%207.2013.pdf](http://www.die-gdi.de/CMS-Homepage/openwebcms3.nsf/%28ynDK_contentByKey%29/ANES-96KDZQ/$FILE/DP%207.2013.pdf)

3 See China-Barbados BIT 1998, Art. 9 (1). On China's BIT programme see Axel Berger (2011): The Politics of China's Investment Treaty-Making Program, in: Tomer Broude, Marc L. Busch and Amelia Porges (Eds.): The Politics of International Economic Law, New York: Cambridge University Press, pp. 162-185.

4 See e.g. BITs signed with Mexico (2008), Colombia (2008), Canada (2012), the trilateral investment treaty signed between China, Korea and Japan (2012) and the PTIAs with New Zealand (2008), Peru (2009) and ASEAN (2009).

5 See Cai Congyan (2009): China-US BIT negotiation and the future of investment treaties regime: A grand bargain with multilateral implications, in: Journal of International Economic Law 12 (02), pp. 457-506.

6 These treaties were negotiated with Pakistan (2006), New Zealand (2008), Peru (2009) and ASEAN (2009). The PTIA with Singapore just incorporates the China-ASEAN investment agreement and the PTIA with Costa Rica from 2010 just reaffirms the China-Costa Rica BIT signed in 2007. The PTIA recently signed with Iceland follows this approach and "recognizes the importance" (Art. 92) of the China-Iceland BIT from 1994.

7 Development Research Center/World Bank (2013): China 2030. Building a Modern, Harmonious, and Creative Society, Washington: The World Bank, p. 389. Online: <http://www.worldbank.org/content/dam/Worldbank/document/China-2030-complete.pdf>

8 Reuters (2013): China to simplify foreign exchange rules on foreign direct investment, online: <http://www.reuters.com/article/2013/05/11/us-china-fx-investment-idUSBRE94A01P20130511>

The Draft Investment Chapter of the Canada-EU Comprehensive Economic and Trade Agreement:

A Step Backwards for the EU and Canada?

Nathalie Bernasconi-Osterwalder

feature 4



When the Lisbon Treaty granted the European Union jurisdiction over foreign direct investment in December 2009, many thought that a window of opportunity opened for the introduction of new approaches and more systemic changes to investment treaties. The EU's member states are party to some 1200 bilateral investment treaties (BITs)—over a third of the global total—and so a more progressive and coherent approach to investment treaties by the EU would have profound changes on international investment law. Unfortunately, the trend so far has not fulfilled these expectations.

Also in 2009, Canada and the EU started negotiating a Comprehensive Economic and Trade Agreement (CETA). The agreement was originally confined to trade,¹ but in September 2011 the European Council expanded the mandate for the European Commission to negotiate an investment chapter.² Today, CETA negotiations, including the investment chapter, are at their final stage and the conclusion of the agreement is expected this year.

Getting the investment text 'right' is critical; any mistakes will live on for a long time. Even if the Canada or the EU decides at some point to terminate the agreement, the draft CETA states that the agreement's provisions will continue to be effective for 20 years.

Unfortunately, a recent draft of the CETA investment chapter (dated May 31, 2013) reveals only minor improvements, mainly on procedural matters, over existing EU member state BITs.³ Moreover, the text largely ignores the "major changes" requested by a committee of the European Parliament in a 2011 report on EU investment policy.⁴ The draft investment chapter is also a step backwards

for Canada, which has introduced a number of procedural *and* substantive innovations into its investment agreements over the last decade that would be significantly eroded under the current text.

This brief article describes some important aspects of the draft chapter, as well as commentary on the potential implications should Canada and EU sign on to these provisions. The article also notes proposals that have been made by either the EU or Canada in the draft text—but where they have not yet agreed.

Definition of investment

The definition of "investment" is broad, covering "any kind of asset" independent of whether or not investments are associated with an existing or new enterprise in the host state. The definition is crucial since it will determine which investments benefit from the strong protections provided in other parts of the agreement. An exhaustive list of covered investments or an enterprise-based definition would better ensure that the agreement is interpreted to protect selected types of investment, rather than the vast universe.

The draft chapter expands the definition of investor to natural persons or enterprises that "*seek to make, are making, or have made an investment.*" This extends the scope of application of the treaty to the pre-establishment phase of an investment (i.e. at the stage when an investor is seeking to invest, but has not yet established an investment). At the same time, Canada and the EU agreed to limit the scope of the term "investor" by excluding enterprises without substantial business activities in the alleged home state from its definition. This addresses the issue of 'treaty shopping' and misuse by 'mailbox' investors, and is a welcome outcome.

Establishment of Investments

The draft chapter suggests that Canada and the EU agree to extensive market access commitments, which would prohibit a wide range of measures that regulate the entry of foreign investors or their operations. While the extent of liberalization commitments will depend on the carve-outs to the market access commitments, this approach nevertheless risks exposing Canada and the EU to longstanding commitments in areas they did not intend to cover. The risk is heightened due to the use of a negative list approach, which is new for the EU, and amplified even further if these commitments are subject to investor-state arbitration.

Another problematic element is the prohibition of performance requirements. This eliminates countries' flexibility to use such measures as economic policy tools, thereby significantly reducing their overall scope of policy discretion. While absent from EU treaties so far, Canada has prohibited the use of some performance requirements in its previous treaties, and has already lost an arbitration brought by US oil companies relating to this provision in NAFTA. If included in the CETA, this provision should not be subject to investor-state arbitration, as suggested by the EU. A more flexible approach to resolving disagreements over the use of performance requirements should be considered instead.

Non-discriminatory Treatment

The draft chapter couples pre-establishment commitments with obligations to provide national and most-favoured nation treatment (MFN). This means that in addition to prohibitions against limits on market access, Canada and the EU are contemplating *relative* establishment rights incorporated through the national treatment and MFN clause. As a consequence, host states have obligations vis-à-vis prospective investors even before the investment is made. This could significantly limit the ability of Canada and EU member states to regulate certain foreign investments at the entry and pre-entry stage, subject to listed exceptions.

One of the most important shortcomings of the draft relates to the formulation of the MFN provision. The MFN provision, as currently drafted, does not limit the possibility for investors to import provisions from other investment treaties. In effect, this would allow foreign investors to cherry pick provisions from other, including older, treaties belonging to the EU and Canada, which risks nullifying any progress made in the CETA to modernize investment law. This would be a serious reversal of Canada's position in its 2004 Model FIPA, which prevented such cherry picking from older language treaties.

Investment Protection and Fair and Equitable Treatment

The draft CETA includes a provision to accord fair and equitable treatment (FET) to investors and investments. Similar provisions have become a 'catch-all' obligation invoked by investors, and in many cases has been interpreted by tribunals in inconsistent and far-reaching manners.

According to an earlier draft text, Canada had favored a closed list of situations that amount to a breach of FET (denial of justice, fundamental

breach of due process, manifest arbitrariness, targeted discrimination, abusive treatment). The EU on the other hand proposed an open list, making the concept of FET very broad and, as a consequence, highly problematic.

The parties have now agreed on a new approach, which begins with a closed list but incorporates a flexibility mechanism that allows parties to regularly discuss the content of the FET obligation. This is an interesting addition that could also be used in other clauses.

In addition, the parties agreed that there could also be a breach of the FET obligation in other situations that amounted to a breach of customary international law (i.e. where an obligation is "recognized in the general practice of States accepted as law.") Unfortunately, this re-introduces uncertainty which was meant to be avoided through the closed list. Defining FET solely through a list of situations that amount to a breach of the obligation would have been preferable.

It is important to note, however, that due to the absence of a proper exceptions clause to the MFN provision (see above), any precision in the formulation of the FET clause could be disregarded by tribunals, since an investor might resort to more vague FET provisions from other treaties when bringing a claim pursuant to the CETA investment chapter.

The EU also proposes the inclusion of the so-called 'umbrella clause,' which makes it possible for investors to claim a breach of contract or other agreement as a violation of the treaty itself. Host state commitments are significantly broadened as a result, leaving states all the more exposed to international arbitration claims. Canadian treaties typically do not contain an umbrella clause, and the EU Parliament has expressed concern about their use investment treaties.

