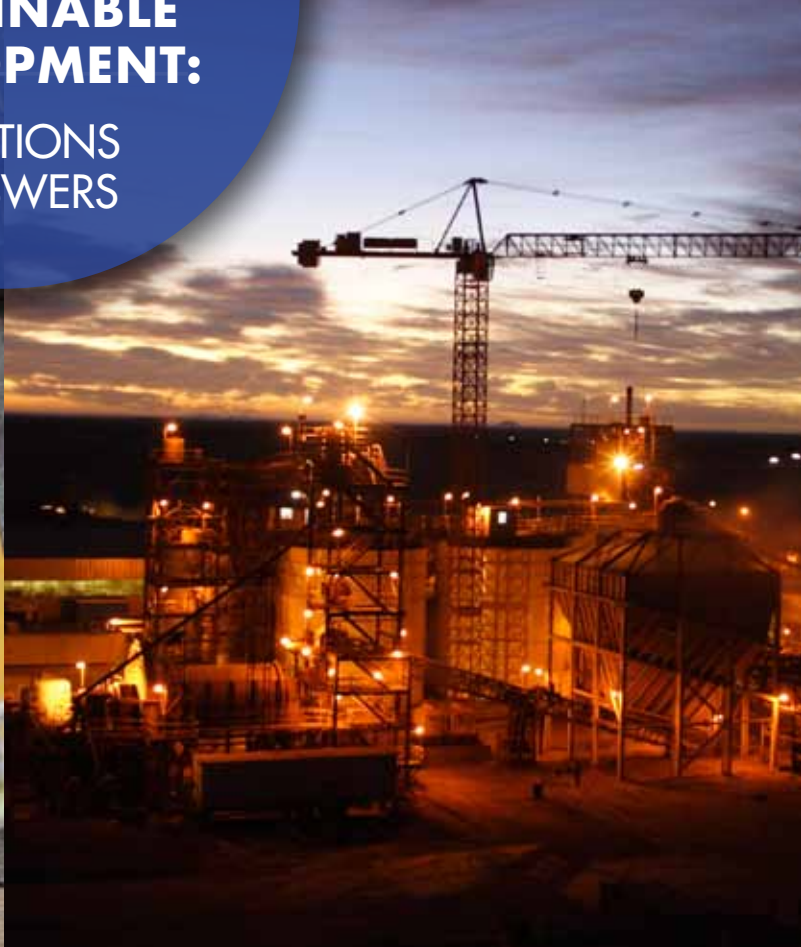




**INVESTMENT  
TREATIES & WHY  
THEY MATTER TO  
SUSTAINABLE  
DEVELOPMENT:**

**QUESTIONS  
& ANSWERS**



NATHALIE BERNASCONI-OSTERWALDER | AARON COSBEY | LISE JOHNSON | DAMON VIS-DUNBAR

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# Contents

List of Acronyms.....	vi
-----------------------	----

Introduction: Sustainable Development, Investment, and Investment Treaties—What’s the Connection? .....	1
---	---

## 1. A Background on Foreign Investment, the History of Investment Treaties, and Their Impacts..... 2

1.1. What Is Foreign Investment?.....	2
1.2. What Sources of Law Govern Foreign Investment? .....	3
1.3. When Did States Start Concluding Investment Treaties And Why? .....	4
1.4. Have There Been Attempts to Create a Multilateral Framework on Investment?.....	5
1.5. Investor–State Dispute Settlement: What Is Different? .....	6
1.6. What Types of State Measures Can Investors Challenge Under Investment Treaties?.....	7
1.7. Have Investment Treaties Been Effective in Increasing Foreign Investment? .....	8

## 2. Investor Guarantees ..... 9

2.1 Who Are the “Investors” Investment Treaties Protect? .....	9
2.2. What “Investments” Do Investment Treaties Cover?.....	10
2.3. What Guarantees Do Investment Treaties Provide to Investors? .....	11
2.4. Fair and Equitable Treatment (FET) .....	12
2.4.1. What Does the FET Obligation Require of Governments?.....	12
2.4.2. How Does the FET Obligation Relate to Government Policy Space and Sustainable Development? .....	13
2.4.3. How Are States Responding to Concerns About the FET Obligation? .....	14
2.5. Expropriation .....	15
2.5.1. What Do Investment Treaties Say About Expropriation?.....	15
2.5.2. What Is an Indirect Expropriation?.....	15
2.5.3. How Does Indirect Expropriation Relate to Government Policy Space and Sustainable Development? .....	18
2.5.4. How Are States Responding to Concerns About Provisions on Indirect Expropriations? .....	18
2.6. National Treatment .....	20
2.6.1. What Is the National Treatment Obligation?.....	20
2.6.2. How Are Pre-Establishment Rights Granted Through the National Treatment Clause? .....	21
2.6.3. What Are the Main Concerns Regarding the National Treatment Obligation and Its Impact on Domestic Law and Policy? .....	22
2.6.4. How Are States Responding to Concerns About the National Treatment Obligation?.....	24



2.7.	Most-Favoured Nation (MFN) Treatment .....	24
2.7.1.	What Is MFN Treatment? .....	24
2.7.2.	What Are the Main Concerns Regarding the MFN Obligation? .....	26
2.7.3.	How Are States Responding to Concerns About the MFN Obligation? .....	27
2.8.	Performance Requirements .....	27
2.8.1.	What Are Performance Requirements? .....	27
2.8.2.	How Do Investment Treaties Limit States' Abilities to Impose Performance Requirements? .....	28
2.8.3.	What Impacts Do Restrictions on Performance Requirements Have on Sustainable Development? .....	28
2.8.4.	How Are States Safeguarding Their Options to Use Performance Requirements? .....	29
2.9.	Requirements for Free Transfers of Capital .....	30
2.9.1.	What Are the Requirements for Free Transfers of Capital? .....	30
2.9.2.	What Are Some of the Concerns Regarding Free Transfer of Capital Clauses? .....	30
2.9.3.	How Are States Responding to Concerns About Free Transfer of Capital Clauses? .....	31
2.10.	Amplified Obligations: Umbrella and Stabilization Clauses .....	32
2.10.1.	What Are Umbrella Clauses? .....	32
2.10.2.	What Are Stabilization Clauses? .....	33
2.10.3.	What Are the Implications of Umbrella and Stabilization Clauses for Sustainable Development? .....	34
<b>3.</b>	<b>Balancing the Investor Guarantees: Obligations of Investors and Home States? .....</b>	<b>35</b>
3.1.	Do Investment Treaties Impose Obligations on Investors? .....	35
3.2.	Do Investment Treaties Impose Obligations on Home States? .....	36
<b>4.</b>	<b>Investment Treaty Arbitration .....</b>	<b>37</b>
4.1.	What Are the Processes for Enforcing States' Obligations Under Investment Treaties? .....	37
4.2.	Who May Bring Claims Against Host States Under Investment Treaties? .....	37
4.3.	Are There Limits on Investors' Abilities to Bring Claims? .....	38
4.4.	What Are Fork-in-the-Road Clauses? .....	38
4.5.	Do Investment Treaties Require Claimants to First Exhaust Local Remedies? .....	39
4.6.	What Rules Govern the Arbitrations? .....	39
4.7.	What Types of Relief Can Investors Obtain When Bringing Claims Against States? .....	40
4.8.	Who Decides the Disputes? .....	41
4.9.	What Are the Main Concerns That Arise Regarding the Use of Private, Party-Appointed Arbitrators to Decide Investment Disputes? .....	42
4.10.	What Could be Done to Address the Concerns That Arise Regarding Arbitrator Independence? .....	42
4.11.	Can Errors of Law or Fact in Investment Treaty Arbitration Be Corrected? .....	43
4.12.	Is There Any Mechanism Available for Ensuring Treaties Are Interpreted in a More Predictable Manner? .....	44
4.13.	Can the Public Access Information About Investor–State Arbitrations? .....	44
4.14.	Can the Interested Public Participate in Disputes? .....	46

<b>5. Fixing the Problems .....</b>	<b>47</b>
5.1. How Can States Fix Past Mistakes in Investment Treaties?.....	47
5.2. How Can States Clarify Terms in Investment Treaties? .....	48
<b>6. Concluding Remarks .....</b>	<b>49</b>
<b>ANNEX:</b>	
<b>Selected Organizations and Resources Focusing on     Investment Treaties and Investor-State Dispute Settlement .....</b>	<b>50</b>

This handbook draws from many years of work by the IISD’s Trade and Investment Program looking for ways in which investment can better contribute to sustainable development. It owes much to the inspiration of our late and much missed colleague Konrad von Moltke, and to the tireless efforts of Howard Mann, who led IISD’s investment program for 10 years, and who has commented extensively on this handbook. It builds on IISD’s pioneering work on a Model Agreement on Investment for Sustainable Development.<sup>1</sup>

We gratefully acknowledge the support of the Swiss Agency for Development and Cooperation (SDC) for supporting an earlier version of the Citizens Guide to Investment Treaties, on which this handbook is based. We thank Martin Brauch for his valuable and excellent assistance in updating the information contained in that earlier version.

Final acknowledgments go to Mark Halle, whose direction of the Trade and Investment Program over the years has been fundamental to its success, and Flavia Thomé, the Program’s manager, without whose support and persistence the completion of this handbook would not have been possible.

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1 The Model Agreement on Investment for Sustainable Development can be found at <http://www.iisd.org/publications/pub.aspx?pno=686>. The website for IISD’s Investment and Sustainable Development Program contains additional IISD publications that further address many of the issues covered in this handbook ([www.iisd.org](http://www.iisd.org)). The “Best Practices” series, for example, includes bulletins on specific topics such as the definition of “investment” in investment treaties, the fair and equitable treatment obligation, transparency in investor-state arbitration, arbitrator ethics, umbrella clauses and fork-in-the-road provisions.

# List of Acronyms

ASEAN	Association of Southeast Asian Nations
BIT	Bilateral investment treaty
COMESA	Common Market for Eastern and Southern Africa
ECT	Energy Charter Treaty
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FTA	Free trade agreement
GATS	WTO's General Agreement on Trade in Services
GATT	WTO's General Agreement on Tariffs and Trade
HGA	Host government agreement
ICSID	World Bank's International Centre for Settlement of Investment Disputes
MAI	Multilateral agreement on investment
MFN	Most-Favoured Nation
NAFTA	North American Free Trade Agreement
TRIMs	WTO's Agreement on Trade-Related Investment Measures
TRIPS	WTO's Agreement on Trade-Related Aspects of Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

# Introduction: Sustainable Development, Investment, and Investment Treaties— What’s the Connection?

It is hard to overstate the importance of investment for sustainable development. Sustainable development requires structural economic change, which can only be brought about by investment in new forms of energy production, transport, manufacturing and resource extraction. Thus the promotion of sustainable development is ultimately the promotion of investment that improves sustainability and promotes equitable social and economic development.

Unfortunately, not all investment works toward the goals of sustainable development. Policy-makers often use the narrow benchmark of increased volumes of investment to judge success, yet few states would knowingly welcome investment that is footloose, that degrades the environment and depletes natural resources, that treats workers poorly or that creates few in-country economic benefits. In the end, the appropriate focus from a sustainable development perspective is not just on the quantity of investment, but equally if not predominately also on its quality.

However, maintaining that focus and attracting investment that helps countries further their sustainable development is more challenging for some countries than for others. Many developing and least-developed countries in particular have pressing needs for more quality investment—needs that may go unmet for a variety of reasons. For productive investments, access to inputs and skilled labour is critical, as is access to markets for the products and services generated by investment. The existence of reliable infrastructure and the quality of services—communications, transport, banking, insurance and government services in particular—are also vitally important. To a significant degree, investment depends on a number of prerequisites in the host country that, in many developing countries, are not present in any strong measure.

Thus we have a paradox: the countries that are in greatest need of investment for sustainable development are those that, by dint of their underdevelopment, may not receive much.

Against that backdrop, this handbook focuses on one of the steps governments commonly take in the pursuit of investment: concluding international treaties that guarantee a certain standard of treatment for foreign investors. Today, there are literally thousands of investment treaties between governments, and many more are signed every year. Historically, developed countries pushed the agreements in order to provide an extra measure of legal protection to their domestic investors who sought to invest in riskier foreign territories abroad. Developing countries, a number of which were long resistant to certain principles and concepts embodied in the agreements, then incorporated them into their strategies for attracting foreign investment and capital into their territories.

Developments over the past two decades have shown these to be powerful instruments, which play a big part in defining the relationship between host states and foreign investors. However, in their current form, they do little to address the challenges discussed above. In fact, despite some promising innovations in recent years to rebalance the agreements, investment treaties can be counter-productive

to achieving sustainable development objectives, imposing high costs on the countries who sign them but questionable returns in terms of attracting investment—much less the quality investment that is so important for sustainable development. This handbook highlights those concerns. It also notes where there is evidence of improvement. Promisingly, a number of governments around the world are taking concerns about the impacts and (failed) promises of investment treaties seriously, and are adopting changes to the way the agreements are drafted.

More generally, this handbook aims to provide an accessible introduction to the world of international investment treaties, and their implications for sustainable development. If sustainable development is, in large part, an investment challenge, then the international agreements that govern investment must be fit for that purpose.

# 1. A Background on Foreign Investment, the History of Investment Treaties, and Their Impacts

## 1.1. WHAT IS FOREIGN INVESTMENT?

Foreign investment can take a number of forms. Some foreign investments imply a more long-term commitment to the host state than others. Contractual rights, for example, may be for a short duration and may not involve any actual or significant presence by the investor in the foreign territory. Minority shareholdings in publicly traded foreign companies are also assets that can be held for only short durations, representing only fleeting ties to the host state.<sup>2</sup>

Foreign direct investment (FDI) is one type of foreign investment. In contrast with portfolio investment (shareholdings of less than 10 per cent) and other forms of investment such as contract rights, FDI is defined as an equity interest and other capital that gives the investor a lasting interest and effective voice in the management of the foreign enterprise. FDI can produce a number of important benefits for the host economy that can be key for sustainable development, including increasing employment, transferring technology to the host country, and increasing the host country's competitiveness. Yet those advantages do not flow automatically from FDI. Rather, a country's ability to attract and benefit from FDI depends on various complex factors, including the policies and circumstances of the host and home countries, and conduct of the investor.

The definitions of "investments" in investment treaties almost always go beyond the narrower concept of FDI. It is common for the definition of investment to include "every kind of asset" "owned or controlled" "directly or indirectly" by a foreign investor. That definition is usually followed by a non-exhaustive list of the forms such assets may take, including movable and immovable property, shares or stock in a company, futures, options, derivatives, contract rights, goodwill and intellectual property

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2 On this and other topics covered in this handbook, see also, M. Sornarajah, *The International Law of Foreign Investment* (3d ed. 2010), which also contains a useful bibliography. The annex to this handbook also contains a list of other resources.



rights including trademarks and copyrights. Some definitions of “investments” also specify that they include entities whether owned or controlled by the government or private entities, and whether or not operated for profit.

## 1.2. WHAT SOURCES OF LAW GOVERN FOREIGN INVESTMENT?

The sources of law that govern foreign investment fall into three overlapping spheres: domestic law, international investment contracts, and investment treaties.

The primary source of law that governs foreign investment is usually the domestic law of the state where the investment is made (i.e., the host state). This may include laws covering the making of such investments, taxation, property laws, human rights laws, labour laws, banking regulations, or environmental laws relating to the potential impacts of the location and operation of investments. These laws are all normal measures of domestic governments. But this array of laws is often incomplete or extremely weak in least developed or less developed states.

The second source of law governing foreign investment is international investment contracts. Sometimes called *host government agreements*, these are direct contracts between a foreign investor and the host government. Because many investments do not involve direct commercial relationships between the investor and the host government, these contracts do not always exist when there is a foreign investment. They are, however, particularly common in cases of capital-intensive and long-lived investments into developing countries such as resource extraction and processing. Investment contracts often set out the nature of the investment and its value, any incentives for the investor, special rights of the investor, the royalty and/or taxation rules to apply to the investment if different from the generally applicable law, any obligations of the investor not included in domestic law, and any additional social or development-related obligations of the investor. The role of the investment contract is critical. Investment contracts can often become the legal code for the investment and determine which laws apply in the event of a dispute. Where domestic law is weak in the host state, investment contracts often supplement the generally applicable law. But, as discussed below, investment contracts can also limit the future application of such generally applicable domestic law as it evolves toward greater coherence and stringency.