Expropriation

Earlier in the negotiations Canada and the EU had diverging proposals with respect to indirect expropriation. In line with its longstanding practice, Canada proposed to exclude public welfare measures (i.e. environmental, or health and safety regulations) from the notion of indirect expropriation, which would help limit expansive interpretation by tribunals on whether a government measure amounts to expropriation. The EU, however, suggested that such measures must be subject to both a "necessity" and "proportionality" test in order to determine if they amount to indirect

expropriation. The May draft on expropriation builds on language from both proposals but does not incorporate the necessity and proportionality elements. This is a welcome development.

Again, as noted above, since the CETA language on expropriation is different from language used in some EU member state BITs or some older Canadian BITs, the MFN clause, if not qualified properly, could allow investors to import such other expropriation clauses into disputes under the CETA.

Reservations and Exceptions

The reservations and exceptions provisions state that selected substantive commitments do not apply to those existing non-conforming measures that are listed in the schedules. This means that states may not maintain pre-existing laws, regulations and other measures that are not in conformity with the commitments in the investment chapter unless explicitly excluded in a schedule. This is risky, as it is very difficult to know with any confidence that all non-conforming measures will be listed in the schedule. A better approach would be to grandfather non-conforming measures across the board, ensuring that *any existing* non-conforming measures may be maintained, unless specifically stated otherwise. Canada sets a precedent for this approach in some of its more recent treaties.

“ The most worrisome element of the EU-Canada draft with respect to investment is the inclusion of investor-state dispute settlement. ”

General exceptions clause

Canada and the EU have agreed on the architecture of a general exceptions clause in the investment chapter, but have not yet come to an agreement on the content. While Canada appears to want to limit the scope of permitted measures ('a party may adopt') to only three categories of measures (to protect human, animal or plant life or health, to ensure compliance with domestic law, and for the conservation of living or non-living exhaustible natural resources), the EU also wishes to add other categories of measures, including to protect public security, public morals and public

order, as well as national treasures of artistic, historic and archaeological value. Both parties wish to subject the exceptions to a so-called 'necessity' test, which poses several legal hurdles, as seen in the WTO context. Exceptions clauses such as the ones proposed will not safeguard government policy space in a satisfactory manner. It is much more important to include clarifications and delimitations to the crucial substantive provisions included in the investor chapter, such as related to fair and equitable treatment, expropriation, MFN, etc. This becomes even clearer since the EU specifically proposes that the exceptions clause should not apply to expropriation and fair and equitable treatment.

Investor-State Arbitration

The most worrisome element of the EU-Canada draft with respect to investment is the inclusion of investor-state dispute settlement.⁵ In light of the well-developed judicial systems in Europe and Canada, allowing investors to bypass national judicial systems in favor of privatized, largely unaccountable tribunals, seems misguided. If maintained, these tribunals should only function as a last resort, after local remedies have been exhausted. Indeed, this is what the European Parliament requested as one of its suggested "major changes"⁶. In its 6 April 2011 resolution the Parliament stated "that changes must be made to the present dispute settlement regime, in order to include... the obligation to exhaust local judicial remedies where they are reliable enough to guarantee due process..." (paragraph 31).⁷ The EU and Canada have entirely ignored this demand.

According to a May 17th table, Canada and the EU have not agreed on the scope of investor-state dispute settlement. It remains to be seen whether market access and establishment issues as well as the prohibition of performance requirements will be subject to investor-state dispute settlement.

In terms of addressing some of the problems inherent to investment arbitration, the main improvement compared to EU member state BITs is the increased transparency at all levels of the arbitration process—something that Canada has long incorporated in its treaties. Further, there is some bracketed language regarding independence of arbitrators. It states that arbitrators must comply with the International Bar Association (IBA) Guidelines on Conflicts of Interest in International Arbitration or a Code of Conduct to be established under the treaty. Introducing a special code of conduct for arbitrators in disputes arising under the treaty is useful and necessary considering the

current state of investment arbitration. It is useful insofar as it will trump or complete less adequate standards set in other bodies such as the World Bank's International Center for Settlement of Investment Disputes (ICSID). However, the parties are considering a formulation where the Code of Conduct will not necessarily apply, as arbitrators have to comply with the Code or the IBA Guidelines on Conflicts of Interest. While the IBA Guidelines are a very useful reference, they are general to international arbitration. A code of conduct can be more readily tailored to address specific concerns on arbitrator conflicts in *investment* arbitration. Therefore, the parties should not have a choice between the IBA Rules or a special code but instead the Code should integrate and build on the IBA Rules and bring in investment-specific elements. In particular, the Code of Conduct should clearly state that arbitrators in an investment treaty case may not concurrently act as counsel in other investment treaty arbitrations. Finally, the compromise draft table indicates that the parties may agree to adopt a code of conduct only *after* the adoption of the agreement. This type of postponement should be avoided.

Canada and the EU also appear to agree to create a "Committee on Services and Investment," which is to oversee the implementation of investor-state dispute settlement provisions. The committee would be tasked with examining "under what conditions, an appellate mechanism could be created." This is a weak commitment to look into the possibility of an appellate mechanism. Given the fact that there is no urgency to introduce investor-state dispute settlement in the Canada-EU context, the negotiating parties are missing an opportunity to introduce a truly new approach. A preferable option would be to make the introduction of investor-state dispute settlement dependent on the creation of a proper appellate or similar mechanism.

Conclusion

The EU and Canada are negotiating an investment chapter that resembles a mix of EU FTA clauses on establishment and market access, Canadian investment treaties and chapters, and EU member state treaties. The May draft does not introduce any major novel changes meant to address the problems that have come to light in investor-state dispute settlement, and appears to disregard the fact that both Canada and EU countries have well-functioning legal frameworks and court systems.

The May 2013 draft of the CETA investment chapter contains timid improvements as compared to EU member state BITs in respect of fair and equitable

treatment and expropriation. However, these improvements are made in vain if the MFN clause allows investors to import guarantees under other Canadian or EU member state treaties in case a claim is brought under the CETA investment chapter.

In terms of investment liberalization both parties have agreed to include binding market access commitments and pre-establishment rights. A particularly disconcerting matter in this context is that the EU seems to have been convinced to shift from a positive to a negative list approach to market access, which is less predictable and more difficult to establish. Another important question that still appears to remain open is whether the EU will agree to subject its market access and establishment commitments to investor-state dispute settlement; it has not done so in the past.

As the EU and Canada enter the final stages of negotiation, there is an opportunity to create a truly progressive approach to international investment law, particularly with respect to dispute settlement issues. This opportunity will hopefully be seized.

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Notes

¹ European Commission, Overview of FTA and other Trade Negotiations, 9 April 2013, available at http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf.

² European Council, Press Release, p. 13, 12 September 2011, available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/EN/genaff/124579.pdf.

³ The May 31st 2013 text has not been made public by the negotiating parties. However, a February 2013 draft text is available at: <http://tradejustice.ca/fr/section/3>.

⁴ See Committee on International Trade (Kader Arif), Report on the future European international investment policy (2010/2203(INI)), 22 March 2011, available at <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0070&language=EN>.

⁵ This information is based on a non-public compromise table of the investor-state dispute settlement text of the CETA investment chapter dated May 17, 2013.

⁶ See Committee on International Trade (Kader Arif), Report on the future European international investment policy (2010/2203(INI)), 22 March 2011, available at <http://www.europarl.europa.eu/sides/getDoc.do?type=REPORT&reference=A7-2011-0070&language=EN>.

⁷ See also European Parliament resolution of 6 April 2011 on the future European international investment policy (2010/2203(INI)), available at <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P7-TA-2011-0141+0+DOC+XML+V0//EN>. For a commentary, see Marc Maes, While the EU member states insist on the status quo, the European Parliament calls for a reformed European investment policy, Investment Treaty News, 1 July 2011, available at <http://www.iisd.org/itn/2011/07/01/while-the-eu-member-states-insist-on-the-status-quo-the-european-parliament-calls-for-a-reformed-european-investment-policy/>.