The third source of law, and the main focus of this handbook, are the investment treaties—treaties between states governing promotion and protection of foreign investment. For investors from one state (home state) investing into the territory of the other state (host state), they provide special protections under international law. Investment treaties come in several forms, including, most commonly, bilateral investment treaties (BITs). Over 2,750 such treaties have been signed, though somewhat fewer are actually in force.<sup>3</sup> As well, there are a growing number of chapters in free trade agreements that include provisions similar to those found in BITs. Finally, some investment treaties take the form of regional investment treaties, for example, covering the countries in the Common Market for Eastern and Southern Africa (COMESA) and the Association of Southeast Asian Nations (ASEAN).

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3 See, e.g., UNCTAD, *World Investment Report 2010: Investing in a Low-Carbon Economy* (2010), pps. 81-82. Many, though not all, BITs are available from UNCTAD at [http://www.unctadxi.org/templates/docsearch\\_\\_\\_779.aspx](http://www.unctadxi.org/templates/docsearch___779.aspx). A number of governments also post the texts of their existing treaties on their own websites.

Section 2 below discusses these agreements, the rights that they grant investors and the obligations they impose on states, in more detail.

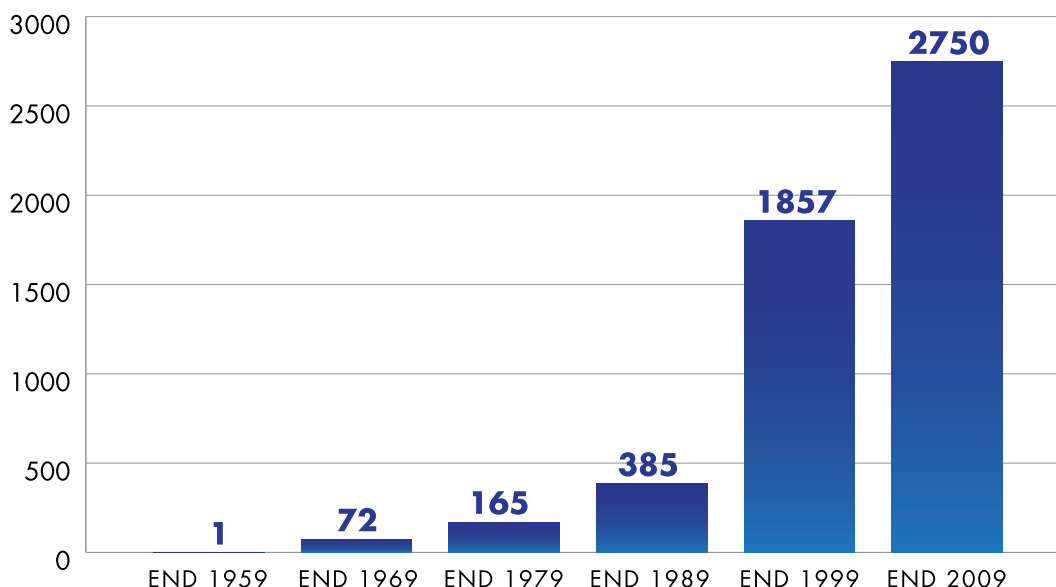
### 1.3. WHEN DID STATES START CONCLUDING INVESTMENT TREATIES AND WHY?

Investment treaties emerged with the signing of the first BIT between Germany and Pakistan in 1959. The time period is important, as it represents the confluence of two major geo-political fears in Western states: the expansion of Soviet communism beyond its post-World War Two boundaries, and the growth in decolonization that was to rapidly emerge during the 1960s. The thinking behind the emergence of these agreements was explained in the introduction to a 1960 journal publication of the first draft BIT, proposed by Lord Shawcross (a former Attorney General of the U.K.) and Herman Abs (Chairman of the Deutsche Bank in Germany):

*Since it is now widely recognized that major steps must be taken to buttress the economic position of the free-world nations, both as a measure against Soviet moves and as a means of resolving some of the demands being made by the peoples of the underdeveloped nations of the world, the notion of greater protection under international law for private investment takes on added importance.<sup>4</sup>*

This basic premise of the dual “threats” to private capital is understandable given the time period. The state of great political uncertainty generated by both these forces, and the interplay between them that underlay much of Cold War politics, created anxiety and risk for private capital holders. Thus, it is not unreasonable that they would seek some responses to these forces through international law. Still, as Figure 2 shows, the growth in the number of such agreements was fairly slow until the early 1990s.

**FIGURE 1: CUMULATIVE NUMBER OF BITS, 1959–2009, PER DECADE**



Source: Based on data from UNCTAD

4 “The Proposed Convention to Protect Private Foreign Investment, A Round Table,” Introduction by the Editors, *Journal of Public Law*, Vol. 9, p. 115, 1960.

Several other critical factors can be seen as prompting the growth in investment treaties. First, major global economic institutions such as the Organisation for Economic Co-operation and Development (OECD) and the United Nations Conference on Trade and Development (UNCTAD) began to push for them, on the premise that the added security they provide to foreign investors would spur an increase in FDI, in particular for developing countries. Today, however, studies have shown that there is a very minimal connection between investment treaties by themselves and the volumes of FDI a host state receives (see Section 1.7). Nonetheless, many organizations and states still hold to the premise that the treaties will lead to an increase in foreign investment.

The second element, again coming from some intergovernmental organizations and financial agencies, was the linking of insurance for private investments into developing states with the presence of an investment treaty to cover that investment. For example, the International Finance Corporation (IFC, the private financing arm of the World Bank) sees investment treaties as an important risk management tool in this regard, though it does not always require them to be in place. The German government's risk insurance agency, however, does require an investment treaty to be in place. It is not surprising, therefore, that Germany has the largest number of investment treaties in force today.

A third factor behind the proliferation of investment treaties is the overall growth in FDI that has occurred in concert with other elements of globalization. Freer trade, integrated production processes, special export zones, and other factors all spurred an increase in the volume of FDI, and that in turn has prompted capital exporting states to pursue the signing of more agreements to protect those investments.

#### **1.4. HAVE THERE BEEN ATTEMPTS TO CREATE A MULTILATERAL FRAMEWORK ON INVESTMENT?**

There have been various attempts to deal with investment at the multilateral level. Indeed, the 1994 WTO agreements that resulted from the 1986–94 Uruguay Round negotiations, and came into force in 1995, cover important aspects relating to investment in the General Agreement on Trade in Services (GATS) and the Agreement on Trade Related Investment Measures (TRIMs). The WTO agreements focus primarily on market access issues rather than investment *protection*. The issue of investment was taken up more comprehensively by the OECD: Negotiations on a proposed multilateral agreement on investment (MAI) were launched by governments in May 1995. The OECD website writes: “The objective was to provide a broad multilateral framework for international investment with high standards for the liberalisation of investment regimes and investment protection and with effective dispute settlement procedures, open to non-OECD countries.”<sup>5</sup> Due to opposition from developing countries, certain OECD members and civil society, the negotiations broke down in 1997 and have not been resumed, though the OECD remains active in the field.

In 1996, WTO member-countries decided at the Singapore Ministerial Conference to set up three new working groups, including one on investment. Investment, therefore, became one of the so-called “Singapore issues,” which were originally included on the Doha Development Agenda launched in 2001. However, developing countries largely opposed the negotiation of a comprehensive

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5 OECD, Multilateral Agreement on Investment, available at [http://www.oecd.org/document/35/0,3343,en\\_2649\\_33783766\\_1894819\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/35/0,3343,en_2649_33783766_1894819_1_1_1_1,00.html).

agreement on investment during the 2003 Ministerial Conference in Cancún, Mexico, and the issue was therefore dropped from the Doha agenda.

It may come as a surprise that developing countries, so active in opposing multilateral approaches to investment liberalization and protection, have been open to negotiating bilateral deals that are potentially extremely far-reaching. The result is a network of over 2,750 bilateral and regional agreements, which UNCTAD describes as “a universe in constant expansion and change, formed by variable constellations that are linked by overlapping membership and complex interactions.”<sup>6</sup>

## **1.5. INVESTOR–STATE DISPUTE SETTLEMENT: WHAT IS DIFFERENT?**

Until the late 1990s, investment treaties existed in a sort of policy backwater; their protective provisions were seldom invoked by investors and it was difficult to establish whether they were indeed doing their job in attracting more foreign investment. Indeed, BITs—the most common form of investment treaty—were more often regarded as photo opportunities for visiting heads of state than they were as important instruments of economic governance.

However, over the last two decades, investors have increasingly used the investor–state arbitration process included in most investment treaties, a process unique in international law that allows private investors to take host state governments directly to international arbitration, without the support or even knowledge of their home state. This unique and powerful tool was first used in 1987. Yet only after the entry into force in 1994 of the North American Free Trade Agreement (NAFTA)—a treaty between the United States, Mexico and Canada that broke new ground by going beyond trade to include a strong investor protection chapter based on the investment treaty model—did investors really begin to discover the latent power of investment treaties and the investor-state arbitration mechanism. In 1997, there were 19 known cases. By 2007, there were over 250 known cases and over 390 by the end of 2010. Figure 1 shows the phenomenal growth in known arbitrations under investment treaties since the late 1980s.<sup>7</sup>

Comparison with other spheres of international law illustrates the novelty and significance of these investor–state disputes. For instance, when a dispute arises under the international legal regime for trade in goods and services, which is governed by the law of the World Trade Organization (WTO) or other free trade agreements (FTAs), that dispute will be settled between the states’ whose enterprises and trade policies are concerned. The individuals and entities whose trade is affected do not have the right to bring the claims themselves.

Indeed, there are only limited circumstances in international law in which private individuals or entities can bring claims directly against states, much less seek and obtain large damage awards. The main context where this can happen is through international human rights law, but in that context affected individuals and entities must as a general rule seek remedies and relief in applicable domestic

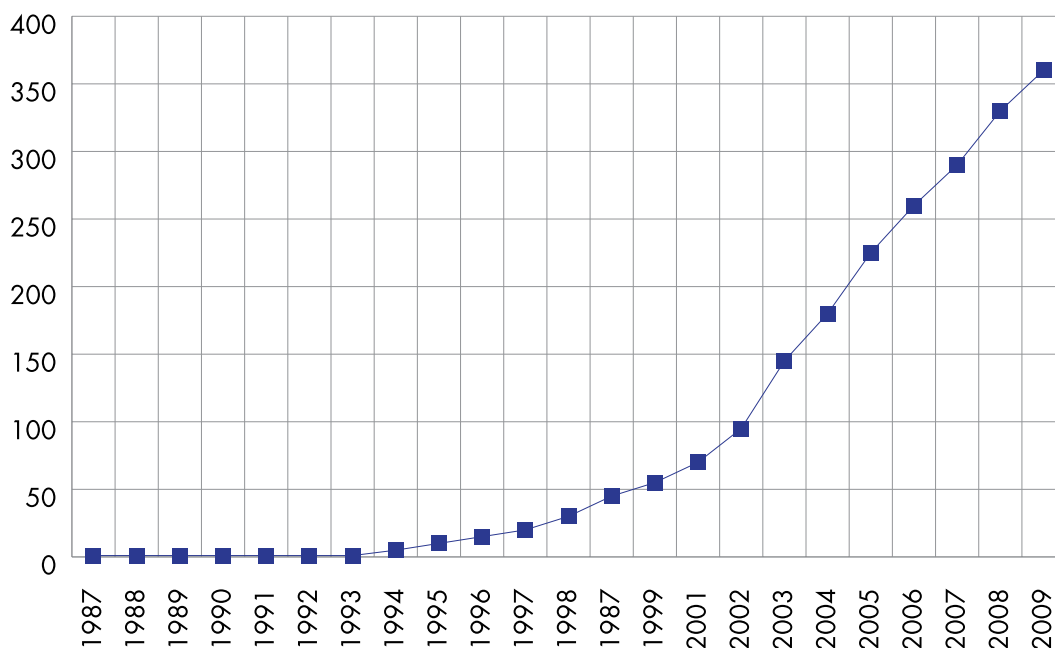
6 UNCTAD, *Investment Provisions in Economic Integration Agreements* (2005), p. 39.

7 As is discussed further in Section 4, the current system of investor–state arbitration is relatively non-transparent, making it impossible to know how many cases have been initiated under investment treaties, who the parties were, what allegations and issues were raised, and what the outcomes of the cases were. Though there is no centralized register, the decisions that have been made public can be found on various web sites. A list of these sites can be found in the annex at the end of this handbook.

forums before bringing human rights claims before international courts and tribunals. That same general rule is not applied in investment treaty disputes. Investors are allowed to proceed directly to international arbitration unless the treaty specifically provides otherwise.

## FIGURE 2: CUMULATIVE NUMBER OF INVESTMENT TREATY ARBITRATIONS, 1987–2009

Source: Based on data from UNCTAD



### 1.6. WHAT TYPES OF STATE MEASURES CAN INVESTORS CHALLENGE UNDER INVESTMENT TREATIES?

Through investor–state arbitrations, investors have challenged a broad range of government measures as allegedly violating the investment treaties and harming the investors’ rights. The measures subject to challenge have included measures imposing and attempting to collect taxes; measures changing domestic fiscal policy; decisions regarding whether to grant development permits; efforts to renegotiate investment contracts; efforts to resist renegotiation of investment contracts; government bans on harmful chemicals; bans on mining; environmental restrictions on the manner in which mining can take place; requirements for environmental impact assessments; regulations regarding transport and disposal of hazardous waste; regulations governing health insurance; measures aiming to reduce smoking; measures affecting the price and delivery of water; regulations aiming to improve the economic situation of minority populations; and measures aiming to increase revenues gained from production and export of natural resources.

In addition to those actual claims, it is estimated that foreign investors often use the threat of such arbitrations to compel governments to alter or abandon regulations which may negatively impact an investor.

The burden these arbitration disputes can place on governments is significant: in addition to potentially impacting their regulatory regimes and policy goals, it can result in significant liability.



One 2011 report put the issue in context:

*[I]n 2004, a U.S. investor won an arbitration against Ecuador...The award and claim amount relative to government expenditure were 1.92% and 7.5%. The importance of these numbers becomes clear in the light that Ecuador spends annually around 7% of their government expenditure on health.<sup>8</sup>*

Further, even when governments do not lose the disputes, they are often saddled with millions of dollars in fees and expenses from defending the cases.

These issues have pushed investment treaties into the light of public scrutiny. That focus has turned up a number of concerns about how investment treaties operate, and the conflicts they can create between the goal of attracting investment and other public policy aims that may be impacted in the process. The concern is that investment treaties may be benefitting foreign investors and investments to the detriment of other equally (or more) worthy goals.

However, despite the public interest nature of many of the regulations challenged by foreign investors under investment treaties, and the potentially significant liability of governments under the agreements, it is surprising that the arbitrations through which foreign investors pursue their claims against states are often conducted in secrecy. Indeed, as is discussed further in section 4.13, even the existence of the disputes can be kept confidential.

The lack of public knowledge of investor–state arbitrations has negative consequences for investment law and policy. Absent full awareness of the disputes and their costs to governments, it is impossible to adequately analyze investment treaties and their desirability as a policy tool for protecting, promoting and attracting foreign investment.

## **1.7. HAVE INVESTMENT TREATIES BEEN EFFECTIVE IN INCREASING FOREIGN INVESTMENT?**

While it is clear that investment treaties have provided significant guarantees and remedies to foreign investors, enabling them to challenge a range of governmental measures and secure large damage awards, it is far from evident that investment treaties have produced the promised increases in FDI. There is a diverse set of factors that affect the amount, direction, and nature of foreign investment. Individuals and business have needs and strategies that shape their decisions on when, where and how to invest; and when making their decisions, factors that may be important include whether it would enable them to access broader markets, more skilled and/or less expensive labour, or to gain access to new or different technology. Other factors that may go into the decision include the availability of reliable infrastructure, access to services to help facilitate business activities, stability of the economic and political situation, and offers of financial or fiscal incentives.