The Evolving BIT: A Commentary on Canada's Model Agreement

Catharine Titi

feature 5



While the revision that gave birth to the United States' Model bilateral investment treaty (BIT) in April 2012 has been closely observed and commented upon,¹ much less attention has been paid to changes made to the Canadian Model BIT. This is most likely because the text has been revised incrementally over time. The last formal update of Canada's Model BIT took place in 2004, but since then there has been a continuous effort to refine and better organise the treaty text. Those changes have accumulated significantly over time; the 2012 the model text is about ten pages shorter than the 2004 version. This brief commentary highlights how the Canadian Model has evolved since 2004. The observations that follow do not purport to be exhaustive but simply to cast light on some amendments or new provisions espoused by the 2012 version of the Model.

Probably the first such change to observe concerns the expropriation provision in Article 10 of the 2012 version of the Model (previously Article 13). While most of its provisions have not changed,² the new article abandons the explicit requirements of the Hull formula for "prompt, adequate and effective compensation,"³ in favour of wording that closely echoes the NAFTA.⁴ It makes reference to "payment of compensation in accordance with paragraphs 2 and 3" of the same article, requiring that "the fair market value of the expropriated investment immediately before the expropriation took place ... be paid without delay and shall be fully realizable and freely transferable." The same provision subsumes an earlier footnote, now part of the text of Article 10(1), specifying that "this paragraph shall be interpreted in accordance with Annex B.10" on indirect expropriation. Annex B.10 remains unaltered.

Probably the most significant change is the addition of a provision on corporate social responsibility. New Article 16 of the Model entitled *Corporate Social Responsibility* provides that:

'Each Party should encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies, such as statements of principle that have been endorsed or are supported by the Parties. These principles address issues such as labour, the environment, human rights, community relations and anti-corruption.'

In the framework of its article on general exceptions, Article 18(1) (ex-Article 10(1)) of the Canadian model BIT does away with the chapeau that preceded its earlier

general exceptions clause modelled after Article XX GATT. The chapeau's requirements relating to application of the permissible state measure in a manner that does not constitute arbitrary or unjustifiable discrimination or a disguised restriction on international trade or investment continue to apply by means of a second subparagraph in the same provision.⁵ The purpose of this change is unclear, if it is not to disassociate the provision from Article XX GATT and the debate that its inclusion in investment treaties has generated. The cultural exception of the Canadian Model BIT is also slightly different, although also in this case it is not evident how the different wording impacts, if at all, the exception. The definition of what constitutes a "person engaged in a cultural industry" (previously the definition of 'cultural industries') is now comprised within Article 18(7) which also incorporates the exception. The latter now reads: "This Agreement does not apply to a measure adopted or maintained by a Party with respect to a person engaged in a cultural industry."

Some final changes to note consist in the elimination of a few provisions from the new version of the Canadian Model BIT. First, ex-Article 8 on *Monopolies and State Enterprises* has been deleted, and, at the same time, a second paragraph has been added to Article 2 on *Scope* regarding the exercise of delegated governmental authority by a person of one of the contracting parties. This change reportedly aims to streamline the Model while explicitly preserving the coverage of monopolies and state enterprises consistent with customary international law. Two further deletions, namely the absence from the current version of the annex on *Submissions by Non-Disputing Parties*⁶ and that of the annex on the standard waiver and consent form,⁷ have likewise taken place in order to streamline the Model BIT.

In conclusion, the Canadian Model BIT has evolved since 2004, although its substantive provisions remain generally unaltered. It's worth noting that Canada also occasionally accepts significant changes to the Model's core provisions in actual negotiations. This was seen most recently in its agreement with China, where Canada agreed to omit provisions relating to pre-establishment national treatment rights and prohibitions of performance requirements, among other deviations from its Model.⁸ In short, as Canada adapts its own Model, it also appears ready to accept changes to some of the core provisions proposed by negotiating partners.

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Notes

¹ For example, see Muchlinski, P. (2010). Trends in International Investment Agreements, 2008/2009: Review of the Model Bilateral Investment Treaties of Norway, South Africa, and the United States. In Sauvant, K. P. ed. *Yearbook on International Investment Law & Policy 2009-2010*. New York: Oxford University Press; BIT Review: Written Comments Concerning the Administration's Review of the U.S. Model Bilateral Investment Treaty (Docket ID: USTR-2009-0019). *Transnational Dispute Management* 7 (1); Alvarez, J. E. (2011). *The Public International Law Regime Governing International Investment*. Hague Academy of International Law, p. 340.

² See especially Article 10(2)-(5) Canadian Model BIT (2012).

³ Article 10(1) Canadian Model BIT (2012).

⁴ See Article 1110 NAFTA.

⁵ Article 18(1)(b) Canadian Model BIT (2012).

⁶ Annex C.39 Canadian Model BIT (2004).

⁷ Annex C.26 Canadian Model BIT (2004).

⁸ Article 5(3) Canada-China BIT.

news in brief

European Commission seeks permission to begin investment treaty negotiations with China

The European Commission has proposed a negotiating mandate to EU member states for an investment agreement with China. This could become the EU's first stand-alone investment agreement since it gained jurisdiction over foreign direct investment in 2009.

The negotiating mandate must be approved by the European Council before the Commission can begin negotiations. China must also give its go-ahead to formally begin talks. The EU and China agreed in February 2012 at the 14th EU-China summit to begin work on an investment agreement.

There are currently bilateral investment treaties between China and 26 EU Member States, which an EU agreement would streamline into "a single, coherent text," according to the Commission.

The Commission is aiming for an agreement that would encompass investment protection and liberalization. A "crucial" issue is "access to the Chinese market," states the Commission. China has so far resisted making national treatment market access commitments in its trade and investment agreements.

The Commission may face a considerable challenge as it tries to sway China's position on market access. The incentives appear stronger for Europe, given the European market is more open to foreign investors than China's. An official from the Commission also acknowledged to the *European Voice* that the protection provided to Chinese investors is not a big concern to China.

In 2011, European companies invested 17.5 billion euros in China, while China invested 2.8 million euros the same year. The Commission notes that this is less than 3% of total outflows for both the EU and China—and therefore asserts "there is a huge potential to further develop bilateral investment ties."

While this would mark the EU's first efforts at a stand-alone bilateral investment treaty, the Commission has been actively packaging investment-related provisions into its broader trade and economic agreements. The EU is currently negotiating with Canada, India, Japan, Malaysia, Thailand, Vietnam and the Mercosur member states.

Greece faces claim over sovereign debt restructuring

A claim has been lodged against the government of Greece over measures related to its sovereign debt.

The claimants, Postova Banka A.S., based in Slovakia, and its shareholder Istrokapital, complain that Greece forced Postova to exchange its Greek bonds for securities of a lesser value. The claim was registered with ICSID on May 20, 2013.

The specialised news service *IAReporter* has also reported on a second potential claim against Greece; this one by the Popular Bank of Cyprus, which filed a notice of dispute in November 2012. According to *IAReporter*, the bank complains that Greece discriminated against foreign-owned banks under the

Emergency Liquidity Assistance program, in which national banks provide support to illiquid banks.

Greece is not the first country to investment face claims by holders of sovereign debt. Argentina faces three such claims related to its debt restructuring in 2005. In the largest of those claims, tens of thousands of Italian bondholders are seeking approximately \$4.3 billion in damages (*Abaclat v. Argentina*).

Investors file for arbitration against Czech Republic in reaction to changes to renewable energy incentives

A group of eight investors in photovoltaic energy have filed for arbitration against the Czech Republic over changes to incentives for renewable energy.

The group, which call themselves the International PhotoVoltaic Investors Club, complains of "dramatic changes introduced to the legal and regulatory framework for the support for the solar sector in late 2010." The measures complained of include a 26 per cent levy on revenues from solar installations.

The investors complain that Czech Republic backtracked on incentives designed to attract foreign capital to investment in solar power projects. In a statement the group claimed it was seeking arbitration under various bilateral investment treaties and the Energy Charter Treaty.

Similar types of claims have arisen elsewhere in Europe. Fourteen investors have lodged a claim against Spain over retrospective cuts to solar energy tariffs. Spain experienced a boom in renewable energy investment due to a favorable feed-in-tariff, which kept rates high even as technology costs came down. Investors in Italy are also complaining that the government broke long-term commitments to provide price-support to renewable energy suppliers.

UNCTAD nominates a new director-general

United Nations Secretary-General Ban Ki-moon has nominated Mukhisa Kituyi, a former member of the Kenyan Parliament and a former Minister of Commerce and Industry of Kenya, to serve as Secretary-General of the United National Conference on Trade and Sustainable Development (UNCTAD) for a four-year term beginning September 1, 2013.

Mr. Kituyi is currently a visiting fellow at the Washington-based Brookings Institution and head of the Institute of Governance in Nairobi. His nomination will go to the UN General Assembly for confirmation.

If confirmed, Mr. Kituyi will succeed Supachai Panitchpakdi of Thailand, who assumed the post on September 1, 2005 and was reappointed in 2009. Mr. Supachai will conclude his second four-year term of office on August 31, 2013.

awards & decisions

Limited breach of FET clause established in claim against Romania; No damages awarded *The Rompetrol Group N.V. v Romania, ICSID Case No. ARB/06/3* Margaret Devaney

In a May 6, 2013 award, an ICSID tribunal ruled that the Rompetrol Group (TRG) had established a limited breach of the Netherlands-Romania bilateral investment treaty (BIT) but had failed to establish economic loss or moral damage. The Dutch company had argued that criminal investigations by the Romanian authorities into individual company officers breached the BIT's provisions on fair and equitable treatment (FET), physical protection and security and non-impairment.

Background

In 1998, an investor group led by Mr. Dinu Patriciu, a Romanian national, purchased a controlling stake in Rompetrol S.A., a Romanian oil services company that was state-owned until 1993. This investment was restructured and came to be held through the Dutch company TRG. TRG purchased from the Romanian state a controlling stake in Petromidia, the owner of a large oil refinery, which later became known as Rompetrol Rafinare S.A (RRC).

In 2004, the National Anti-Corruption Office of Romania commenced investigations relating to the Petromidia privatisation. The file was soon transferred to the General Prosecutor's Office (GPO). The GPO opened an investigation into RRC, which included the arrest and detention of Mr. Patriciu, the wire-tapping of his telephone calls and the imposition of a travel ban on him.

TRG alleged that the state authorities' investigations of Mr. Patriciu and his associates were conducted in an oppressive and non-transparent manner and in breach of international standards of due process. It argued that the investigations amounted to state-sponsored harassment and were motivated by a desire to injure Mr. Patriciu for political and commercial reasons. It further claimed that these state entities (or individual prosecutors) were in collusion with a competing oil refinery. TRG also alleged breaches of procedural rights in relation to various criminal charges brought against Mr. Patriciu and another officer of TRG, Mr. Philip Stephenson, shortly following the commencement of the investment treaty proceedings.

Romania responded that the investigations formed part of a national anti-corruption strategy, also involving the investigation of other commercial actors, which was pursued with increasing vigour in order to gain access to the EU. Romania also claimed that TRG was abusing the investment arbitration process by using it to seek the closure of investigations against Mr. Patriciu.

Need for link between state conduct towards individuals and treaty breach

The tribunal noted that, unusually, the measures primarily complained of were not directed at the claimant or its principal Romanian subsidiary, RRC, but rather at individuals who directed the affairs of those companies. The tribunal held that the rights of such individuals were personal and distinct from those of TRG and stated that, even where an act directed at an individual had been established as being in breach of his personal rights, a claimant would still have to show a connection between such conduct and conduct directed at the investor or its investment in order to establish a BIT breach.

The tribunal considered that the necessary link might take one of two forms: (a) conduct directed against the individuals for actions taken on behalf of, and in the interest of, the investor or (b) conduct directed against individuals (even in their personal capacity) for the purpose of harming the investor.

No evidence of state-sponsored harassment but limited FET breach

While emphasising that an investment treaty tribunal's role is not to judge whether investigations or criminal prosecutions are justified under domestic law, the tribunal determined that the criminal allegations against Mr. Patriciu and his associates did not appear to be "trumped up" and that the investigation and prosecution of those individuals was not of itself wrongful. In addition, it stated that the allegations of a state-sponsored harassment campaign were not substantiated by evidence, as there was no proof of a common purpose linking the actions of the state authorities.

Despite this, the tribunal accepted that a "pattern of wrongful conduct" during otherwise lawful investigations could give rise to a BIT breach if it is sufficiently serious and persistent enough to affect the interests of the investor and where the state fails to pay adequate regard to how the investor's interests ought to be protected. The tribunal linked this obligation to the legitimate expectations of the protected investor, taking the view that the investor's legitimate expectations include the expectation that the host state will seek to avoid unnecessary damage to the investment if the investor's interests are directly or indirectly affected by the criminal process.

Applying this rationale to the facts, the tribunal determined that the actions of certain individual prosecutors were driven by "animus and hostility" towards Mr. Patriciu. The tribunal also concluded that procedural irregularities had occurred during the criminal investigations together with an unnecessary delay in removing a GPO order that imposed an attachment on RRC shares. Crucially, from a certain point in time, the state authorities were, the tribunal concluded, aware that such actions were adversely affecting TRG and took no steps either to assess or to minimise the possibility of harm. On this basis, the tribunal found that a limited breach of the BIT's FET clause had occurred.

The tribunal emphasised that this finding was based entirely on the facts and should not be taken to indicate that breaches of procedural safeguards in the context of a criminal investigation or prosecution automatically give rise to a FET breach.

Failure to establish economic loss

Turning to TRG's claim for damages, the tribunal stated that, while, as a matter of law, breaches of provisions such as the FET clause do not necessarily require proof of damage, if a party chooses to put its claim in terms of monetary damages, it must prove the extent of its loss and the causal link between the loss or damage and the BIT breach.

In this regard, the tribunal found that, given the limited nature of the FET breach, many of the assumptions on which TRG's valuation was based no longer held. In particular, the tribunal ruled that the method used by TRG's valuation experts to calculate the loss was flawed as it proceeded from the premise that all of the criminal investigations conducted by the Romanian authorities

should be regarded as unlawful in their entirety under the BIT, which had been established not to be the case. On this basis, the tribunal determined that TRG had failed to prove that the BIT breach had caused any actual economic loss. The tribunal also denied TRG's request for declaratory relief, given the limited nature of the BIT breach.

Moral damages denied

The tribunal denied TRG moral damages. The tribunal made this determination primarily on the basis that a discretionary amount of moral damages should not be awarded as a proxy for the inability to prove actual economic loss. In this regard, the tribunal noted that costs arising from reputational damage (such as increased financing costs) are actually a form of economic loss that must be proved, and that TRG had failed to adduce sufficient proof that it faced increased problems with its bankers and potential investors during the relevant period. More generally, the tribunal expressed the view that, since moral damages are notional and discretionary, tribunals should adopt "a considerable degree of caution" in awarding such damages to a corporate investor.

Costs

While endorsing the principle that costs should 'follow the event,' the tribunal determined that costs should be borne equally by the parties as it took the view that the proceedings in fact constituted a series of events. The tribunal noted that TRG was successful in two of these 'events' (namely at the preliminary objections phase and in the challenge to TRG's lead counsel initiated by Romania) but that, at the merits stage of proceedings, the balance of success lay primarily with Romania, as TRG had succeeded in establishing only a limited breach.

The arbitrators in the case are Franklin Berman (president), Donald Francis Donovan (claimant's nominee) and Marc Lalonde (respondent's nominee).

The award is available here: <http://www.italaw.com/sites/default/files/case-documents/italaw1408.pdf>

Majority dismisses Argentina's objections to jurisdiction in second sovereign bonds claim *Ambiente Ufficio S.p.A. and others (Case formerly known as Giordana Alpi and others) v. Argentine Republic, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility* **Diana Rosert**

The majority of an ICSID tribunal has accepted jurisdiction over a claim by some ninety Italian bondholders against the Argentine government. In coming to that decision, arbitrators Judge Bruno Simma and Professor Karl-Heinz Böckstiegel drew heavily on a controversial 2011 jurisdictional decision in *Abaclat and others v. Argentina*, a case involving over 60,000 Italian claimants with similar grievances against Argentina.

The third arbitrator, Santiago Torres Bernárdez, dissented from the majority decision. Notably, Mr. Torres Bernárdez also sits as arbitrator in the *Abaclat* case where he replaced Professor Georges Abi-Saab who resigned shortly after the publication of his dissenting opinion in 2011.