Investment treaties as they have been drafted and interpreted focus on addressing only a limited

<sup>8</sup> Kevin P. Gallagher & Elen Shrestha (2011, May). Investment Treaty Arbitration and Developing Countries: A Re-Appraisal, Global Development and Environment Institute, Working Paper No. 11-01, p.10 (referring to *Occidental Exploration and Production Company v. Ecuador* (LCIA Case No. UN3467)).

set of those issues—helping investors minimize the risk of loss caused by “wrongful” government conduct. They do not, however, do much otherwise to alter the characteristics of a host country and its desirability as a site of foreign investment. Not surprisingly, therefore, businesses appear to place little if any weight on whether an investment treaty is present (much less what specific protections it provides) when making their investment decisions (though they may then rely on the treaty to seek to recover damages if their investment does not go as planned).<sup>9</sup>

There have been a number of quantitative studies using various econometric methods to identify whether concluding a BIT will result in increased foreign investment.<sup>10</sup> Although some studies do show some degree of correlation, they also raise questions regarding whether that correlation in fact indicates investment treaties actually cause an increase in investment flows, or whether other factors, such as broader changes in economic policy, are responsible. Overall, there seems to be a stalemate in the research regarding what, if any, impacts investment treaties have on investment flows. What is clear, however, is that investment treaties alone are neither necessary nor sufficient for attracting foreign investment. This begs the question of whether the rather uncertain benefits that the treaties may have for countries outweigh their costs, which are addressed further in sections of Chapters 2, 3 and 4.

## 2. Investor Guarantees

### 2.1 WHO ARE THE “INVESTORS” INVESTMENT TREATIES PROTECT?

Investment treaties tend to broadly define the “investors” they cover. The agreements commonly state that an “investor” under the treaty is a natural or juridical person (e.g., a corporation) of one contracting party that has made an “investment” in the territory of the other. Some agreements broaden that definition further by stating that a covered “investor” may include those that have not yet established an actual investment in the host country, but are “seeking” to do so. In today’s era, a corporate entity can relatively

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9 Economic Intelligence Unit. 2007. *World Investment Prospects to 2011* (containing a survey of high-level executives from roughly 600 MNEs regarding their decisions to invest abroad).

10 See Sachs & Sauvant Eds. (2009). *Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* Oxford; See also Kevin P. Gallagher & Melissa B.L. Birch (2006, December). Do Investment Agreements Attract Investment? Evidence from Latin America. *Journal of World Investment and Trade*, 7(6), who found that “signing a BIT with the United States does not have an independent effect on attracting foreign direct investment from the United States,” but that “there is a correlation between the number of total BITs signed and the amount of foreign investment that flows to Latin American countries”; Jennifer Tobin & Susan Rose-Ackerman (2006). When BITs Have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties: “... BITs cannot be judged in isolation. Their impact on host country FDI flows must be studied within the context of the political, economic and institutional features of the host country that is signing the BIT and in light of the worldwide BITs regime.” Eric Neumayer and Laura Spess (2006). Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries? Available at <http://eprints.lse.ac.uk/archive/00000627>: “... BITs fulfill their purpose and those developing countries that have signed more BITs with major capital exporting developed countries are likely to have received more FDI in return.” Jeswald W. Salacuse & Nicholas P. Sullivan (2005). Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain, 26 *Harv. Int’l L.J.* 67; Mary Hallward-Driemeier (2003). Do Bilateral Investment Treaties Attract FDI? Only a Bit.... and They Could Bite: “Analyzing twenty years of bilateral FDI flows from the OECD to developing countries finds little evidence that BITs have stimulated additional investment.”

easily establish at least a formal presence in a foreign country by, for example, changing the place of incorporation, incorporating a new affiliate, and/or registering itself with the appropriate domestic authorities. Consequently, it can be a rather simple task for an entity to create a formal presence in the home state for the purpose of seeking the protection of an investment treaty.

Some more modern investment treaties, however, have been responding to this issue and attempting to prevent opportunistic use of the agreements by stating that investors will only be protected if they have sufficiently substantial business activities in the home state. “Mailbox companies,” or companies with only a minimal presence in the home country are excluded from the agreements’ coverage.

## 2.2. WHAT “INVESTMENTS” DO INVESTMENT TREATIES COVER?

Investment treaties provide rights to foreign “investors” and “investments.” As noted above, “investments” are often defined in investment treaties to be “any kind of asset” in the host country. And as investment tribunals have interpreted the agreements, they have declared that the phrase means to a large extent what it says, i.e., that it is any kind of asset, which could include such tangible or intangible properties as an offshore bank account, holiday home, rights under domestic law or contract, minority shareholding in a foreign company, and a company’s “goodwill.” Even contracts for the sale of goods manufactured by the investor in its home country, or services performed by the investor in its home country, and then sold to consumers in the host country, may potentially qualify as an investment.<sup>11</sup> Although these types of assets may make little or no contribution to the host state’s economy or sustainable development, they can benefit from the heightened rights and protections offered by the investment agreement.

Some countries have included language in their treaties to try better ensure that the agreements are not interpreted to protect the vast universe of even fleeting and minimal rights, interests, and holdings in the host country that one could claim was an “asset.” For example, states have excluded from the scope of covered “investments” such items as debt securities issued by a government; portfolio investments; or claims to money that arise solely from commercial contracts for the sale of goods or services. Some states have also defined “investment” through a closed, exhaustive list of covered assets, rather than including a reference to “all assets.”

Some states have taken a completely different approach by moving away from an asset-based towards an enterprise-based definition. Under this approach, the investment definition is limited to direct investments or investments made through a locally established enterprise. Accomplishing a similar function, some states have introduced criteria indicating that, in order to be covered by the treaty, investments must be made for commercial purposes (thereby excluding assets such as a vacation home), or must contribute to the economic development of the host state.

A final example of a way states have narrowed the category of “investments” their treaties will

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

protect is by stating that covered investments must be made in accordance with the host country's laws. This helps ensure that investments made through bribery, fraud or corruption, or investments not approved by the host country (if such approval is required) will not be able to benefit from the heightened rights and remedies offered by the treaty.

Absent such restrictions in the language of the treaty, tribunals have appeared unwilling to read them into the text. (One caveat is that tribunals have in at least a few cases determined that investments that were secured through fraud, corruption or other illegal means cannot benefit from investment treaties' protections). The language used in the treaty is therefore crucial: It will determine which investments benefit from the extraordinary investment treaty protections.

### **2.3. WHAT GUARANTEES DO INVESTMENT TREATIES PROVIDE TO INVESTORS?**

The obligations of investment treaties—what they commit states to do, or not do, in their treatment of investors—vary from agreement to agreement. While some countries have their own preferred templates for such agreements, these are constantly evolving, such that the “model” BITs used by many countries today are markedly different from those they used 20 years ago. The result is a complex web of agreements, with provisions that differ even among parties to agreements with the same third country.

That said, most of the recent treaties have an identifiable core set of provisions, often with identical or similar definitions. The obligations most relevant for sustainable development are commitments by host governments to provide the following to investors:

- Fair and equitable treatment (FET);
- Compensation in the case of direct or indirect expropriation;
- National treatment, or treatment no less favourable than that given to domestic investors;
- Most-favoured nation (MFN) treatment, or treatment no less favourable than that given to investors from third countries;
- Freedom from so-called “performance requirements” as a condition of entry or operation. These are requirements, for example, to transfer technology, to export a certain percentage of production, to purchase inputs domestically, or to undertake research and development;
- Free transfer of capital;
- A blanket obligation, known as an “umbrella clause,” which obliges the host state to respect any legal or contractual obligations it may have to the investor; and
- The right to bring arbitration claims against host governments.

Each of these provisions is examined in more detail in the sections that follow.

## 2.4. FAIR AND EQUITABLE TREATMENT (FET)

### 2.4.1. WHAT DOES THE FET OBLIGATION REQUIRE OF GOVERNMENTS?

Most investment treaties include a provision that commits the host government to provide FET to investors.<sup>12</sup>

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

In practice it is difficult to predict when the actions of a state will violate the FET standard. The treaty wording itself typically gives no detailed guidance, and tribunals considering this obligation have delivered widely differing interpretations.

A prime example of the high standards that some tribunals have demanded of host state behaviour was delivered in 2003 in the *Tecmed vs. Mexico* case (and echoed in a number of subsequent cases<sup>13</sup>), where the local government had refused to relicense an operating waste treatment plant, in effect shutting it down. The tribunal found that to avoid violating the FET obligation, the host state must act in a manner that, among other things:

- "Does not affect the basic expectations that were taken into account by the foreign investor to make the investment;" and
- Is consistent, "free from ambiguity and totally transparent," so that the investor may know all the relevant rules and regulations and their respective goals before investing.<sup>14</sup>

These requirements clearly place a much heavier burden of responsibility on states than a commitment not to behave in a manner that is egregious and shocking, a lower standard that some tribunals have stated is all that the FET obligation requires.<sup>15</sup>

The notion that the FET obligation protects investors' "legitimate expectations" is now repeated as a rather standard feature of most arbitral decisions addressing whether the obligation has been breached. But, while the *Tecmed* tribunal interpreted the notion of "legitimate expectations" broadly, other tribunals have differed. A subsequent tribunal, for example, cautioned that taking *Tecmed* too

12 Some Asian investment treaties do not contain this provision, however. For example, investment treaties from Pakistan, Saudi Arabia and Singapore typically do not. OECD, Fair and Equitable Treatment Standard in International Law, September 2004, <http://www.oecd.org/dataoecd/22/53/33776498.pdf> above, pp.5-7.

13 Excerpts from *Tecnicas Medoambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003, para. 154, cited in *MTD v. Chile*, ICSID Case No. ARB/01/7, Award, May 25, 2004, Sept. 9, 2008, para. 112; *Occidental Exploration and Production Co. v. Ecuador*, LCIA Case No. UN3467, Award, July 1, 2004, para. 185; *Azurix v. Argentina*, ICSID Case No. ARB/01/12, Award, July 14, 2006, para. 371; *Siemens v. Argentina*, ICSID Case No. ARB/02/8, Award, Feb. 6, 2007, para. 297-99; *Eureko v. Poland*, Partial Award, Aug. 15, 2005, para. 235.

14 *Tecmed v. Mexico*, supra, para. 154.

15 See *Glamis Gold v. United States*, UNCITRAL, Award, June 8, 2009 (citing at various points *Neer v. Mexico*, 4 R. Int'l Arb. Awards, 60-62 (1926)).



literally would result in host state obligations that were “inappropriate and unrealistic.” Moreover, it reasoned that investors’ expectations must be reasonable and legitimate *in light of the circumstances prevailing in the host country*.<sup>16</sup> Along these same lines, another tribunal decided that it was not legitimate for the investor to expect Lithuania, a country undergoing significant regulatory changes as part of the process of EU accession, to remain at a legislative standstill.<sup>17</sup>

At the end of the day, and even taking into account the need to consider the specifics of each individual case, there is a wide range of views on what is meant by investment treaty commitments to FET. Some argue that certain agreed principles may be emerging. Yet, under the current dispute settlement processes, tribunals are not obliged to follow any one, or indeed any, precedent, often delivering awards that seem to be at odds with previous decisions. As such, we can expect tribunals will continue to arrive at different interpretations of FET, leading to ongoing uncertainty for host governments and investors alike.

#### 2.4.2. HOW DOES THE FET OBLIGATION RELATE TO GOVERNMENT POLICY SPACE AND SUSTAINABLE DEVELOPMENT?

The bar set by *Tecmed* is particularly high for some developing countries to meet. For one thing, many of them are constrained by a lack of financial, technical and human resources to bolster their regulatory regimes. Clearly they *should* always be transparent and consistent, but the reality is that they are not always so, particularly when more than one agency or level of government is involved. Coordination among ministries and different levels of government is difficult even for developed countries, making a standard of freedom from ambiguity and total transparency seem unrealistic for any country.

Apart from the stringent standard pronounced by *Tecmed*, the more widespread notion that investors’ legitimate expectations deserve protection can impose a weighty burden on governments, particularly if the tribunal takes a broad view of what expectations are “legitimate.” Importantly, the regulatory regimes in many developing countries are not as mature as those in developed countries. They may be at the stage where most OECD regimes were in previous decades – experimenting with different types and stringencies of regulations to determine what works and what is appropriate. This is particularly so for countries in sub-Saharan Africa and many Asian states that continue to have relatively meagre regulatory toolboxes. Many developing countries are now adopting innovative policies such as fiscal and market-based measures, in some cases pioneering approaches that have not been tried elsewhere. And getting it right may take some tinkering. In the process, however, host states may be violating the assumptions that investors had when they invested, and some investors may suffer economic damage.

The key question is whether and in what circumstances an investor going into such a country has a right to have its expectations become legally binding on all levels of government in the host state for the duration of the investment. What, in the end, are the investor’s legitimate expectations? And were they induced by the host state, or generated by the investor? If “inducements” are relevant, what “inducements” by government officials in the host state should be binding on the state under the treaty? Is it legitimate for investors to develop enforceable “expectations” from a verbal representation by one state official? As a more general matter, is it legitimate to expect a resource-strapped and

<sup>16</sup> *Saluka Investments BV v. Czech Republic*, UNCITRAL, Partial Award, Mar. 17, 2006, paras. 304-05.

<sup>17</sup> *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8, Award, Sept. 11, 2007, para. 335.

uncoordinated regime to function better than it has historically done, or to expect an immature regulatory regime to remain without major changes? Or should investors take such risks into account before investing, as part of their due diligence? Should any investor have a legitimate expectation that the laws applying to it will not change over time?

The fundamental uncertainty regarding the meaning of the FET obligation is a concern, particularly for developing countries, which, as noted above, may be ill-equipped to meet some of the more demanding interpretations of the obligation. One result may be that states will proactively improve their regulation and administration with respect to investors, where they have the capacity for this kind of reform, and this would have positive impacts on both domestic and foreign investors. But another possibility is that states will shy away from the risk of costly and embarrassing arbitration when considering regulatory changes, particularly changes that might be seen as departing from foreign investors' legitimate expectations under some interpretations of the FET obligation. In an uncertain environment, regulatory change becomes a gamble. States that take this gamble may be forced to pay out settlements that will strain their treasuries. This is the dynamic that is asserted to create a regulatory chill on host governments, a state where the fear of arbitrations and damage awards acts to forestall the advancement of public interest regulation.

### 2.4.3. HOW ARE STATES RESPONDING TO CONCERNS ABOUT THE FET OBLIGATION?

In order to guide arbitral tribunals in interpreting the FET obligation, states are increasingly taking certain precautionary measures. One is to avoid including the standard in their investment treaties. The investment chapter of the 2005 trade agreement between Singapore and India, for instance, omits the FET clause.

Another approach—and one that has been adopted by a number of countries in their BITs and investment chapters of their FTAs—is to draft the FET standard, or craft an interpretative note, indicating that the FET requirement is synonymous with the customary international law minimum standard of treatment of aliens.<sup>18</sup> As it is commonly described, the minimum standard of treatment sets a basic floor below which states may not go. Even if they treat their own citizens worse than permitted by that minimum standard or floor, that fact does not excuse similar treatment of foreigners. States must treat foreigners equal to or better than required by that minimum standard.

What the minimum standard of treatment actually requires in practice is an unsettled matter. Some tribunals have determined that it bars conduct that is outrageous or egregious.<sup>19</sup> Others have concluded that the conduct required is somewhat more exacting. Nevertheless, by equating the FET obligation to the minimum standard of treatment of aliens under customary international law, states aim to ground that treaty obligation. The concern is that if left untied, the standard can be and has been interpreted as requiring states to comply with a higher, more demanding standard of conduct regarding their treatment of foreign investors/investments. However, even if grounded in customary

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18 See, e.g., U.S.–CAFTA-DR, Art. 10.5(1) (signed May 24, 2004 by the United States, Costa Rica, El Salvador, Honduras, Guatemala and Nicaragua; the Dominican Republic signed August 5, 2004; entered into force March 1, 2006, for El Salvador, April 1, 2006, for Honduras and Nicaragua, July 1, 2006, for Guatemala, March 1, 2007, for the Dominican Republic, and January 1, 2009, for Costa Rica; India–Korea FTA, Art. 10.4(1) (signed Aug. 7, 2009; entered into force Jan. 1, 2010).

19 See, e.g., *Glamis Gold v. United States*, Final Award, 8 June 2009.

international law, some have argued that customary international law, too, is evolving, and is moving towards a more demanding standard.<sup>20</sup> It thus seems that today, uncertainty reigns even when states take the precaution to ground the FET obligation in customary international law on the treatment of aliens. As a consequence, some states are exploring the option of being more specific and explicitly demanding, for instance, that state conduct be outrageous or egregious in order to violate the FET or minimum treatment standard.