A jurisdictional decision in a third ICSID case dealing with Argentina's government bonds, Giovanni Alemanni

and others v. Argentine Republic (ICSID Case No. ARB/07/8), is pending.

Background

The tribunal was constituted in 2008 after a request to institute proceedings under the Argentina-Italy BIT. The claim began with over 100 Italian bondholders seeking compensation for the alleged failure of the Argentine government to fulfill treaty obligations in the course of the country's sovereign debt restructuring in 2001.

Based on the consent of both parties, the tribunal allowed 29 claimants who had accepted Argentina's 2010 offer to exchange bonds for new ones to withdraw from the proceedings. At that point the case formerly known as *Giordano Alpi v. Argentina* became *Ambiente Ufficio S.p.A. and others v. Argentina*.

The claimants assert that Argentina's acts constitute breaches of fair and equitable treatment, full protection and security, and compensation standards for expropriation included in the BIT. They seek a refund of the nominal value of the bonds at issue, interest, other damages and arbitration costs from the Argentine government.

Multi-party arbitration found "in harmony" with BIT and ICSID Convention

Argentina insisted that this case constituted a class action or mass claim which necessitated its explicit consent, as neither the ICSID Convention nor the BIT covered collective claims. Argentina also argued that the acceptance of the claim could come at the cost of due process.

However, the majority determined that no such risk existed in this particular case. The tribunal also found that sufficient commonalities existed among the claimants, and therefore rejected Argentina's assertion that the claimants pursued unrelated interests and held different bonds, which forbade them from forming a collective claim.

Further, Judge Simma and Professor Böckstiegel established that numerous ICSID tribunals had accepted jurisdiction over cases with multiple claimants. According to the tribunal, case law and academic literature also regarded multi-party arbitration as common practice.

The tribunal also considered the role played by the North Atlantic Société d'Administration (NASAM) in the proceedings, a company with which the claimants had signed a funding agreement that established, amongst others, the payments the claimants are due to pay to NASAM for its services and the respective shares of any awarded compensation.

According to Argentina, NASAM enjoyed "full control over Claimants' claims in the arbitration" and distorted the client-attorney relationship. Argentina further asserted that NASAM had canvassed for potential claimants to initiate arbitration against Argentina and that NASAM was the "sole beneficiary" of the dispute.

But the tribunal found that, despite the existence of "a special relationship" between the claimants and NASAM, NASAM did not have the role attributed to it by Argentina and "no substantiated indications" existed that the arrangement would impair the tribunal's jurisdiction.

Claimants fulfill nationality requirement

Both the ICSID Convention and the Argentina-Italy BIT contain a nationality requirement that is relevant for determining whether the tribunal has jurisdiction. While the BIT requires claimants to be nationals of Italy, the ICSID Convention requires Italian nationality of the claimants on the day of the claimants' consent to the submission of the dispute to the ICSID Secretariat and its registration date, while disallowing claimants to have Italian-Argentinian double nationality.

Whereas Argentina contended that the documents submitted by the claimants did not satisfy the necessary requirements, the tribunal ruled that the claimants provided sufficient evidence to fulfill the nationality requirements at the jurisdictional stage.

The two arbitrators' decision to split the burden of proof contributed to this conclusion. They adopted the view that it was upon the claimants to prove Italian nationality, while to disqualify claimants the respondent had to demonstrate Argentinian or Argentinian-Italian double nationality. Argentina had not provided concrete evidence on that matter. The tribunal did not assess whether individual claimants complied with all nationality requirements, but it stated its will to revisit this issue at a later stage if necessary.

"No doubt" that bonds are protected investment

The tribunal endorsed the findings of the Abaclat tribunal on this matter, ruling that there is "no doubt" that the bonds held by the claimants constituted an investment under the ICSID Convention and the Argentina-Italy BIT.

Given the absence of a definition of investment in the ICSID Convention, the tribunal examined the discussions that took place around the adoption of the ICSID Convention and the general climate at that time. While noting the controversy in case law and academic writing over the exact meaning of "investment" under the Convention, the majority found that it was the deliberate decision of the ICSID signatories to leave the definition open and thereby cover a broad range of economic operations. However, the tribunal noted that the Convention's notification mechanism and the signatories' BITs gave countries the possibility to impose limits on the scope of covered investment.

The majority also considered that the Argentina-Italy BIT provided an open-ended list covering different types of investments, including bonds. Argentina's main counter-argument was that the words "obligaciones" and "obbligazioni" used in the authentic Spanish and Italian versions of the BIT should be translated into English as "obligations" not as "bonds." Argentina disputed that the signatories of the BIT meant to include bonds. Argentina had also asserted that the claimants "are not the bondholders themselves, they only have, at best, indirect interests in the globally registered bonds" and "have no direct relationship with the bond issuer (in this case, the Respondent) or with the bond underwriter." Yet, the tribunal agreed with the claimants that the purchase did not alter the nature or quality of the investment.

Argentina also insisted that the tribunal should undertake the so-called "Salini test" for the alleged investment, examining whether the bonds satisfied "a certain duration, regularity of profits and return, risk, a substantial commitment, and a significant contribution to the host State's economy." The tribunal agreed with the claimants that the bonds complied with the above

criteria, yet concluded that, in any case, the ICSID Convention did not necessitate a test of this kind.

Assessing Argentina's assertion that the investment lay outside of its territory and was thus not covered by the BIT, the tribunal found the most important criterion to be that Argentina had been the beneficiary of the investment, and the investment had contributed to its economic development, which was deemed sufficient to establish that the investment was made "in the territory" of Argentina.

No lack of standing established

The tribunal also ruled that the investment was made in accordance with host state law, as required by the Argentina-Italy BIT.

Argentina had contended that the claimants' purchase of the bonds violated the selling restrictions that existed for bonds under Italian law. The laws allegedly prohibited the sale of bonds to retail customers like the claimants.

Contrary to Argentina's pleading, however, the tribunal found that the provisions of the BIT did not extend to an investment's legality under the Italian (i.e. home state) law, but rather only referred to the laws of the host state. Furthermore, the tribunal added that the alleged illegality would have been committed by the banks and thus not affected the claimants' standing.

Based on its decision to accept bonds as a protected investment, the tribunal also denied Argentina's objection concerning the claimants' alleged lack of standing. Despite the fact that the bonds were purchased through intermediaries on a secondary market outside of Argentinian territory, the claimants were deemed to have entitlements with respect to Argentina. The majority ruled that "there is neither too remote a relation between the Claimants and Argentina nor does there exist [...] any 'cut-off point' beyond which the Claimants could not rely on the bonds/security entitlements vis-à-vis the Respondent."

Most of the respondent's arguments concerning the lack of standing of claimants were rejected because Argentina could not convince the tribunal that its objections applied to all or most claimants or were based on "omnipresent" problems.

However, one of Argentina's arguments was partly accepted. The tribunal agreed with Argentina that those claimants that pursue separate domestic proceedings against the seller bank to invalidate sale contracts might risk their standing as an investor. However, the tribunal determined that the claimants would only have to withdraw from the ICSID proceedings in the event that "those Claimants' whole loss has been wholly compensated for" in a domestic court decision. Parallel proceedings at the domestic and international level were not deemed to create conflicts with ICSID jurisdiction *per se*. The assessment of individual claimants' situation in this respect was postponed to the merits stage.

"Potential breaches" of Argentina-Italy BIT determined

The tribunal had to establish whether the claimants' allegations might constitute breaches of BIT provisions or whether, as alleged by Argentina, this was a contractual dispute relating to non-payment of debts that lay outside of treaty provisions. The tribunal found that the case was capable of demonstrating potential breaches of treaty provisions to the extent that it involved Argentina's use of its sovereign powers, law and acts.

Claimants did not violate prerequisites of amicable consultations and recourse to domestic courts

Argentina alleged that the claimants had failed to fulfill the BIT requirement to attempt amicable consultations and submit the dispute to an Argentinian domestic court before the initiation of international arbitration. While Argentina argued that these were two “mandatory jurisdictional requirements,” the claimants argued that the provision at question “merely provides for procedural prerequisites which do not need to be strictly followed.”

The tribunal acknowledged that ICSID case law was inconsistent on these questions.

In accordance with the findings of the *Abaclat* majority decision on jurisdiction, it deemed the prerequisites to be “requirements of admissibility rather than jurisdiction”; however it also supported Professor Abi-Saab’s dissenting opinion which considered them to be of a binding nature.