## 2.5. EXPROPRIATION

### 2.5.1. WHAT DO INVESTMENT TREATIES SAY ABOUT EXPROPRIATION?

States need to be able to expropriate for a wide range of reasons, including to build necessary infrastructure and roads. The issue is not so much whether a state has the right to expropriate but in which situations a state will also have to compensate the affected rights holder. Investment treaties, too, allow states to expropriate, but add that a state must provide compensation. In addition, investment treaties require that an expropriation be for a public purpose; non-discriminatory (that is, not targeted at a specific company or nationality); and in accordance with the due process of law. Because investment treaties require that any expropriation must be compensated, the big question is what qualifies as expropriation in the first place.

Expropriation is generally described as falling into two categories: direct and indirect. Many treaties state this explicitly, using a number of different formulations to express that their expropriation provisions cover both types of takings. Many state simply that they govern “direct and indirect expropriation,” or “expropriation and measures tantamount to expropriation.” Even if treaties do not specifically refer to indirect expropriation, tribunals have interpreted the agreements to also cover those types of takings.

These concepts of “direct” and “indirect” expropriations are rarely defined in treaties. This is not as problematic with “direct” expropriation —the physical taking or nationalization of an enterprise, which usually involves a transfer of ownership to the state. A direct expropriation is easier to identify, and there is a significant body of international law to guide arbitrators in the task. Defining indirect expropriation is much more difficult; and the definition adopted has significant potential impacts for sustainable development.

### 2.5.2. WHAT IS AN INDIRECT EXPROPRIATION?

Indirect expropriation is generally understood as an action by the state which takes effective control of the investment, but not through a direct taking of the legal property. A typical example would be putting in place a government board of directors. But what other situations amount to an indirect expropriation? Can measures taken for a clear public purpose, such as public health or environmental protection, constitute an indirect expropriation? The cases decided to date do not provide a clear answer. The outcome depends on the facts of the case, as well as the test applied by the particular tribunal evaluating it.

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20 Those taking this position have included claimants in investor–state disputes such as the investor in *Glamis Gold v. United States*. The tribunal in that case agreed that the customary international law standard may have evolved beyond earlier formulations. The tribunal stated, however, that it was the investor’s obligation to establish how the standard had changed and the investor in that case failed to meet its obligation. *Id.* at paras. 598-627.

Past tribunals have dealt with indirect expropriation in three ways:

- The “sole effects doctrine:” this approach considers the purpose of the measure to be irrelevant. The only thing that defines an indirect expropriation is the extent of the measure’s impact on the investor.
- Proportionality: A second approach balances the public purpose of the measure against the burden placed on the investor. It demands that the two should be proportional—that is, that the burden on the investor should not be excessive in light of the public benefits.
- The “police powers” carve-out: A third approach carves out a class of measures that are deemed not to be expropriation, however great their impact. The measures must be non-discriminatory regulations taken in good faith for public welfare reasons. These are considered to be within the safe haven that has traditionally been called the “police powers” of states.<sup>21</sup>

These three approaches are fundamentally different ways of looking at the same obligation. Nonetheless, each has been used in different arbitral awards, making regulatory expropriation something of a moving target.

The sole effects doctrine, for example, was followed in the *Metalclad v. Mexico* case. Metalclad involved two separate government “measures.” The first was a set of events that cumulatively denied the company a permit to operate a hazardous waste disposal facility. In this context, the tribunal stated:

*Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State. (paragraph 103)*

With respect to the second measure, which was a state-level act that essentially converted the area for the proposed operations of the investor into an ecological reserve, the tribunal found that this act, too, amounted to an expropriation. In this context, the tribunal explicitly decided that the purpose of the measure was not important: “*The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree.*”<sup>22</sup> In other words, it was not important whether or not the decree in question was aimed at increasing public welfare. Rather, the tribunal declared that the threshold question was whether there was enough of an interference with the investor’s investment. It concluded that there had been, and that was enough to establish expropriation. Other tribunals have also used this approach.<sup>23</sup>

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21 See the American Law Institute’s “Restatement of the Law Third, the Foreign Relations of the United States,” USA, American Law Institute Publishers, Vol. 1, 1987, Section 712, comment g.

22 *Metalclad Corporation v. United Mexican States*, ICSID Case No. Arb/AF/97/1, Award, Aug. 2000, para. 111

23 *Compañía del Desarrollo de Santa Elena S.A. v. Costa Rica*, ICSID Case No. ARB/96/1, Award, Feb. 17, 2000.

The sole effects doctrine casts a wide net. It captures any government regulation that has a significant economic impact on an investor, whether or not it is discriminatory, and whether or not it is taken in good faith for the public good. Followed rigorously, such a standard could see the government paying out compensation in a wide variety of cases where the measure in question had, in fact, no intent to “take” the property of the investor. Almost by definition, any effective regulation will have an economic impact—it will alter a production process, ban a product, demand additional technologies, etc. When the impact is deemed significant enough, the regulation could be deemed an “expropriation” requiring governments to pay investors for losses.

The proportionality approach, by contrast, agrees that a substantial interference with the investment can constitute expropriation, but argues that the reasoning does not end there. Having found an economic impact, it is necessary to ask whether the negative impact on the investor is proportional to the positive impact the measure seeks to achieve. This approach was taken in the case *Tecmed v. Mexico*, described above, where the government had refused to renew the operating licence of a hazardous waste facility because the facility’s owner and operator, Tecmed, had breached some terms of its permit and applicable regulations. Concerned by those violations and the landfill’s close proximity to the population center, community groups mounted strong opposition to continued operation of the hazardous waste facility. In this case the tribunal decided that the reasoning behind the refusal was not environmental, but rather that the government measures were taken to appease local protestors. As such, the tribunal concluded that the impacts on the investor (resulting in complete shutdown of its facilities) were out of proportion to the environmental benefits of the measure (it was basically assumed that there were none), and therefore amounted to expropriation.

The third approach—the police powers carve-out—is taken in the case of *Methanex Corporation v. United States*.<sup>24</sup> In this case the State of California banned methyl tertiary butyl ether (MTBE), a gasoline additive, because it was found to be contaminating groundwater supplies. Methanex, a Canadian company, argued that this was a regulatory expropriation of its investments in the United States since its business was the production of methanol—a key ingredient of MTBE. In its 2005 award, the tribunal dismissed Methanex’s claim, explaining that “*as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process*”<sup>25</sup> is not an expropriation, unless the state has given explicit guarantees that it will not take the measures in question. In other words, there is a class of measures that is carved out from the category of expropriation, and if a measure falls into this class it is not necessary to even consider the extent of the economic impact. To fall into this class a measure must be undertaken for a legitimate public purpose, must be of general application and non-discriminatory, and must be enacted fairly. The police powers doctrine is described as a carve-out rather than an exception—it is not a case of expropriation for which compensation is not due because an exception excuses the government from its duty to pay damages. Rather, it is a case where the measures are not considered to be expropriation in the first place, and therefore no liability arises and no compensation is required.

As with any carve-out, the challenge is in deciding what is in and what is out. Another tribunal

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24 *Methanex Corporation v. United States*, Final Award, Aug. 3, 2005.

25 *Ibid*, Part IV Chapter D, para. 7.



that followed the police powers doctrine noted that there was no “bright and easily distinguishable line” between non-compensable regulations and compensable expropriations. The distinction must be made in each case by the tribunal based on the facts before it and on answers to relevant questions such as: Was the measure legitimately aimed at achieving public welfare? Was it discriminatory, treating the investor differently from similar domestic investors or investors from other countries? Was it elaborated and implemented in accordance with due process? These judgments can only be made on a case-by-case basis, and will be influenced by the degree of deference the tribunal accords the government’s reasoning and actions.

### 2.5.3. HOW DOES INDIRECT EXPROPRIATION RELATE TO GOVERNMENT POLICY SPACE AND SUSTAINABLE DEVELOPMENT?

The concept of indirect expropriation raises several concerns for sustainable development. Most importantly, indirect expropriation—depending on how it is interpreted—could end up requiring taxpayers to pay investors to change or stop behavior that is contrary to the public interest. Another concern is that if governments are held liable for their regulations’ impacts on investors, they will not regulate to the extent that they should, or will modify or remove regulations when threatened with investor claims (the *regulatory chill* argument).

A third issue relates to the nebulous definition of “indirect expropriations.” As noted above, the three main approaches used to identify whether an indirect expropriation has occurred are fundamentally different. This leaves the host state in an uncertain position, not knowing in advance whether a pending piece of legislation will require costly and potentially embarrassing litigation and compensation. A natural reaction to this uncertainty would be a risk-averse approach that erred on the side of less stringent regulation or no regulation at all—leading again to the phenomenon described above as *regulatory chill*.

### 2.5.4. HOW ARE STATES RESPONDING TO CONCERNS ABOUT PROVISIONS ON INDIRECT EXPROPRIATIONS?

The legal uncertainty reigning today is problematic for both the host state and the investor, as it leaves both unclear regarding their respective rights and obligations, and may have the impact of driving up litigation costs. As a response, an increasing number of states are incorporating additional language in their investment treaties clarifying the scope of indirect expropriation. The approach that began in Canada and the United States has now spread over Asia (2009 ASEAN Comprehensive Investment Agreement), Africa (the 2007 Investment Agreement for the COMESA Common Investment Area (COMESA CCIA)) and even some European countries, such as Austria (2008 Austrian Model Investment Treaty and recent treaties based thereon). All of these limit the scope of indirect expropriation and set out criteria that must be considered when determining whether or not one has occurred.

For example, the 2004 Canadian model and the 2008 Austrian texts provide:

*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.*<sup>26</sup>

A yet different approach is that taken in the COMESA CCA. Article 20(8) reads:

*Consistent with the right of states to regulate and the customary international law principles on police powers, bona fide regulatory measures taken by a Member State that are designed and applied to protect or enhance legitimate public welfare objectives, such as public health, safety and the environment, shall not constitute an indirect expropriation under this Article.*

The U.S. and Canadian texts additionally provide three criteria for determining if an indirect expropriation has taken place:

- (a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:
  - (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
  - (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
  - (iii) the character of the government action.<sup>27</sup>

The U.S. Model also refers to customary international law on expropriation.

The 2009 ASEAN Comprehensive Investment Agreement (ASEAN CIA), probably inspired by the Canadian and U.S. approach, also sets out a list of factors for tribunals to consider. These are largely the same as those contained in the Canadian and U.S. models, but with some important differences. For example, the ASEAN version avoids the term “legitimate expectations” and replaces it with a reference to written assurances. It also qualifies what is meant by “character of the government action.”<sup>28</sup>

## **2.6. NATIONAL TREATMENT**

### **2.6.1. WHAT IS THE NATIONAL TREATMENT OBLIGATION?**

This non-discrimination obligation is found in almost all investment treaties. While the wording may

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26 Canada Model FIPA, 2003, Annex B.13(c); Austria Model BIT, 2008, Art. 7(4). Canada’s most recent model BIT, the Model Foreign Investment Protection Agreement (FIPA), was updated in 2003. Austria updated its model BIT in 2008.

27 U.S. Model BIT, 2004, Annex B, Expropriation; Canada Model FIPA, 2003, Annex B.13(1), Expropriation. The text of the Canadian Model is slightly different. The United States last approved a model BIT in 2004, and still conducts its negotiations based on that model. In 2009, the United States commenced efforts to update its model BIT. As of September 2011, however, no new agreement had yet been approved.

28 Annex 2, ASEAN Comprehensive Investment Agreement. The ASEAN member states are Brunei Darussalam, Cambodia, Indonesia, Lao, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam. It was signed Feb. 26, 2009, but, as of October 2011, had not yet entered into force.

differ from agreement to agreement, national treatment essentially means that host states will treat foreign investors no less favourably than they would treat domestic investors. In any investment treaty that features this obligation, it will apply to investments that have been made and are operating in the host country. A typical national treatment clause could read:

*Each Contracting Party shall accord investors of the other Contracting Party, as **regards the management, maintenance, use, enjoyment or disposal** of their investments, treatment not less favourable than that which it accords to its own investors...*

Some treaties also specify that the investors, in order for them to be compared, have to be “in like circumstances.” This addition can guide tribunals in limiting the scope of application of the national treatment principle to a more reasonable set of situations. It reinforces the notion that when comparing the treatment of domestic and foreign investors, tribunals should be mindful to ensure they are not comparing apples to oranges. It is not clear that the language is necessary: some tribunals have examined whether foreign and domestic investors were in “like circumstances” even when, as in the example above, the reference to “like circumstances” was not explicitly included in the treaty. A specific reference to the limitation, however, provides more guidance to the tribunals and can produce more predictable outcomes.

Two key issues relevant to the meaning of the national treatment obligation relate to the importance of (1) intent, and (2) the domestic comparator. With respect to the first issue, some tribunals have stated that intent to discriminate is not a necessary element of a national treatment violation. A host state can violate that obligation even if it had no aim to treat foreign investors less favourably than domestic investors. All that matters is whether the host state’s actions or omissions had a (more) negative impact on the foreign investors. Assume, for example, a country permitted foreign investment in health services, but required service providers to be certified in accordance with domestic professional standards. If certification processes were designed to regulate and ensure the quality of health services, but imposed burdens that foreign service providers had more difficulties complying with, such measures could arguably violate the national treatment obligation.

The second issue relates to that of the domestic comparator. As noted above, to establish a violation of the national treatment obligation, a foreign investor will likely have to demonstrate that a domestic investor in similar or “like circumstances” with the foreign investor has been treated more favourably than the foreign investor. If no domestic investor in “like circumstances” was treated more favourably than the foreign investor, there will probably be no breach of the national treatment obligation. The more finely a tribunal identifies differences and draws distinctions between domestic and foreign investors, the less likely it will be that it will find a domestic investor has been treated differently than the foreign investor. To illustrate, if a foreign investor owned a manufacturing facility in the host country and produced the same product as a domestic investor, but did so using a process that emitted more greenhouse gases than the domestic investor, a law aiming to reduce emissions might have the impact of according less favourable treatment to the foreign investor. If the foreign investor challenged that the measure discriminated against it in violation of the national treatment obligation, a tribunal may determine that, due to the processes used (and in light of the goals of the regulation) the two investors were not in “like circumstances,” and therefore no violation of the national treatment obligation could be found.

In contrast, tribunals might take broad views of what are investors “in like circumstances” – even grouping investors involved in completely different economic sectors and activities in the same category. In one case, for instance, the tribunal determined that the claimant, a foreign investor involved in oil production and exportation, was in “like situations” with domestic entities involved in the production and export of lumber, bananas, and palm oil.<sup>29</sup> Applying that rather expansive notion of “likeness,” the tribunal determined that the state had discriminated against the foreign investor in violation of the national treatment obligation.

## 2.6.2. HOW ARE PRE-ESTABLISHMENT RIGHTS GRANTED THROUGH THE NATIONAL TREATMENT CLAUSE?

In some agreements, the national treatment obligation will apply not only to investors who are already operating in the host country (post-establishment national treatment) but also to potential investors seeking to make investments.

When the national treatment obligation is extended to potential investors, it creates what are called pre-establishment rights (or “rights of establishment”). They give foreign investors the right to enter a host country and make an investment on terms no worse than those faced by a domestic investor that might be considering the same type of investment. For example, the NAFTA—one of the first treaties to contain such a provision—states in Article 1102 (National Treatment):

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

The bolded words create NAFTA’s pre-establishment rights. Pre-establishment rights are not traditionally found in investment treaties, and even today are present in only a relatively small number of agreements. All of the United States and Canadian agreements since the NAFTA contain them, as do countries such as Japan. The ASEAN CIA has language based on the NAFTA wording. The EU Member states - who until 2009 had the exclusive competence on FDI - have not negotiated pre-establishment rights, since the competence on pre-establishment lay with the European Union. The European Union has indeed negotiated market access rights in the context of its free trade or economic partnership agreements. However, the European Commission did not negotiate pre-establishment rights in the context of investment protection. Recently, however, the European Union has the competence over FDI, and it is likely that the European Commission will negotiate investment treaties or chapters with pre- and post-establishment rights. Pre-establishment rights also feature in the WTO’s General Agreement on Trade in Services (GATS), where members can offer or request pre-establishment rights to investors in particular service sectors.

Through these agreements, governments give away a key power they traditionally hold as sovereigns – i.e., the authority to regulate and control the entry of foreign individuals and entities. Countries of course may always decide to open up their borders to foreign investors unilaterally. Through domestic measures, they can opt to liberalize their markets in a piecemeal or wholesale fashion depending on

<sup>29</sup> *Occidental Exploration and Production Co. v. Ecuador*, LCIA Case No. UN3467, Award, July 1, 2004, paras. 167-179.

their policy needs and aims. Investment treaties that grant pre-establishment rights, in contrast, lock countries into longstanding commitments to open their borders and allow foreign investors to enter.

### 2.6.3. WHAT ARE THE MAIN CONCERNS REGARDING THE NATIONAL TREATMENT OBLIGATION AND ITS IMPACT ON DOMESTIC LAW AND POLICY?

Governments may have a number of valid reasons for treating individuals or entities differently at the pre- and post-establishment phases. The national treatment obligation, however, can limit their abilities to do so.

If a tribunal too broadly identifies what are “like circumstances,” the national treatment obligation can restrict governments’ freedom to differentiate between investors and investments based on factors that are related to their activities, and not to their nationality. Various characteristics of any two investment projects in the same sector – including such aspects as who the investor hires, where the investment is located, what benefits it provides, what it produces, and what impacts it has on the surrounding environment – can result in the two investment projects having very different costs and benefits for the host economy. Based on those different costs and benefits, and without regard to the nationality of the investors, a government may want to favour (through, e.g., fiscal measures or permit approvals) one such investment project over the other. If a broad view of “likeness” is applied to the investments, however, the national treatment obligation could bar such differential treatment.

Further, there may be legitimate reasons why a government might take action to enforce laws or policies against one entity before (or without) taking similar enforcement actions against others, for example: resource constraints preventing action against all offenders; the desire to “set examples;” and the goal of targeting the worst violators of the law. Additionally, if a government makes a legitimate change in law or policy, treatment of a foreign investor after that change may differ from treatment of domestic (and other foreign) investors prior to the change. Both types of situations could also potentially result in de facto differential treatment of the foreign and domestic investors.

If a tribunal, however, solely focuses on the impact of the measure and does not view the reasons for the differential treatment as being relevant to whether there is a breach of the national treatment obligation, that obligation may hinder governments’ abilities to apply, enforce, and modify laws and policies serving legitimate and important public interest goals.

Additional concerns arise from the issue of pre-establishment national treatment. For one, legitimate national security concerns may counsel a country to want to guarantee a domestic presence, and strictly regulate foreign involvement, in a particular sector or activity.

Another concern with pre-establishment rights in investment treaties starts from the premise that in some countries the laws governing host country enterprises—which may include environmental, health, labour or safety laws—may be weak or missing. In such cases, particularly for foreign investments with significant potential impacts, states might wish to stipulate a high standard of conduct for incoming investments, for example to take advantage of the technical capacity of the foreign investor. If this were to occur, the investor could argue that such requirements violated the host state’s obligations for pre-establishment national treatment. That is, it could argue that the host state



was granting it less favourable treatment than it would grant similar domestic investors, which would be covered only by the less demanding domestic law.

Pre-establishment rights are sometimes criticized from an economic development perspective as well. This line of criticism follows on the “infant industry” argument, which says that in order to develop a strong domestic presence in a particular sector, it is sometimes necessary to give that sector temporary support and/or protection – assistance to help compete with, or a shelter behind which to develop free from, the potentially crushing competition of more efficient and/or more powerful foreign producers. Not allowing foreign investment in the sector is one way of doing that; giving assistance to domestic players is another.

There are a number of economic reasons why a state might prefer a strong domestic presence in a sector to foreign domination. Spending on research and development (closely correlated with capacity for innovation) is typically higher in head office states than in subsidiaries. Capacity to innovate is also increased by having local technicians and management learn by doing. And it may be that some of the decisions of domestic firms, including on re-investment of profits, will be more beneficial to the domestic economy than would be the decisions of foreigners.

On the other hand, the infant industry approach can hinder the beneficial injection of new technologies and management practices that might be quickly imported by foreign investors. It also can leave domestic consumers, at least initially, spending more on the goods produced by less efficient local producers, and perhaps consuming lower quality goods. Arguably the greatest downside of the infant industry approach is the risk that the infants will never “grow up” and the economy will be indefinitely saddled with inefficient low-quality producers.

There is little consensus on whether the benefits of the infant industry strategy outweigh the costs, and the specifics of each sector, country, and means of implementation will obviously be important in determining the outcome. It is clear, however, that those countries wanting to avail themselves of such a strategy or other similar practices that might disfavour foreign investors cannot do so if, rather than simply determining unilaterally that they do not want to adopt an infant industry policy, they commit in a treaty to grant foreign investors pre-establishment rights. Such commitments would be, moreover, somewhat final; it is very difficult to reverse such decisions under most investment treaties.

Finally, there is a more fundamental question: whether the promotion of requirements under international law for states to allow foreign investors to enter their state without any distinction from domestic investors is emerging as a new form of colonialism.<sup>30</sup> International law has in myriad manners provided a legal support for colonialism in its various historic forms. In the case of pre-establishment rights, while notionally these rights are reciprocal, in practical reality many countries have significantly less capacity than their other treaty parties to both (a) take advantage of and benefit from investment opportunities abroad, and (b) benefit from the inward investment they may receive. And while it is true there is a growing volume of FDI by investors from developing countries overall, patterns of inequality persist.<sup>31</sup> The encouragement of largely irrevocable rights of access in such circumstances remains an issue requiring considerable additional attention.

30 Howard Mann, “International Investment Agreements: Building the New Colonialism?” Proceedings of the American Society of International Law, Vol. 97, 2003.

31 See, e.g., OECD, FDI in Figures (July 2011).

## 2.6.4. HOW ARE STATES RESPONDING TO CONCERNS ABOUT THE NATIONAL TREATMENT OBLIGATION?

States have taken various steps in order to clarify and rein in the impacts of the national treatment obligation. Some states have included in their BITs language clarifying that discrimination is only prohibited when it is between “like” investments/investors. Such text reflects the principle that countries may legitimately accord different treatment to investors or investments that are in dissimilar circumstances. Although arbitral decisions indicate that the principle may be read into the treaty even when “like circumstances” language is not included in the text, it is nevertheless more prudent to make this clear in the treaty language. Additionally, some treaties provide language guiding tribunals in determining when situations or circumstances will be “like.”<sup>32</sup>

A number of states have also inserted explicit reservations and limitations into their treaties to preserve their rights to take measures that will intentionally or foreseeably discriminate against foreign investor. For example, some states have included in their agreements exceptions designed to protect particular aims and objectives (e.g., exceptions allowing more favourable treatment of indigenous or other minority groups), sectors or sub-sectors (e.g., provision of security services), and/or particular measures (e.g., exceptions for “non-conforming measures” existing at the time the agreement enters into force). The NAFTA, for example, has over 100 pages of such exceptions to national treatment.

Pre-establishment national treatment rights entail particularly significant commitments, and are seldom offered across the board. Rather, as with the GATS and some investment agreements, states that offer these rights will offer to do so only in certain identified sectors (the *list-in* or positive list approach), or they will specify a list of sectors, activities, and/or policy areas in which the commitments do *not* apply (the *opt-out* or negative list approach). The positive list approach is more predictable since states do not run the risk of forgetting to exclude a sector they had not intended to open up.

## 2.7. MOST-FAVoured NATION (MFN) TREATMENT

### 2.7.1. WHAT IS MFN TREATMENT?

Almost all investment treaties contain obligations to provide MFN treatment. If a state is given MFN treatment by an investment treaty partner, then this means the partner should treat that state’s investors no less favourably than it treats investors from other countries.

This seems straightforward enough, but in the last decade or so a new meaning has been argued for MFN provisions that gives them greater significance. MFN obligations have been used to allow investors to “import” commitments from among the many different agreements to which their host states might be party. That is, investors have successfully argued that although the BIT between their home country and

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32 See COMESA Investment Agreement, Art. 17(2). The COMESA Investment Agreement for the COMESA Common Investment Area was adopted May 2007 at the Twelfth Summit of COMESA Authority of Heads of State and Government). COMESA states are Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

the host state might be unfavourable to their claims, they are entitled to treatment as favourable as that promised to investors covered by any investment treaty that the host country had signed.

This gives investors a broad array of choices. There are over 2,750 BITs, and a host of investment chapters in free trade agreements, as well as commitments under the WTO's GATS and the Energy Charter Treaty (ECT). All have roughly similar elements, but they are not all identical. Any given state may be party to dozens of agreements with different wording to describe the basic obligations, or even fundamentally different obligations and procedures. These differences might stem from the fact that the agreements were signed at different points in the evolution of investment treaties, because the state's different treaty partners were powerful enough to offer their own boilerplate agreements on a take-it-or-leave-it basis, or a variety of other possible reasons.

Many of these differences are superficial, but some may be significant, and the new interpretation of MFN means that an investor might be able to pick and choose from among the various different formulations of the provisions on, for example, expropriation, to find one that is more favourable to its case, even if that one does not happen to be from the agreement signed by its home country.

For example, in *MTD v. Chile*, the Malaysian investor successfully claimed that the MFN provision in the Malaysia-Chile BIT entitled it to invoke the FET provisions in Chile's BITs with Denmark and Croatia, which contained more extensively worded obligations.<sup>33</sup> In *Maffezini v. the Kingdom of Spain*, the Argentine investor effectively invoked the MFN provision in order to bypass restrictions in the Argentina-Spain BIT – restrictions which required that investors first turn to domestic courts before resorting to international arbitration. It has now been held by a number of tribunals that the MFN obligations in investment treaties allow for this type of cherry-picking among existing treaties.<sup>34</sup>

Not all commentators and tribunals agree with this approach however. Indeed there is an ongoing debate on whether and to what extent it should be possible to use the MFN clause in BITs to import more favourable provisions from other treaties that have been concluded by the host state. Thus, although cases like *Maffezini*, *MTD*, *RosInvest Co. v. Russia*,<sup>35</sup> and others have allowed investors to use the MFN provision to expand their substantive and procedural rights, tribunals in other cases have come to contradictory conclusions regarding the effect of the MFN provision.<sup>36</sup>

Other questions regarding the impact of the MFN obligation also exist. Could an investor, for example, import obligations from agreements other than BITs? Could it complain that a host country had caused it harm by actions that violated commitments under the WTO's GATS, Trade-Related Investment Measures (TRIMs), or Trade-Related Aspects of Intellectual Property Rights (TRIPS)? These contain commitments covering the treatment of investors, after all. How about the WTO Agreement on Government Procurement, which is clearly not an investment agreement? These matters are still largely unsettled, giving rise to uncertainty regarding the actual scope and impact of the MFN obligation.

33 *MTD Equity v. Chile*, supra.

34 See *RosInvest v. Russian Federation*, SCC Arbitration V (079/2005), Award on Jurisdiction, Oct. 2007 & Award, Sept. 12, 2010.

35 SCC Arbitration V (079/2005), Award on Jurisdiction, Oct. 2007 & Award, September 12, 2010.

36 See, e.g., *Plama Consortium Ltd. v. Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction, Feb. 8, 2005; *Salini Costruttori S.p.A. v. Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction, Nov. 9, 2004.

### 2.7.2. WHAT ARE THE MAIN CONCERNS REGARDING THE MFN OBLIGATION?

As noted above, the MFN obligation has evolved over roughly the past 10 years from a relatively uncontroversial obligation designed to level the playing field among foreign investors from different states, to one that raises important questions regarding the capability of the obligation to distort investment treaties and enlarge countries' commitments under them beyond what the state parties to the agreements originally intended or envisioned.

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

Allowing foreign investors to isolate, extract and import more favourable provisions from other investment treaties can broaden states' obligations under investment treaties, undoing what may have been the results of hard-fought negotiations between the host and home country, and nullifying what might have been purposeful limits in the agreements. Assume, for instance, that one treaty, the "basic treaty" grants foreign investors relatively broad rights as compared with other investment treaties, but uses various procedural mechanisms to reduce the investors' abilities to proceed directly to investor-state arbitration to enforce those rights. A foreign investor covered by that basic treaty, and enjoying its rather broad substantive protections could potentially use the basic treaty's MFN provision to import less-restrictive provisions on investor-state arbitration found in other investment treaties, and bring its claims directly before an arbitral tribunal. This use of the MFN provision impacts the host states' potential liability under the basic treaty, and alters the cost-benefit equation for that investment treaty.

Similarly, if an investor were able to import obligations from agreements other than BITs, such as the GATS, the concern here would be, among other things, that the drafters of those agreements never intended to grant private investors the right to enforce those treaties' provisions through binding arbitration.

Above and beyond those concerns over scope, there are other problems with an expansive interpretation of MFN protection. The most serious is that it may stymie efforts to improve investment treaties. It was argued above, for instance, that the majority of the world's some 2,750 BITs have worryingly unclear provisions in the areas of expropriation and FET. And it was noted that as a result some countries have tried to innovate in their modern investment treaties to tighten up that wording. All of those countries, however, still have BITs in force that contain the older language. MFN provisions may allow investors to simply sidestep around the improved text, unless the MFN provisions themselves are more carefully worded.

### 2.7.3. HOW ARE STATES RESPONDING TO CONCERNS ABOUT THE MFN OBLIGATION?

To avoid such uses of the MFN provision, some countries have decided to entirely exclude the MFN obligations from their treaties. The investment chapters in the India–Korea Comprehensive Economic Partnership Agreement (CEPA)<sup>37</sup> and India–Singapore CEPA,<sup>38</sup> for example, completely omit the MFN provision.

Other countries have continued to include the provision, but have then adopted relevant exceptions or limitations to it. Examples of limitations used in existing treaties to prevent unintended “ratcheting-up” of the agreements include those indicating that the MFN provision cannot be used to (a) import more favourable provisions relating to certain rights and obligations such as dispute settlement procedures,<sup>39</sup> (b) import rights from specific agreements,<sup>40</sup> or (c) import protections from treaties concluded before a certain date.<sup>41</sup>

## 2.8. PERFORMANCE REQUIREMENTS

### 2.8.1. WHAT ARE PERFORMANCE REQUIREMENTS?

A performance requirement is a condition that investors must meet in order to establish or operate a business, or to obtain some advantage offered by the host state. Performance requirements can include, for example:

- Requirements to export a certain percentage of total sales, or total production;
- Requirements to enter into joint venture arrangements with domestic partners;
- Requirements to transfer or share technology;
- Requirements that a certain amount of inputs be locally sourced;
- Requirements to expend a certain amount on research and development; and
- Requirements to hire a certain number or percentage of local employees.

Governments may impose performance requirements as mandatory measures. Governments may also provide investors fiscal incentives or other advantages in exchange for businesses’ compliance with the performance requirements.

Performance requirements have been and are being used by many countries to further (with varying levels of success) diverse policy goals such as regulating trade balances, improving the

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37 This agreement, which entered into effect January 1, 2010, is available at <http://commerce.nic.in/trade/india%20korea%20cepa%202009.pdf>.

38 Comprehensive Economic Cooperation Agreement between the Republic of India and the Republic of Singapore, Ch. 6 (signed June 29, 2005; entered into force Aug. 1, 2005). Taking the place of an MFN provision, the agreement states in Article 6.17(1), “Review of Commitments:” If, after this Agreement enters into force, a Party enters into any agreement on investment with a non-Party, it shall give consideration to a request by the other Party for the incorporation herein of treatment no less favourable than that provided under the aforesaid agreement. Any such incorporation should maintain the overall balance of commitments undertaken by each Party under this Agreement.

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

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

41 See *id.*

competitiveness of domestic industries, gaining technology and increasing employment.<sup>42</sup>

### 2.8.2. HOW DO INVESTMENT TREATIES LIMIT STATES' ABILITIES TO IMPOSE PERFORMANCE REQUIREMENTS?

States have increasingly been committing in international treaties not to impose certain performance requirements. One main body of international law restricting states' freedoms to impose performance requirements is the WTO's Agreement on Trade-Related Investment Measures (TRIMs Agreement). The WTO's TRIMs Agreement prohibits certain categories of *trade-related* performance requirements such as requirements for domestic sourcing of inputs, and restrictions on imports and exports related to local production. Although the TRIMs Agreement covers only a sub-set of all performance requirements, these commitments are significant given that almost all of the world's trading nations subscribe to them.