The tribunal stressed two features in the precise wording of the article for amicable consultations. First, it noted that the dispute should be settled amicably “insofar as possible.” Second, it attached importance to the absence of a minimum consultations period that is common in other treaties.

It ruled that the claimants, although they did not enter into consultations, did not breach the article because various circumstances made consultations for the settlement of the case with the Argentine government impossible. The majority pointed to the adoption of an Exchange Offer in 2005 and Law No. 26.017 regulating the eligibility and exchange of bonds, which it held prevented Argentina from entering into consultations.

While the claimants also failed to submit the case to domestic courts before initiating international arbitration, the majority concluded that such an effort would have been “futile,” and therefore an exception to the 18-month domestic court requirement was justified. The tribunal also pointed out that the article demanded a “temporary recourse to domestic courts, as opposed to a fully-fledged exhaustion of local remedies requirement.”

The decision is available in English here: <http://www.italaw.com/sites/default/files/case-documents/italaw1276.pdf>

Spanish investors clear jurisdictional hurdle in claim against Argentina some 5 years after case is registered *Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa v. The Argentine Republic, ICSID Case No. ARB/07/26*
Damon Vis-Dunbar

An ICSID tribunal has accepted jurisdiction to hear a claim by Spanish claimants who invested in water and sewage services in Argentina.

The decision, rendered on December 19, 2012, deals with the contentious question of whether claimants must abide by a rule to litigate disputes in domestic court for 18 months prior to resorting to international arbitration—a requirement that features in a number of Argentina’s investment treaties, and has been the subject of significant attention by arbitral tribunals.

The claimants also overcame Argentina’s arguments that they lacked legal standing as shareholders in

the concessionaire, and that their investment was not protected under the Argentina-Spain BIT.

Like the majority of investment claims facing Argentina, the dispute is rooted in the measures the country introduced to combat its financial crisis in 1999-2002.

A ruling on the merits in a separate case involving an Italian investor (Impregilo S.p.A.) in the same water and sewerage concession was rendered in June 2011. Impregilo was awarded \$21 million plus interest. The *Urbaser* case has progressed very slowly, in contrast. While the case was registered in 2007, the parties struggled for a number of reasons to agree on the selection of arbitrators.

Background

The claimants, Urbaser and Consorcio de Aguas Bilbao Bizkaia (CABB), collectively held a 47 percent share of Aguas del Gran Buenos Aires S.A. (AGBA), an Argentine company with a concession to supply drinking water and sewage services in 7 districts of Buenos Aires.

As Argentina entered a deep financial crisis, tariffs were reduced and frozen. Later, the Province of Buenos Aires reversed the privatization of certain public services, which ultimately pushed AGBA into liquidation. The claimants seek over \$100 million in damages, plus interest, for alleged breaches of the Argentina-Spain BIT.

Argentina counters that its dealings with AGBA tell a “story of a total failure to comply with the expectations that the State had.” Even before the emergency measures were introduced to respond to the financial crisis, Argentina holds that AGBA failed to meet its obligations.

18 months litigation period is a “precondition,” but “unfair” in this case

Roughly a third of the tribunal’s decision is focused on Article X (2) and (3) of the BIT, which sets out conditions for proceeding to international arbitration. This Article, and similar articles in other Argentine BITs, has preoccupied over a dozen tribunals—and arbitrators have drawn conflicting conclusions.

Argentina has consistently argued that the Article, which requires disputes to be tried by a competent tribunal in the home state for at least 18 months before it is submitted to international arbitration, is a jurisdictional condition that must be met. Nonetheless, a majority of tribunals—including this tribunal— have found reason why claimants may bypass the requirement.

Some tribunals have focused on whether Article X is a matter of jurisdiction or admissibility, on the basis that matters of jurisdiction are unalterable by the tribunal, while matters of admissibility may be waived at the tribunal’s discretion. However, this tribunal dismissed such categorizations as “misguided theoretical constructs,” noting that “the ICSID Convention does not contain a concept akin to ‘admissibility’ of claims. The Convention distinguishes between jurisdiction and the merits of a claim.”

Setting aside the ‘admissibility’ versus ‘jurisdictional’ distinction, the tribunal settled on two questions: “were Claimants required to submit the dispute to the competent tribunals of the Republic of Argentina before resorting to ICSID arbitration?”; and second,

“was Argentina deprived of a fair opportunity address the dispute within the framework of its own domestic legal system because of Claimants’ disregard of the 18 months litigation requirement?”

In answering those questions, the tribunal affirmed that Article X indeed presents a “precondition” to accessing arbitration. Yet it went on to state that the Article also implies an obligation on the part of the host state. Specifically, the host state must allow “its courts to operate in a manner that the opportunity to reach a suitable remedy is provided in efficient terms.”

According to the tribunal, Argentina failed to provide such an opportunity to the claimants. The options available would “far exceed” 18 months before reaching a decision on the substance, and it would therefore be unfair to the claimants to insist on proceedings that had no hope of reaching a conclusion within that time-frame.

The tribunal also noted that Argentina has argued that the claimants lack legal standing before domestic courts on the grounds that they are asserting rights that belong to the Argentine concessionaire, AGBA, rather than to shareholders. “The Respondent cannot have it both ways,” wrote the tribunal.

The claimants had also argued that they could by-pass the 18-month local litigation requirement by means of the BIT’s most-favoured nation clause—as Argentina has also signed BITs that do not contain the same rule. But having concluded that it would be “unfair” to impose the requirement on the claimants, the tribunal found it unnecessary to consider the application of the MFN clause.

Claimants’ legal standing upheld

The tribunal swiftly dismissed Argentina’s objection to the claimants’ legal standing. Argentina had charged that claimants’ were asserting a “derivative or indirect” claim, given their status as shareholders in AGBA. However, the tribunal accepted the claimants’ response that their claims related to their own rights, not those of AGBA.

The tribunal also rejected Argentina’s argument that the claimants’ were asserting claims of a contractual nature, rather than claims relating to the BIT. The tribunal noted claimants’ assurances that their claims related to their rights as shareholders, and also emphasized that the BIT refers to “shares” and “participation in a company” within its description of protected investments.

In response to Argentina’s concern that the claimants could benefit from a “double recovery” in the event that they also initiated a case in domestic courts, the tribunal acknowledged that this is a risk that is “inherent in many investment disputes ...” However, it added that in such an event, compensation provided in either international arbitration or domestic courts would affect a decision on compensation in the other forum.

A protected investment under the BIT?

Argentina provided several reasons why the claimants’ investment is not protected by the Argentina-Spain BIT, all of which were dismissed by the tribunal.

First, Argentina argued that Urbaser acquired shares in AGBA from a company named Dycasa in violation of Argentine law. Dycasa held two categories of shares—those which were transferrable, and those that needed

government approval to be transferred within the first six years of the concession. Argentina alleged that Dycasa transferred non-transferable shares to Urbaser without the requisite authorization.

However, the tribunal determined that while there was an agreement to transfer the non-transferable shares to Urbaser within the six year timeframe, the *actual* transfer took effect after the six years had elapsed.

Second, Argentina asserted that CABB had illegally transferred its shares to Urbaser. As the technical operator of the concession, CABB was obliged to hold a minimum of 20 percent of the nominative shares and voting rights. Argentina alleged that CABB had transferred shares that it was obligated to retain, but again the tribunal determined this was not the case. Rather, Urbaser had provided financing to support CABB’s shareholder interests, but did not take ownership of the shares.

Finally, Argentina characterized CABB as an agency of the Spanish government (CABB serves a large number of municipalities in Spain, and its membership includes municipalities and the Basque government). Referring to Article 25 (1) and (3) of the ICSID convention, Argentina argued that CABB required the approval of the Spanish government to commence an ICSID claim.

The claimants accepted that CABB was indeed a public agency, but one that pursues private activities. They also emphasized that CABB’s legal nature was distinct from its membership.

Turning to Article 25 (1) and (3), the tribunal concluded that the reference to consent in cases involving a government agency referred to the host state (i.e., cases where an agency of a state becomes a party to an arbitration as a respondent.) The same rule does not apply to the contracting state of the investor.