Apart from the TRIMs Agreement, the majority of investment treaties do not mention performance requirements. However, the United States and Canadian agreements since the NAFTA contain them, as do agreements concluded by some Asian countries.<sup>43</sup> The European Commission might negotiate rules to limit the use of performance requirements in its future investment treaties or chapters.

Some of the investment treaties that contain provisions on performance requirements simply reference and incorporate the TRIMs Agreement. These agreements do not expand the number or scope of restrictions beyond those already provided for in the TRIMs Agreement; they may, however, allow investors to bring an investor–state arbitration claim against the host government to challenge and seek damages for a measure on the ground that it is an impermissible performance requirement. The TRIMs Agreement itself does not similarly permit investors to bring claims against states challenging measures as performance requirements.

Other investment treaties go beyond the TRIMs Agreement in terms of the restrictions they place on performance requirements. Some investment treaties with provisions on performance requirements, for instance, also prohibit such policy measures as (1) requirements for foreign investors to transfer technology, production processes, or other proprietary knowledge, and (2) requirements to appoint people of a particular nationality to senior management provisions.

### 2.8.3. WHAT IMPACTS DO RESTRICTIONS ON PERFORMANCE REQUIREMENTS HAVE ON SUSTAINABLE DEVELOPMENT?

The relationship between performance requirements, restrictions on them, and sustainable development is complex and multifaceted. One issue is that foreign investment is often touted as an important means of facilitating the transfer of technology, a phenomenon that, among other effects, can enable developing countries to “leapfrog” over highly polluting phases of growth and development that developed countries faced during their periods of industrialization. Yet when

42 See, e.g., Rachel Denae Thrasher & Kevin P. Gallagher (2010). 21<sup>st</sup> Century Trade Agreements: Implications for Development Sovereignty. 38 *Denv. J. Int'l L. & Pol'y* 313, 338–340; UNCTAD (2005). World Investment Report 2005L Transnational Corporations and the Internationalization of R&D, at 214–216, 229; UNCTAD (2003). *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries*.

43 See, e.g., US–CAFTA-DR, *supra*, Art. 10.9; India–Singapore FTA, *supra*, Art. 6.23; Japan–Mexico FTA, art. 65 (signed Sept. 17, 2004; entered into force April 1, 2005); Canada–Croatia BIT, Art. VI (signed Feb. 3, 1997; entered into force Jan. 30, 2001).

investment treaties limit countries' rights to mandate or incentivize the transfer of technology, these restrictions on performance requirements may hinder such knowledge transfer and thereby slow the spread of cleaner, more environmentally friendly practices.

Even more fundamentally, from a sustainable development perspective, the key question is whether the Washington Consensus had it right; the Washington Consensus held that performance requirements are unwise economic policy, and therefore are unnecessary barriers to investment which should be discouraged. But are performance requirements necessarily bad policy? What empirical evidence there is seems to suggest that performance requirements are not all equal on this score, but that some have in fact assisted countries in reaping the asserted benefits of foreign investment and furthering their development goals.<sup>44</sup>

From a sustainable development perspective it would be better for countries to have the flexibility to use some types of performance requirements. A state can unilaterally decide not to implement performance requirements if it believes such requirements are not good economic policy; it need not commit via treaty to remove those measures from its "toolbox" of available policy options. No state can force an investor to make an investment that is not economically viable, but this does not mean that formulas for the mutual benefit of the investor and the local community and host state cannot be found. Treaty restrictions on performance requirements, however, reduce the variety of formulas available.

#### 2.8.4. HOW ARE STATES SAFEGUARDING THEIR OPTIONS TO USE PERFORMANCE REQUIREMENTS?

In some agreements containing limits on performance requirements, states have carved out exceptions to the limitations to make clear that they can continue to take certain measures to help ensure that investment aids them in furthering their domestic policy goals. The TRIMS+-type agreements to which the U.S. is party, for instance, specify that the prohibitions on mandatory performance requirements "shall not be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage ... on compliance with a requirement to locate production, supply a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory."<sup>45</sup> These measures are among those that can help host countries maximize benefits from FDI. Yet despite recognizing the rights of countries to implement such important policy measures through the use of *incentives*, these provisions nevertheless prevent host countries from implementing *mandatory* regulations in this area, and may therefore negatively impact host states' bargaining power when entering into agreements with specific foreign investors for particular projects or investments.

### 2.9. REQUIREMENTS FOR FREE TRANSFERS OF CAPITAL

#### 2.9.1. WHAT ARE THE REQUIREMENTS FOR FREE TRANSFERS OF CAPITAL?

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44 For surveys of experience, see Zampetti, Americo Beviglia & Torbjörn Fredriksson (2003). The Development Dimension of Investment Negotiations in the WTO—Challenges and Opportunities. *Journal of World Investment*, 4(3); UNCTAD (2003). *Foreign Direct Investment and Performance Requirements: New Evidence from Selected Countries*. New York and Geneva: United Nations; Moran, Theodore H. (1999). Foreign Direct Investment and Development: A Reassessment of the Evidence and Policy Implications. in OECD, *Foreign Direct Investment, Development and Corporate Responsibility*, pps. 43–55.

45 See, e.g., US–Panama FTA, art. 10.9(3)(a) (signed June 28, 2007).



Investment treaties almost universally require host countries to permit foreign investors to freely transfer their investment-related capital in and out of the host country. This can include flows of capital into the country to establish, expand, and maintain an investment. It can also include flows of capital out of the country such as wages, returns (e.g., profits, dividends, and interest), payments to creditors, and proceeds from sale or liquidation of the investment.

The standard is an absolute standard, meaning that foreign investors protected by these provisions may have more freedom to move their capital in and out of the country than domestic investors who would remain subject to the host country's measures restricting transfers. Additionally, many treaties broadly state the obligation, requiring the host state to guarantee free transfers in and out of its territory with little or no exceptions. A number of recent investment treaties and chapters, however, limit the obligation by stating that states may restrict transfers for a number of reasons, including to enforce laws relating to (1) bankruptcy and the protection of creditors' rights, (2) issuing, trading, or dealing in securities, (3) enforcement or collection of fines and judgments, and (4) financial reporting. Some, although similarly a minority, also contain safeguard or other provisions allowing states to take measures to prevent or respond to balance of payments or other general macroeconomic crisis situations.

### 2.9.2. WHAT ARE SOME OF THE CONCERNS REGARDING FREE TRANSFER OF CAPITAL CLAUSES?

Governments may have a number of important and legitimate reasons for wanting to regulate flows of capital in and out of their territories, including to protect the stability of their currency and markets, minimize effects of global economic crises, restrict funding of terrorism or repressive regimes, and ensure the collection of taxes, fines or judgments. Broad obligations to permit free flows of capital in and out of the country, however, can limit countries' freedoms to regulate in these areas. The consequences for host countries threaten to be significant. Countries may even find themselves exposed to claims and potential liability for taking good faith measures of general applicability such as using capital controls in order to prevent or respond to economic meltdowns.

The short essay by Kevin P. Gallagher, which appeared in *Investment Treaty News* on April 5, 2011, describes this last issue well. Although he focuses on the issues faced by developing countries, the concerns are also relevant to developed countries and countries-in-transition, which attract the bulk of foreign investment:

*Capital flows—cross-border non-foreign direct investments—can help developing countries grow. Indeed, many developing countries may lack the savings or financial institutions that can help finance business activity. Capital from abroad can fill that gap. Therefore, under normal circumstances, the more capital flowing into a developing country, the more the country benefits. However, cross-border capital flows tend to be “pro-cyclical:” too much money comes in when times are good, and too much money evaporates during a downturn.*

*A key characteristic of the global financial crisis has been the mass swings of capital flows across the globe. Indeed, international investment positions now surpass global output. Developing and emerging markets are no strangers to these flows. When the*

*crisis hit, capital rapidly left the developing world in a flight to the “safety” of the United States market. In the attempt to recover, many industrialized nations, including the U.S., have resorted to loose monetary policy with characteristically low interest rates. Relatively higher interest rates and a stronger recovery have triggered yet another surge in capital flows to the developing world. The result has been an increasing concern over currency appreciation, asset bubbles, and even inflation.*

*Under these circumstances, capital controls can help smooth the inflows and outflows of capital and protect developing economies. Most controls target highly short-term capital flows, usually conducted for speculative purposes.<sup>46</sup>*

Investment treaties, however, rarely leave countries the freedom to implement these measures. And although one country may be unwilling to bring a claim against a foreign country for breach of the treaty in such circumstances (perhaps due to its own use of capital controls in response to the same or similar economic crisis), investors who have suffered losses due to the measures will likely not share the same reluctance.

### 2.9.3. HOW ARE STATES RESPONDING TO CONCERNS ABOUT FREE TRANSFER OF CAPITAL CLAUSES?

As noted above, several states have begun introducing limitations to the free transfer of capital clause in investment treaties, through more or less wide exceptions clauses with hard or flexible time limits. Some exceptions, such as the one used in the Japan–Republic of Korea BIT, provide relatively ample room for host state measures, by allowing restrictions on transfers for domestic policy reasons including to secure payment of fines, penalties and court judgments, while also providing protection for measures addressing “external financial difficulties,” “macroeconomics management” policies, “balance of payment” problems or measures taken for “prudential” reasons. Also, this BIT does not impose any specific time limits for measures taken in response to balance-of-payments problems, external financial difficulties, or other exceptional macroeconomic difficulties, though it does specify that such measures be temporary.

European member states have also been called by the European Court of Justice to review and re-negotiate the sweeping free transfer clauses contained in their BITs. According to the Court, this is necessary in order to bring the agreements into compliance with European law, which demands more flexibilities in times of financial and macroeconomic crises.<sup>47</sup>

## 2.10. AMPLIFIED OBLIGATIONS: UMBRELLA AND STABILIZATION CLAUSES

46 Kevin P. Gallagher (2011, April 5). Reforming United States Trade and Investment Treaties for Financial Stability: The case of capital controls. *Investment Treaty News*.

47 Case C-205/06, *Commission v. Austria* [2009] ECR I-1301; Case C-249/06, *Commission v. Sweden* [2009] ECR I-1335; Case C-118/07, *Commission v. Finland*, of 19 November 2009.

### 2.10.1. WHAT ARE UMBRELLA CLAUSES?

A 2004 article estimated that roughly 40 per cent of the existing investment treaties contain what is known as an umbrella clause.<sup>48</sup> The precise wording differs from agreement to agreement, but generally they look something like this:

*“Each Party shall observe any obligation it may have entered into with regard to investments.”<sup>49</sup>*

Such provisions are called umbrella clauses because, by committing the host state in the investment treaty to fulfilling both investment treaty and non-investment treaty obligations, they may bring a wide range of obligations under the umbrella-like coverage of the investment treaty. They may, for example, bring in obligations found in investment contracts, the actual contracts between states and foreign investors, which specify the terms under which the investment will take place. This would allow investors to enforce a wide variety of host country obligations—legislative, contractual, and treaty-based—through the investment treaty’s powerful investor–state dispute settlement mechanisms. It would also make it possible for investors to have at least two tries at justice – one from the domestic legal regime that covers the contract, and the other (in case the first does not work) from the legal recourse offered by the investment treaty.

However, it is not yet clear that umbrella clauses are able to transform all types of state undertakings into treaty obligations. The first known case to consider the question, *SGS v. Pakistan*, rejected the argument that they had such broad powers, arguing that the legal consequences would be

*so far-reaching in scope, and so automatic and unqualified and sweeping in their operation, so burdensome in their potential impact upon a Contracting Party, we believe that clear and convincing evidence must be adduced by the Claimant ...that such was indeed the shared intent of the Contracting Parties.<sup>50</sup>*

Subsequent tribunals, however, have taken quite the opposite position, arguing that the plain meaning of “respecting any obligations made with respect to the investment” is clear: it means all obligations, including contractual commitments and other obligations not based on the investment treaty itself.<sup>51</sup> As with MFN, it is uncertain how far this could be taken. It might be, for example, that the commitments made under WTO law would become part of the obligations of an investment treaty, allowing investors to directly seek redress against governments in a way that the WTO members never intended.

The umbrella clause may become particularly potent when combined with an investor–state contract that features a stabilization clause.

### 2.10.2. WHAT ARE STABILIZATION CLAUSES?

48 Gill, Gearing and Birt (2004). Contractual Claims and Bilateral Investment Treaties: A Comparative Review of the SGS Cases. *J. Int. Arb.* 21(5) 397.

49 U.S.–Argentina BIT, Art. II(c) (signed Nov. 14, 1991; entered into force Oct. 20, 1994).

50 *Ibid.*, para. 167.

51 *Eureko B.V. v. Poland*, UNCITRAL, Partial Award, Aug. 19, 2005.

Stabilization clauses are clauses that promise to insulate the investor from changes in the host state's laws, and they typically feature in capital-intensive, site-specific, long-lived investments such as extractive sector projects.<sup>52</sup> They are not found in investment treaties, but rather in investor–state contracts. A 2008 study found that stabilization clauses exist in three main forms: “freezing clauses” that freeze the law of the host state for the investor for the life of the project; “economic equilibrium clauses” that leave the investor to comply with new laws, but promise compensation for the cost of compliance; and “hybrid clauses” that have characteristics of the two previous forms, and may commit the state to restore the investor to the same position it was in prior to the law change, including by exempting it from the effects of new laws.<sup>53</sup> These powerful promises are given even greater force if an umbrella clause causes them to become enforceable through the investment treaty dispute settlement provisions.

Even where umbrella clauses do not exist, or are not interpreted so as to bring contract obligations under investment treaty provisions, stabilization clauses may change the nature of the obligations found in the investment treaties. On expropriation, for example, stabilization clauses may completely moot the police powers carve-out described above. Even if a tribunal were inclined to follow the *Methanex* reasoning that considered non-discriminatory public welfare measures to be outside the definition of expropriation, if an express commitment has been made to shelter an investor from such measures, then the picture might change entirely. *Methanex*, for example, held that such measures were not normally to be considered expropriation “unless specific commitments had been given by the regulating government to the ... foreign investor contemplating investment that the government would refrain from such regulation.”<sup>54</sup> In other words, if the United States had signed a stabilization agreement with *Methanex Corp.*, the California ban on MTBE would probably have been considered expropriation after all.

Stabilization clauses may alter the nature of the commitment to FET as well. An important component of FET in many of the arbitration rulings is the requirement that the host state respect the “legitimate expectations” of the investor when it decided to invest.<sup>55</sup> A critical source of such expectations, it is widely understood, is to be found in the investment contracts, and in particular any stabilization clauses. In the case *Parkerings v. Lithuania*, the tribunal stated that a stabilization clause can give rise to a legitimate expectation by the investor that the investment will not be negatively affected by law changes.<sup>56</sup> As such, if a host state failed to honour a stabilization clause in an investment contract, under the *Parkerings* reasoning it would likely also be breaching the FET standard of its investment treaty. The investor could then effectively use the investment treaty's investor–state dispute settlement provisions to seek compensation for the breach of contract.

### 2.10.3. WHAT ARE THE IMPLICATIONS OF UMBRELLA AND STABILIZATION

52 Andrea Shemberg, *Stabilization Clauses and Human Rights*, a research project conducted for IFC and the United Nations Special Representative to the Secretary General on Business and Human Rights, Mar. 11 2008, p. 27, p. ix. Of the contracts containing freezing clauses analysed in the research, 83 per cent were in extractive sector contracts (all were mining projects).

53 *Ibid*, p. vi.

54 *Methanex*, Part IV Chapter D, para. 7.

55 E.g. *Técnicas Medioambientales Tecmed, S.A. v. Mexico*, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003. para. 154.

56 *Parkerings-Compagniet v. Lithuania*, ICSID Case No. ARB/05/8, Award, Sept. 11 2007, para. 332.

## CLAUSES FOR SUSTAINABLE DEVELOPMENT?

The concerns with umbrella clauses and stabilization agreements are straightforward: depending on how they are interpreted they may make desirable public welfare measures more costly and less likely to be enacted. Both of them may greatly expand the power of the protection that investment treaties offer to investors, at the same time shrinking the policy space governments may have to enact measures for purposes such as protection of the environment, health and safety. Umbrella clauses may bring a whole class of commitments out of their originally intended legal frameworks to make them subject to binding investor–state arbitration. Stabilization agreements are expressly about limiting policy space—a concern in and of itself, given the desirability of improved regulatory regimes for environment, health and safety and other matters related to sustainable development in most jurisdictions—and when combined with umbrella clauses they become even more potent. Further, they may change the nature of state obligations under an investment treaty, making public welfare measures more likely to be found in breach of commitments on expropriation and FET.

A growing concern with both umbrella clauses and stabilization clauses, and the interplay with other investment treaty provisions, is a disequilibrium that is being created in the scope of the treaty provisions. As *Parkerings* and *Methanex* indicate, some decisions that seem to take the view that investment treaties leave host states with relatively wide latitude to regulate also appear to view states as having significantly less freedom under the treaty when there is a contractual stabilization clause. The issue that arises from the impact contractual stabilization clauses have on the application of the treaty relates to the fact that it is almost exclusively developing countries that sign such contracts with stabilization clauses. Most OECD states operate through more widely applicable licensing or other administrative procedures. Hence, in practice, this approach to applying the treaty provisions would likely lead to greater regulatory constraints on those states likely to need regulatory development the most, as they would generally now have the least developed public interest regulatory framework.

# 3. Balancing the Investor Guarantees: Obligations of Investors and Home States?

## 3.1. DO INVESTMENT TREATIES IMPOSE OBLIGATIONS ON INVESTORS?

The answer to this question has long been, and with only a few exceptions, continues to be, “no.” Investment treaties contain guarantees for investors, but do little to balance those guarantees by imposing substantive obligations on them. Perhaps the only real exception is that, as noted above, treaties may impose the rather basic duty on investors to establish their investments in accordance with the host state’s laws and regulations. In at least some cases, failure to comply with this treaty requirement to *establish* an investment legally has resulted in the investor being barred from pursuing an investment treaty arbitration against the state.<sup>57</sup> Tribunals have also considered investor corruption in the making of an investment even in absence of any explicit clause on investor conduct in the treaty or the contract.<sup>58</sup> The consequence of such misconduct has led tribunals to deny arbitration rights to the investor by rejecting jurisdiction. Other times, investor conduct (or, more accurately, misconduct) has affected tribunal’s findings on a breach of the treaty by the host state, or on the amount of damages awarded.<sup>59</sup> Overall however, tribunals do not appear to be considering investors’ compliance with domestic environmental, labour, or tax law after the investment is established.

Features of some more modern treaties may change this picture. A couple of Austrian agreements, for instance, emphasize in their preambles the need “for all governments and civil actors [such as investors] to adhere to the UN and OECD anti-corruption efforts....”<sup>60</sup> They also refer, albeit through much softer language, to the value of having companies behave responsibly in accordance with the OECD Guidelines for Multinational Enterprises.<sup>61</sup> Even if non-compliance with these principles does not impact investors’ rights to maintain arbitration actions, it may at least impact tribunals’ assessments of their claims.

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

58 *World Duty Free v. Kenya*, ICSID Case No. ARB/00/7, Award, Oct. 4, 2006. World Duty Free alleged that Kenya breached its contractual obligations toward the investor and also violated international law. It did not base its action on a BIT or other investment agreement.

59 See Peter Muchlinski (2006). *Caveat Investor? The Relevance of the Conduct of the Investor Under the Fair and Equitable Treatment Standard*. 55 *ICLQ* 527. See also, e.g., *Biwater v. Tanzania*, Award, July 24, 2008, paras. 788-807 (finding that due to the investor’s poor bid for and mismanagement of the concession, the value of the concession had evaporated to the degree that the no additional economic losses were suffered as a result of the state’s breach of the BIT).

60 Austria–Tajikistan BIT, pmb. (signed Dec. 15, 2010); Austria–Kosovo BIT, pmb. (signed Jan. 22, 2010).

61 *Ibid.* Some treaties dedicate specific articles to the issue of investor obligations. The COMESA investment agreement, for example, contains an article requiring investors to comply with the host state’s regulations in all phases of the investment. It states in Article 13, “COMESA investors and their investments shall comply with all applicable domestic measures of the Member State in which their investment is made.”

Several observers would have the treaties go further and suggest imposing binding obligations on investors under the agreements, including obligations on corruption, environmental impact assessments and management, and labour and human rights issues. Work continues on this. Overall, however, most investment treaties in the universe of such agreements are still fairly one-sided: guarantees flow from host states to foreign investors, and there little or no conditions for foreign investors to satisfy in order to receive the full benefit of the treaties' protections.

### **3.2. DO INVESTMENT TREATIES IMPOSE OBLIGATIONS ON HOME STATES?**

Investment treaties can typically be described as imposing obligations on host states, without likewise assigning obligations to home states. One problem with this one-way flow of obligations is that it may prevent the treaties from doing what they can to further one of their purported main goals: promoting foreign investment.<sup>62</sup>

As explained above, there a number of factors that influence investors' decisions on whether and where to invest abroad. Among them are the needs and strategies of the investor (e.g., if it wants access to a market or resources) and characteristics of the host state (e.g., the size of its markets, available resources, presence of reliable infrastructure, and stability of the business and legal environment). The investors' home states can also play an important role, as there are a variety of measures they can take to promote outward investment. These include (1) providing information and technical assistance to their domestic firms to help them identify and seize opportunities abroad; (2) providing information and technical assistance to developing countries to help them attract investment; (3) providing incentives to investors to invest abroad; and (4) providing insurance to mitigate investment risks.

Investment treaties can include commitments by home states to implement such measures, yet at present, they generally do not. Only a small set deviates from that pattern, taking at least some steps to more widely distribute the burdens imposed by investment treaties.<sup>63</sup>

There are other ways that home states could help ensure that their investors are contributing positively to sustainable development in the host states. One is a commitment by the home state to cooperate with the host state on domestic environmental and labour matters by, for instance, providing the host state with information and expertise on developing and implementing regulatory policies in these areas. Another is a commitment to provide the host state with information regarding its firms' records of compliance with the home state's laws. Home states can also commit to ensure that there is a forum for addressing and seeking redress for the

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

63 See, e.g., CARIFORUM–EU Economic Partnership Agreement, arts. 7, 121, 135-138. By December 2009, the agreement had been signed by all CARIFORUM countries and approved by the European Parliament. CARIFORUM countries are Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, the Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Lucia, Saint Vincent and the Grenadines, Saint Kitts and Nevis, Suriname, and Trinidad and Tobago. See also UNCTAD (2005). *International Investment Agreements: Key Issues*, Vol. II, at 3–5; UNCTAD (2001). *Home Country Measures*.



conduct of their overseas investors. They can do this, for example, by establishing a mechanism under the treaty to review and decide complaints, and/or allowing civil suits against the investor in the investor's home state to recover for harms caused by the investor in the host state. Investment treaties could also commit home states to regulate investors' conduct abroad. A relatively minute number of investment treaties take some of these steps.<sup>64</sup> The traditional and majority approach is to be silent on these issues.

## 4. Investment Treaty Arbitration

### 4.1. WHAT ARE THE PROCESSES FOR ENFORCING STATES' OBLIGATIONS UNDER INVESTMENT TREATIES?

The obligations countries assume under investment treaties can be particularly powerful when combined with enforcement mechanisms. Nearly all investment treaties include mechanisms through which violations can be alleged and disputes resolved. Generally, there are two processes under which this may happen: one is a state-state process for disputes arising between contracting parties; the second is a process through which an investor can bring a claim directly against the host state for alleged violations.

The first type of process—state-state dispute settlement—is the traditional process under international law for resolving conflicts arising under treaties. In the WTO context, for instance, only signatory states may bring claims against other signatory states. Companies that have suffered injuries from a foreign government's improper trade practices have no right to bring a direct claim alleging violations of WTO law. The second type of process—one through which private individuals and entities can bring claims directly against states for a breach of the treaty—is relatively novel and unique. Prior to the ascendancy of investment treaties, complaints of investors were generally dealt with between states. In other words, if foreign nationals believed that a host government had violated international law with respect to their investment, it was up to their government to take up the matter on their behalf.

### 4.2. WHO MAY BRING CLAIMS AGAINST HOST STATES UNDER INVESTMENT TREATIES?

The specific answer to this question will depend on the language of the governing investment treaty. Nevertheless, the general answer is that any covered foreign "investor" can bring a claim against the host state alleging that the government's treatment of the investor's "investment" violated the treaty. As noted above, most treaties provide broad definitions for the terms "investment" and "investor." Consequently, investment treaties can expose a host state to claims from a seemingly unlimited number of individuals and entities. To illustrate the range of possibilities, minority shareholders in Company A which, in turn, holds an interest in a foreign investment, Company B, may each independently bring claims against the host government if they believe a particular measure taken by

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64 The agreements with the most comprehensive provisions on cooperation on environmental and labour measures and capacity tend to be free trade agreements or economic partnership agreements. See, e.g., U.S.–CAFTA-DR, *supra*, Chs. 16 & 17.

the host state harmed their indirect investment in Company B. Company A as well as any other direct or indirect shareholders in Company B may also bring their own claims against the host country alleging that the same government measure harmed their investments in Company B. In practice, this means that one measure taken by the host state can generate a potentially significant number of claims against it relating to impacts suffered by just one company operating in the host state. If the measure is one of general applicability, affecting a number of enterprises involved in a particular sector or activity, the number of claims against the host state can potentially expand exponentially.

### **4.3. ARE THERE LIMITS ON INVESTORS' ABILITIES TO BRING CLAIMS?**

The governing investment treaty may impose a number of restraints on investors' abilities to pursue investor–state arbitrations. One threshold condition that must be met for a claim to survive is that the claimant must establish that it is a covered “investor” and that there is a dispute under the treaty related to its existing or, in some cases, potential “investment.” As noted above, however, broad definitions of the terms “investor” and “investment” have tended to make this a relatively easy condition to satisfy.

Another restraint on investors' rights to bring claims can relate to the subject matter of the dispute. Treaties may carve out particular types of disputes, such as disagreements over taxation, or disputes over pre-establishment issues, from going to investor–state arbitration.

Investment treaties may also require investors to comply with certain time periods before initiating claims. These time periods can be “cooling off” periods requiring the investor to wait a specified time before commencing the arbitration; they can also include “limitations” periods stipulating that investors must notify governments of a dispute within a certain number of years from the point at which they should have been aware of the breach of the treaty. If an investor fails to meet either of these criteria, a claim may well be dismissed by an arbitral tribunal. Existing practice, however, illustrates that at least some tribunals are willing to allow an investor to use the MFN provision in the governing investment treaty to bypass these requirements if the investor can identify another treaty to which the host state is party that does not impose similar “cooling off” or “limitations” periods. In some cases involving “cooling off” periods, tribunals have also watered down the force of these restrictions by stating that compliance with them is not strictly required for investors to bring claims.

### **4.4. WHAT ARE FORK-IN-THE-ROAD CLAUSES?**

A potentially important limit on investors' abilities to bring claims is the so-called “fork-in-the-road” provision. The system of investor–state arbitration is often promoted as a means of providing a “neutral” and “depoliticized” forum for settling investment disputes by allowing investors to bypass domestic courts, which may be considered corrupt, politicized, or simply over-burdened and inefficient. “Fork-in-the-road” provisions allow investors to weigh their options and choose whether to pursue their claims in domestic courts or through investor–state arbitration, but require that once an investor has elected one route, the other is closed off.

Fork-in-the-road provisions can prevent foreign investors from having the opportunity to try their claim twice: both through domestic courts and through arbitration. So far, however, tribunals have been

reluctant to bar claims based on fork-in-the-road clauses. For instance, investors have been allowed to claim breaches of a contract in local courts, and breaches of an investment treaty in international arbitration, even when the same fundamental complaints lie at the heart of both claims.<sup>65</sup> This controversial approach allowing investors to frame their claims so as to pursue different avenues of relief for essentially one set of grievances, multiplies the potential number of cases against a state and provides investors with multiple bites at the apple.

#### **4.5. DO INVESTMENT TREATIES REQUIRE CLAIMANTS TO FIRST EXHAUST LOCAL REMEDIES?**

Exhaustion of local remedies is a principle of customary international law according to which, for an international claim to be brought against a state based on alleged violations of rights of another state's national, all remedies available in the domestic legal system of the respondent state must be exhausted. This gives the state an opportunity to redress an alleged international wrong within its domestic legal system before the dispute is raised to the international plane. There are some exceptions to the requirement to exhaust local remedies, such as when there are no reasonably available remedies to provide effective redress or if the available remedies do not provide reasonable possibility of redress.

In contrast to this principle, which is also applied in international human rights cases, investment treaties typically do not require the exhaustion of local remedies, and allow investors to proceed directly with international arbitration. In some instances, the requirement to exhaust local remedies is explicitly excluded. Moreover, where the treaty is silent, tribunals have not appeared willing to read such requirement into the agreement despite the customary international law rule.

A few investment treaties explicitly oblige investors to pursue their case through domestic courts, or other administrative channels, prior to launching international arbitration proceedings. Demanding that investors thoroughly test out domestic courts before turning to international arbitration helps prevent unripe and frivolous claims, and can give the government an opportunity to remedy alleged wrongs. Moreover, by dealing with investor complaints through their own judicial and administrative channels, governments are encouraged to develop and nurture these institutions.

#### **4.6. WHAT RULES GOVERN THE ARBITRATIONS?**

In order to understand the process of investment treaty arbitration, it is best to start with the treaties themselves. The treaties will outline the procedures for initiating arbitration proceedings, such as the steps a foreign investor must take to notify a government of an investment dispute, the rules that can be applied to the arbitration, and the steps for selecting arbitrators.

Treaties will usually spell out which of the various sets of arbitration rules parties may use in the event of arbitration, sometimes specifying a single set of rules, and sometimes offering a menu of options from which the investor may choose. The election made by the investor claimant is then binding on

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<sup>65</sup> *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision on Jurisdiction, July 17, 2003; *Toto Construzioni Generali v. Lebanon*. ICSID Case No. ARB/07/12, Decision on Jurisdiction, Sept. 11, 2009.

the respondent government. Most treaties provide a choice between the rules developed under the auspices of the World Bank's International Centre for Settlement of Investment Disputes (ICSID), or those developed by the United Nations Commission on International Trade Law (UNCITRAL), the UN body responsible for international business law. Sometimes additional options are offered, such as the arbitration rules those of the arbitration facilities of the Stockholm Chamber of Commerce (SCC) or the International Chamber of Commerce (ICC).

Arbitration rules break down broadly along two categories: those associated with an institution, and ad hoc rules. The latter are rules which the disputing parties can adopt, without any—or very little—institutional support.

The only arbitration institution dedicated solely to settling disputes between foreign investors and governments is ICSID. ICSID was established in 1965 under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) which has been signed by over 140 states. ICSID's caseload has expanded significantly in the last decade; 166 claims were registered with ICSID during 1995–2005, compared with 30 cases in the 30 years prior. Today ICSID is by far the most commonly used arbitration facility for investor-state arbitrations. It is also the most visible, in part because of its popularity but also because it maintains a publicly accessible docket of cases. In fact, among the facilities commonly used for investor–state disputes, ICSID is the only arbitration facility to consistently publicize the existence of its cases. More importantly, ICSID receives greater public scrutiny because of its relation to the World Bank, an intergovernmental organization with a mandate for poverty alleviation in developing and least developed countries. In the words of one arbitrator, ICSID is not “meant to be just another arbitration institution.”<sup>66</sup>

ICSID has its own set of procedural rules for disputes submitted to it. Due to the nature of the ICSID institution as one designed to handle disputes between investors and states, ICSID's arbitration rules were specifically drafted for such cases, and are currently the only set of arbitral rules with this focus.

The second most used rules are those developed by UNCITRAL. First adopted in 1976, and revised for the first time since then in 2010, the UNCITRAL Arbitration Rules are used for a variety of arbitration types, including commercial, state–state, and investor–state disputes. Importantly, the UNCITRAL rules can be used in so-called *ad hoc* arbitration, where a dispute is resolved outside of any institution. The parties to a dispute may also decide they want to use the administrative and logistical support of an institution, such as the SCC's arbitration facility, but use the UNCITRAL rules to govern the dispute. The UNCITRAL secretariat has no involvement in administering arbitrations conducted under its rules.