On costs related to the arbitration, the tribunal reserved its decision for a later stage in the proceedings.

The arbitrators in the case are Andreas Bucher (president), Pedro J. Martinez-Fraga (claimant’s appointee), and Campbell McLachlan (respondents appointee).

The decision is available here: <http://www.italaw.com/sites/default/files/case-documents/italaw1324.pdf>

German companies awarded 3 million euros in sailing ship dispute against Ukraine

Inmaris Perestroika Sailing Maritime Services GmbH and others v. Ukraine, ICSID Case No. ARB/08/8, Award Diana Rosert

An ICSID tribunal has ruled in favour of four German companies in a dispute over the use of a Ukraine government-owned sailing ship. According to Grischenko & Partners, the law firm representing Ukraine in this case, the claimants were awarded some 3 million euros plus interest out of 13 million euros claimed.¹

ICSID recently published excerpts of the award rendered in March 2012. The redacted award contains the tribunal’s findings on the disputed issues, but omits much of factual background to the dispute, the positions of the disputing parties, the sums claimed and awarded. A detailed description of the factual background is contained in the tribunal’s jurisdictional decision of March 2010.

Background

The dispute relates to the joint operation of a ship by the German claimants, the Inmaris companies, and a Ukrainian state institute, the Kerch Maritime Technological Institute (KMTI). The Inmaris companies used the ship for commercial sailing tours and events, while KMTI used it to train Ukrainian cadets.

A number of contracts between the Inmaris companies and KMTI established the framework for the joint operation. The first contract agreed that the Inmaris companies would cover operational expenses, while being entitled to the income from the tours. Later, a complex financing and operational structure was set up to fund the restoration of the sailing ship, amounting to some 550 thousand euros, including a leasing agreement and multiple side contracts.

The dispute mainly concerns an alleged 'travel ban' on the ship imposed by a Ukrainian ministry in 2006, as well as actions taken by the government shortly before the ban. According to the claimants, these measures caused serious damages to its investments and led to the insolvency of two of the Inmaris companies, in violation of the Ukraine-Germany BIT. Specifically, the claimants alleged that Ukraine's acts breached the obligation to provide fair and equitable treatment, were arbitrary and discriminatory and amounted to compensable expropriation.

Apart from rejecting any wrongdoing vis-à-vis the Inmaris companies, Ukraine raised a counterclaim in which it sought compensation for the ship's winter operation costs.

Denial of fair and equitable treatment

The claimants alleged that a "series of actions" taken by the Ukrainian government violated fair and equitable treatment obligations. The first violation allegedly occurred in the aftermath of the 2005 change of government in Ukraine, when a Ukrainian ministry "arbitrarily questioned the legality" of the contracts and demanded the claimants to pay 50,000 euros as a "non-repayable loan" to the state institute. According to the claimants, another, more significant violation occurred a year later when a minister's order prohibited the ship from leaving port. Due to this 'travel ban,' or what the claimants considered an "arrest" of the ship, the Inmaris companies cancelled their scheduled summer tours, and have not operated the ship since.

Ukraine insisted that, to amount to a breach of the standard, a government's actions needed to be "gross" and "shocking" violations as established under the international minimum standard of treatment and customary international law. However, the tribunal upheld that the BIT did not prescribe such an interpretation and decided to adhere to the "language as written" in the BIT.

It then ruled that the travel ban was indeed a state act that constituted a violation of fair and equitable treatment. It also deemed the travel ban to be an "arbitrary measure" that impeded the use of the investment and was thus not permissible.

However, the tribunal found that Ukraine's actions prior to the travel ban—including the non-repayable loan—did not amount to a breach. It also considered that Ukraine had not "acted in bad faith or otherwise denied Claimants due process" when it questioned

the contractual arrangement. In the tribunal's view, the contracts "were far from clear" and "contained many apparent internal inconsistencies, that require significant interpretive effort to decipher." For instance, the tribunal noted that one contract failed to determine how the revenues and profits should be distributed, while another one did not identify who was responsible for the winter costs of the ship.

Expropriation without compensation

The tribunal held that the travel ban deprived the claimants of their investment, caused "substantial harm" and thus constituted expropriation without compensation in breach of the BIT. Rejecting the Ukraine's argument that the travel ban was temporary in nature, the tribunal determined that the ban led to the insolvency of two of the claimants' companies. In coming to that decision, the tribunal did not consider it important to determine whether the travel ban was a case of direct or indirect expropriation.

Contrary to Ukraine's assertions, the tribunal also decided that the BIT did not contain a pre-requisite to exhaust local remedies.

Notably, the tribunal accepted that the "Ministry's actions were genuinely motivated by an intent to protect the public interest," but added that they nonetheless amounted to expropriation and compensation must be paid.

While the redacted award does not shed light on the government's intent, a press release from the Agrarian Policy Ministry 2006² hints at its concerns. The ministry asserts that the government's expenses on the boat increased eleven fold over 7 years, "but no money was earned through leasing" the ship. The press release also claims that the KMTI "had no right to sign" contracts with the claimants, since it was not in charge of the ship's property management. The press release explains that the travel ban was imposed due to "multitudinous legal irregularities."

Compensation for damages

The tribunal determined that Ukraine's actions directly caused damages to the claimants, the insolvency of the Inmaris companies being the most evident one. It awarded the claimants compensation for the insolvency-related claims, including a proportion of a loan agreement and lost profits. The calculation of the lost profit was based on the average past performance, which was lower than the "overly optimistic" revenue projections claimed by the claimants.

The tribunal did not award damages for "either disputed or unverified" items and noted mistakes in the claimants' calculation of damages. It also rejected the claim for compensation of terminal expenses and the repayment of the non-repayable loan given to the institute in 2005. Since it considered the dispute to be the result of a "genuine misunderstanding," it decided not to compensate for "moral damages."

Counterclaim

The tribunal dismissed the Respondent's counterclaim for the compensation of the ship's winter costs. While the tribunal assumed jurisdiction over the counterclaim, it found that, under the applicable contract, Ukraine had to bear the costs.

Costs

The tribunal ordered both parties to cover their own costs and fees. It explained this decision by emphasizing that “the facts of the dispute and the parties’ own contractual relationship were complex and, at times, ambiguous” and pointed to “deficiencies in both Parties’ presentations.”

The members of the tribunal are Dr. Stanimir A. Alexandrov (presiding arbitrator), Prof. Bernardo Cremades (respondent’s nominee) and Mr. Noah Rubins (claimant’s nominee).

The award is available at: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC3296_En&caselId=C320

The decision on jurisdiction is available at: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1490_En&caselId=C320

Dutch investor overcomes preliminary jurisdictional objection by a narrow margin *Tulip Real Estate and Development Netherlands B.V. v. Republic of Turkey, ICSID Case No. ARB/11/28* **Damon Vis-Dunbar**

In a decision that was “close to the margin,” an ICSID tribunal has accepted that a Dutch claimant satisfied a mandatory notification and negotiation period before initiating arbitration against Turkey.

The March 5, 2013, decision comes in response to Turkey’s earlier request for bifurcation in which it asked that the tribunal deal with three jurisdictional objections as preliminary questions: 1) the claimants asserted contractual, not treaty claims; 2) it is premature to consider any treaty claims; and 3) claimant had not respected a requirement to seek resolution of the dispute first through consultation.

The tribunal agreed on November 2nd, 2012, to deal with the third objection, while postponing a decision on the other objections to the merits stage of the proceedings.

Background

The claimant, Tulip Real Estate and Development, is a Dutch-based company that invested in a Turkish real-estate project, in partnership with a company named Emlak, owned by Turkey’s Housing Development Administration (TOKI). TOKI and Emlak also share the same the director.

Some four years into the project, Emlak terminated the contract with Tulip for delays in the project, and soon after seized control of the construction site. The claimant argues that Emlak ended the contract as a pretext to seize its assets, and complains that Emlak was the responsible for the delays.

Article 8(2) of the Turkey-Dutch BIT requires claimants to initially seek to resolve disputes through consultation and negotiation for a year, before resorting to arbitration. The tribunal noted at the outset that there is no consensus among arbitrators on how to interpret provisions.

“Lines of decisions that have decided that such consultation and negotiation provisions are not of a jurisdictional nature, and do not have to be strictly

followed, are matched by a lesser number of decisions that have held that compliance with such requirements for notice and negotiation ensure as a pre-condition to the jurisdiction of the Tribunal, and must be strictly complied with,” wrote the tribunal.

Positioning itself in the latter category, the tribunal determined that the language in Article 8(2) is “mandatory in form.”

The tribunal considered the first step in fulfilling the requirement to be providing notice to the respondent of an investment dispute. Turning the characteristics of that notice, the tribunal clarified that the claimant need not “spell out its legal case in detail.” Rather, it is sufficient have informed the host state that it faced allegations of a treaty breach that could lead to arbitration should efforts at negotiation fail.

Turning to the claimant’s correspondence with TOKI and Emlak, the tribunal asked whether notice had been given a year in advance of the arbitration claim, along with efforts to negotiate a resolution to the dispute. On the whole, the tribunal found the correspondence to be “confusing,” and later admitted that that is was “at a loss to understand why explicit notice was not given.”

Nonetheless, the tribunal was convinced that the claimant had sought to resolve the dispute through negotiation. And one letter to the president of Turkey served as notification of the investment dispute. The letter outlined the alleged illegal actions by Emlak, and also made reference to ICSID as a forum in which it could seek recourse.

The letter was imprecise and appears to have been misunderstood by the president’s office. It was therefore with “with difficulty and hesitancy” that the tribunal accepted it as fulfilling the notification requirement set out in Article 8(2).

The decision is available here: <http://www.italaw.com/sites/default/files/case-documents/italaw1340.pdf>

Notes

¹ Grischenko & Partners, Press Release of 29.03.2012, available at <http://gp.ua/en/Press/review/itm/142/>

² Government of Ukraine, Agrarian Policy Minister’s decision to ban Chersonese from sailing triggers vocal protests in Ukraine and abroad, 20 April 2006, available at http://www.kmu.gov.ua/control/en/publish/article?art_id=34549021&cat_id=32598.

resources and events

Resources

Investment Contracts for Farmland and Water: 10 Steps *Carin Smaller, International Institute for Sustainable Development, 2013*

This brief paper outlines 10 important steps to follow when negotiating investment contracts for agricultural land and water. It is intended as a resource for parliamentarians, government officials, landholders and local communities. It provides an overview of a forthcoming comprehensive handbook that proposes model legal provisions for investment contracts. The paper discusses the following steps in the negotiation process: preparing the negotiating environment; conducting feasibility studies; conducting impact assessments; allocating land and water tenure rights; determining financial and other incentives; avoiding stabilization provisions; specifying the investor's development obligations; identifying environmental parameters; choosing an appropriate dispute settlement mechanism; and ensuring reporting, monitoring and evaluations. The paper is available here: <http://www.iisd.org/publications/pub.aspx?pno=2804>

Reform of Investor-State Dispute Settlement: In Search of a Roadmap

United Nations Conference on Trade and Development, 2013

As part of its IIA Issues Notes series, UNCTAD has published a new paper entitled *Reform of Investor-State Dispute Settlement: In Search of a Roadmap*. Concerns with the current Investor State Dispute Settlement (ISDS) system relate, among other things, to a perceived deficit of legitimacy and transparency; contradictions between arbitral awards; difficulties in correcting erroneous arbitral decisions; questions about the independence and impartiality of arbitrators; and the length and the costs of arbitral procedures. These challenges have given rise to a broad discussion about the need to reform the current system of investment arbitration. To give shape to this debate, the paper puts forward five main reform paths: promoting alternative dispute resolution; tailoring the existing system through individual IIAs; limiting investor access to ISDS; introducing an appeals facility; and creating a standing investment court. UNCTAD notes that each of the five proposed reform options comes with its specific advantages and disadvantages and responds to the main concerns in a distinctive way. Some of the options can be implemented via actions by individual governments, while others require joint action by a larger group. The options that require collective action would go further in addressing the existing problems, but would also face more difficulties in implementation. The paper is available here: [http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=508&Sitemap_x0020_Taxonomy=Investment and Enterprise;#607;#International Investment Agreements \(IIA\);#20;#UNCTAD Home](http://unctad.org/en/pages/newsdetails.aspx?OriginalVersionID=508&Sitemap_x0020_Taxonomy=Investment+and+Enterprise;#607;#International+Investment+Agreements+(IIA);#20;#UNCTAD+Home)

Prospects in International Investment Law and Policy

Cambridge University Press, edited by Roberto Echandi and Pierre Sauvé, World Trade Forum, 2013

The negotiation of a patchy but burgeoning network of international investment agreements and the increasing use to which they are put is generating a growing body of jurisprudence which, while still evolving, requires closer analytical scrutiny. Drawing on many of the most distinguished voices in investment law and policy, and offering novel, multidisciplinary perspectives on the rapidly evolving landscape shaping international investment activity and treaty-making, this book explores the most important economic, legal and policy challenges in contemporary international investment law and policy. It also examines the systemic implications flowing from frenetic recent judicial activism in investment matters and advances several innovative propositions for how best to promote greater overall coherence in rule-design, treaty use and policy making and thus offer a better balance between the rights and obligations of international investors and host states. The book aims to provide readers with an informed discussion of the rapidly evolving field of international investment law and policy; analyse the main issues concerning international investment relations from a multidisciplinary perspective; and bring together the world's leading scholars

drawn from business, economics, law and political science with vast experience in the field of international investment law and policy and international trade regulation. The book is available to order here: http://www.cambridge.org/ch/knowledge/isbn/item7113132/?site_locale=de_CH

Harnessing Foreign Investment to Promote Environmental Protection

Cambridge University Press, Edited by Pierre-Marie Dupuy and Jorge E. Viñuales, Graduate Institute of International Studies, 2013

Harnessing Foreign Investment to Promote Environmental Protection investigates the main challenges facing the implementation of environmental protection and the synergies between foreign investment and environmental protection. Adopting legal, economic and political perspectives, the contributing authors analyse the various incentives which encourage foreign investment into pro-environment projects (such as funds, project-finance, market mechanisms, payments-for-ecosystem services and insurance) and the safeguards against its potentially harmful effects (investment regulation, CSR and accountability mechanisms, contracts and codes of conduct). The book is available to order here: http://www.cambridge.org/ch/knowledge/isbn/item7077639/Harnessing%20Foreign%20Investment%20to%20Promote%20Environmental%20Protection/?site_locale=de_CH

Events 2013

June 20-21

CULTURE AND INTERNATIONAL ECONOMIC LAW,

Maastricht University, Maastricht, The Netherlands, <http://www.maastrichtuniversity.nl/law/conferences/>

June 26

LAUNCH OF THE WORLD INVESTMENT REPORT

2013 United Nations Conference on Trade and Development, Geneva, Switzerland, <http://unctad.org/en/Pages/MeetingDetails.aspx?meetingid=297>

June 28

INTERNATIONAL ARBITRATION AT A CROSSROADS: IS THERE A COMING BACKLASH?

International Bar Association, St. Petersburg, Russia, <http://www.ibanet.org/Article/Detail.aspx?ArticleUid=D1AAE6B9-1568-4ECE-9024-A574A703A087>

October 10-11

INTERNATIONAL INVESTMENT AGREEMENTS - BALANCING SUSTAINABLE DEVELOPMENT AND INVESTMENT PROTECTION,

Free University of Berlin, Berlin, Germany, http://www.jura.fu-berlin.de/en/fachbereich/einrichtungen/oeffentliches-recht/lehrende/hindelang/Berlin_Oct__2013

November 7

SALIENT ISSUES IN INTERNATIONAL COMMERCIAL ARBITRATION

American University, Washington College of Law, Washington, DC, United States, <https://www.wcl.american.edu/arbitration/symposium.cfm>

November 8

THE ROLE OF THE STATE IN INVESTOR-STATE ARBITRATION,

World Trade Institute and University of Bern, Bern, Switzerland, <http://www.wti.org/news-archive/call-for-papers-the-role-of-the-state-in-investor-state-arbitration/>

November 13

EIGHTH COLUMBIA INTERNATIONAL INVESTMENT CONFERENCE,

Columbia University, New York, United States, <http://www.vcc.columbia.edu/content/eighth-columbia-international-investment-conference>



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