#### **4.7. WHAT TYPES OF RELIEF CAN INVESTORS OBTAIN WHEN BRINGING CLAIMS AGAINST STATES?**

Investors have asked for various types of remedies in their claims against states. The claims for relief can be broken down into five general categories: (1) monetary compensation; (2) restitution or return of property; (3) punitive damages (i.e., an assessment of damages against the state designed

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<sup>66</sup> *Malaysian Historical Salvors, SDN, BHD v. Malaysia*, ICSID Case No. ARB/05/10, Dissenting Opinion of Judge Mohamed Shahabuddeen, Annulment Proceedings, Feb. 19, 2009, para. 64.

not to compensate the investor for harms suffered, but to punish the state for wrongful conduct); (4) declaratory relief (i.e., a declaration deciding a particular issue in dispute); and (5) injunctive relief (i.e., an order telling the government to take, or refrain from taking, certain action).

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

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

#### **4.8. WHO DECIDES THE DISPUTES?**

Investment treaties and the various procedural rules governing investor–state arbitrations leave the disputing parties significant freedom to decide on important aspects of the arbitration proceedings, including the selection of arbitrators. In contrast to domestic or international courts, in which a judge is assigned to a case by the court, the parties to an arbitration select their own “judges” and have considerable autonomy when doing so.

Usually, three arbitrators preside over investment treaty arbitrations; one selected by the claimant (the investor), another selected by the respondent (the state), and a third selected with the consent of both parties. If the two parties cannot agree on the third arbitrator, which is not unusual, an arbitration institute is often designated as the appointing authority.

The treaties and procedural rules applicable to investor–state disputes place few restrictions on who may be appointed as an arbitrator outside of vaguely stated requirements that arbitrators be independent and/or impartial. Under the ICSID Convention, there is a sitting panel of arbitrators designated by member governments; however, the parties are free to select their arbitrator from outside the ICSID panel.

Despite the fact that the disputing parties are provided with generous discretion in electing arbitrators, the professional community of active investment treaty arbitrators is relatively small, often with a commercial law background. Moreover, the worlds of arbitrators and counsel are tightly intertwined. It is common for lawyers to move between the roles of arbitrator and counsel (albeit in different cases), and arbitrators often hold senior partner positions in law firms that specialize in counselling investors and governments on investment treaty arbitrations.

## 4.9. WHAT ARE THE MAIN CONCERNS THAT ARISE REGARDING THE USE OF PRIVATE, PARTY-APPOINTED ARBITRATORS TO DECIDE INVESTMENT DISPUTES?

Some characteristics of arbitration tribunals have led to concerns as to the independence and impartiality of the system. In particular, there is a concern that the current approach leads to a systemic bias in favour of investor rights over competing public interests. While there are a number of dimensions to this critique, the most obvious one is that professional arbitrators are offered perverse incentives to encourage investor claims. They may do this by deciding disputes in favour of investors, or by issuing decisions broadly interpreting their jurisdiction. For instance, the more expansively a tribunal interprets investment treaty terms such as “investors” and “investments,” the more likely it is that it will find the claimant’s claim is an action by an “investor” relating to an “investment,” and therefore one the tribunal has the power to adjudicate. Similarly, allowing investors to use MFN clauses to bypass “cooling off” periods, and narrowly reading “fork-in-the-road” provisions are also interpretations of investment treaties that help expand tribunals’ jurisdictions over claims. As one respected analyst points out, “more claims mean more business for the arbitration industry.”<sup>67</sup>

A second critique regarding the current system is that, as long as each party appoints its own arbitrator, there will be doubts that the party-appointed arbitrator can be truly impartial or independent. Even if the arbitrator is not actually biased, there remains an appearance of partiality.

A third critique relates to the “dual-role” issue—the fact that lawyers who work on investor–state cases can also serve as judges of those disputes. In investor–state disputes, the universe of claims and legal issues is relatively small, generally revolving around application of the FET, expropriation, non-discrimination, and umbrella clause obligations. An investor’s attorney who is arguing in one investor–state dispute for a broad interpretation of the FET standard may be sitting as an arbitrator in another dispute where the scope of the FET obligation is at issue. When the arbitrator issues a decision, it may be difficult for him or her to not be influenced (consciously or subconsciously) by the arguments advanced by his or her investor client in the separate dispute, by the effect the arbitral decision may have on shaping the law applicable to the investor/client’s claim, or by the desire to expand the prospects for future business in his or her role as counsel. Even if this type of situation does not have an actual impact on the arbitrator’s decision making, it can create a perception of bias.

## 4.10. WHAT COULD BE DONE TO ADDRESS THE CONCERNS THAT ARISE REGARDING ARBITRATOR INDEPENDENCE?

A number of alternatives have been suggested to strengthen the independence and accountability of an international system for settling investment disputes. One is a roster of permanent arbitrators, under tenure for a given number of years, which would help insulate arbitrators from economic and political pressures. Another possibility would be to have institutions appoint all arbitrators (thereby getting rid of party-appointments) and to disallow arbitrators from also serving as counsel in investment treaty arbitrations for a certain period of time.

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67 Gus van Harten (2009, Aug. 7). A Case for an International Investment Court. *Investment Treaty News*.

A more ambitious proposal is an international investment court. It is argued that a centralized international investment court would not only strengthen the independence of the system, but also increase the transparency and legitimacy of the international investment law regime more broadly. Additionally, if an effective mechanism for appeals were also introduced, an international investment court could address another problem with the arbitration model: conflicting judgments by different tribunals.

#### **4.11. CAN ERRORS OF LAW OR FACT IN INVESTMENT TREATY ARBITRATION BE CORRECTED?**

One aspect of investor–state arbitration that makes it such an attractive mechanism for investors is that, in contrast to judgments issued by domestic courts, governments have only minimal avenues for challenging awards and resisting their enforcement, even if the awards are based on errors in law or fact. Two international treaties give arbitral awards this force. The first is the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”); the second is the 1965 ICSID Convention.

The New York Convention requires its roughly 150 state parties to recognize and enforce foreign arbitral awards. It provides that states may only refuse to do so on seven limited grounds: (1) there was no valid arbitration agreement; (2) there was a lack of proper notice of, or due process in, the proceedings; (3) the award falls outside the terms of the submission to arbitration; (4) the tribunal was improperly constituted; (5) the award has been suspended or set aside at the place of arbitration; (6) the subject matter of the dispute is not subject to arbitration; and (7) enforcement of the award would be contrary to the public policy of the state where enforcement is sought. The New York Convention does not list errors of law or fact as grounds for refusing to recognize or enforce an award.

If an arbitral tribunal issues an award against a respondent state, and the investor seeks to execute the award in a state party to the New York Convention, the default rule is that the New York Convention will compel courts in that country to enforce the award. The respondent state may only resist enforcement by arguing to the relevant court that one of the New York Convention’s seven grounds for rejecting the arbitral award apply .

States’ rights to challenge awards under the ICSID Convention are even more limited. In particular, under the ICSID Convention, arbitral awards cannot be resisted or appealed before national courts. When a victorious claimant seeks to enforce an award against a losing respondent state, the ICSID Convention requires every state party to that treaty to enforce the award as if it were a final domestic judgment.

The only way for a losing respondent state to challenge an ICSID award is to ask for the constitution of another ICSID arbitral tribunal to review and annul all or part the award. That new tribunal, however, is not an appellate instance with broad powers of review. Pursuant to the ICSID Convention, the tribunal, or, more specifically, “annulment committee,” can only annul an award on five grounds: (1) if the tribunal was improperly constituted; (2) if the tribunal manifestly exceeded its powers; (3) if there was corruption on the part of the tribunal; (4) if there was serious departure from a fundamental rule of procedure; and (5) if the award failed to state the reasons on which it was based.

Annulment committees have declared that even if an award is based on manifest errors of law or fact, the award must nevertheless stand because such errors are not a ground for annulment under the ICSID Convention. Moreover, unlike under the New York Convention, being inconsistent with public policy is not a permissible ground for annulment.



If, notwithstanding application of the ICSID or New York Convention, a country refuses or is unable to enforce an award and pay a judgment, it may suffer significant consequences. In particular, a state's failure to pay an award or its efforts to prevent enforcement will likely be taken into account by foreign investors and lenders such as the World Bank, potentially affecting the country's credit rating and ability to attract future investment.

#### **4.12. IS THERE ANY MECHANISM AVAILABLE FOR ENSURING TREATIES ARE INTERPRETED IN A MORE PREDICTABLE MANNER?**

The short answer to this question is "no." As noted above, many of the decisions issued to date have produced inconsistent interpretations of similarly or identically worded treaty obligations. These inconsistent outcomes, in turn, effectively make every issue one that can generate costly litigation, and have led to much uncertainty for states and investors, neither of which can be confident in the protections offered under investment treaties.

Various aspects of investor–state arbitrations contribute to this inconsistency and uncertainty. First, it must be noted that the universe of investment treaties is comprised of thousands of treaties negotiated by hundreds of countries. The language used in these agreements is often vague, similar, but not always identical; and it is not clear that even when two investment treaties contain identical provisions, the contracting parties meant the same thing by them. Thus, to some extent diverging interpretations can be expected. Nevertheless, the problem is exacerbated by the fact that there is no binding rule of precedent (or *stare decisis*) in investment treaty arbitration. Although arbitral tribunals routinely refer to previous decisions, they are under no obligation to adhere to past precedent.

This lack of coherence in international investment law is made worse by the absence of an appeals mechanism for investment treaty arbitrations. As explained above, in the current system, a decision by an arbitral tribunal can only be annulled, amended or rejected on a very limited set of grounds. Even being wrong in law is generally not a basis in and of itself to annul or reject an arbitration decision. The situation enables erroneous or faulty decisions to remain uncorrected, and has led to calls for a centralized mechanism for appeal, such as exists for international trade law disputes under the auspices of the WTO. Some investment treaties even specifically contemplate future establishment of an appellate system. To date, however, it appears that such a mechanism has yet to receive sufficient endorsement from governments.

#### **4.13. CAN THE PUBLIC ACCESS INFORMATION ABOUT INVESTOR–STATE ARBITRATIONS?**

The answer to this question is complex, and depends on the investment treaty that governs the dispute, domestic law of the respondent state, domestic law governing the investor, and the applicable procedural rules. However, in general, access is highly limited.

With respect to the initiation of disputes, the ICSID arbitration rules state the claimant must file a request for arbitration with the ICSID Secretary-General, who then registers the request. ICSID's Administrative and Financial Regulations then require the ICSID Secretary-General to publish information about the registration of those requests. In accordance with that mandate, the ICSID secretariat maintains a website on which is listed basic information about the initiation of disputes,

such as who the parties to the dispute are and when the arbitration was commenced. In contrast, nothing in the UNCITRAL arbitration rules specifies that the notice of arbitration or other information about the commencement of a dispute must be made known to the public. Moreover, even if there were a requirement in the UNCITRAL rules to disclose such information, no register currently exists to publish it similar to the register managed by the ICSID secretariat.

Once the proceedings are underway both the ICSID and UNCITRAL arbitration rules are essentially silent on the issue of public access to documents submitted to or issued by the tribunals. There are no rules mandating that the disputing parties keep such information confidential, but neither are there rules requiring or facilitating disclosure. With respect to hearings, public access to information is similarly limited and uncertain: both the ICSID and UNCITRAL rules indicate that hearings can be open, but provide that if one of the disputing parties wishes, the hearings must be closed.

Finally, and perhaps most significantly, under the ICSID and UNCITRAL rules in force, the public has no right to access the awards issued by the tribunals. Under the ICSID arbitration rules, one or either of the parties may disclose the award, but is not required to do so. The only guaranteed disclosure will come from the ICSID secretariat, which, pursuant to 2006 revisions to the ICSID arbitration rules, is required to publish excerpts of the tribunal's legal reasoning behind the award.

Under the 1976 and 2010 UNCITRAL arbitration rules, disclosure is even more limited. An award may be made public only if both parties agree (or if one of the parties is required by law to disclose it); and there is no system or requirement for publication of excerpts.

There are, however, a limited number of ways in which the public can access information about investor–state disputes.

First, in some more modern investment treaties, state parties are including provisions on transparency. For instance, under the 2003 Canadian model BIT, the 2004 United States model BIT, and subsequent investment treaties concluded by those two countries, open hearings and public access to documents filed in and issued by the tribunals in the proceedings are the default practices. Other agreements, such as the COMESA investment agreement similarly include provisions ensuring that the public has access to documents submitted to and issued by arbitral tribunals in investor–state arbitrations. When investment treaties include provisions requiring arbitrations to be transparent, they also note that certain confidential or privileged information may be withheld from the public. Nevertheless, it remains that, irrespective of who the claimant is or what procedural rules apply, the public will be able to learn about the initiation of the dispute, its proceedings and outcome in a timely fashion.

In addition to investment treaties, domestic law may also require some information about investor–state proceedings to be disclosed. Corporate and securities regulations, for instance, may require investors to disclose information about disputes in which they are or may be involved. Countries may also be required under freedom of information laws to disclose to the public information about investor–state disputes. Currently, however, domestic law requirements on investors and governments to make public information regarding investor–state disputes are not uniform or stringent enough to result in automatic, consistent or full disclosure about these important cases.

The difficulties the public currently faces in accessing information relating to investor–state arbitration may, however, diminish in the coming years. One important development is that in October 2010,

the UNCITRAL Working Group on International Arbitration commenced work on the task of ensuring transparency in investor–state arbitration. Measures the working group is contemplating include creating a public registry of cases, opening hearings to the public, and providing for the publication of documents pertinent to the arbitration. As of October 2011, the effort was still underway, and was not expected to be completed before February 2012 at the earliest.

#### 4.14. CAN THE INTERESTED PUBLIC PARTICIPATE IN DISPUTES?

Investor–state disputes under international investment treaties are of interest to the wider public for a number of reasons. Often the subject matter of the dispute affects or is of heightened concern to citizens generally, or particular entities or groups such as a business lobby, indigenous peoples, or even a government. Individuals or entities who are not party to the dispute, but who may nevertheless be affected by or interested in it, may wish to make a submission to the tribunal. Such a non-party participant is commonly referred to as an *amicus curiae* (Latin for “friend of the court”).

*Amici curiae* can play an important role in investment treaty arbitration. They can provide expertise on points of law, offer historical and cultural context to a dispute, and reveal how a particular dispute has wider ramifications beyond the interests of the disputing parties.

The 2001 *Methanex* Tribunal was unequivocal on the potential value of *amicus* briefs:

*There is an undoubtedly public interest in this arbitration. [...] There is also a broader argument [...]: the Chapter 11 arbitral process could benefit from being perceived as more open or transparent; or conversely be harmed if seen as unduly secretive. In this regard, the Tribunal’s willingness to receive **amicus** submissions might support the process in general and this arbitration in particular; whereas a blanket refusal could do positive harm.<sup>68</sup>*

Nonetheless, non-disputing parties do not have a right *per se* to submit a petition in investment treaty arbitrations; rather, the decision rests with the tribunal, sometimes in consultation with the disputing parties. This situation is consistent with most jurisdictions that support *amicus curiae* briefs. What is important, however, is that it be clear that investment treaties and arbitration rules give the tribunals the authority to permit *amicus curiae* submissions. In 2006, for example, the ICSID arbitration rules were updated to include the following provision:

After consulting both parties, the tribunal may allow a person or entity that is not a party to the dispute (in this Rule called the “non-disputing party”) to file a written submission with the Tribunal regarding a matter within the scope of the dispute.<sup>69</sup>

Under this article, an ICSID tribunal must consult with the disputing parties, although neither party can block *amicus* submissions. In contrast, the other commonly used arbitration rules, such as the UNCITRAL rules, are silent on the matter of *amicus curiae*. Tribunals have, however, interpreted those rules as giving arbitrators the power and discretion to decide whether to allow *amicus curiae* participation. The current work to revise the UNCITRAL arbitrations rules to ensure transparency in investor–state disputes includes as part of its agenda work to clarify *amicus curiae* practice.

68 *Methanex v. United States*, Decision of the Tribunal on Petitions from Third Persons to Intervene as “*Amici Curiae*,” 15 January 2001, para. 49.

69 Article 37(2) (Submissions by non-disputing parties)

# 5. Fixing the Problems

## 5.1. HOW CAN STATES FIX PAST MISTAKES IN INVESTMENT TREATIES?

When states recognize problems and shortfalls in their investment treaties, they have several options to address them. The most far-reaching option would be to terminate the treaty. This can be done legally without any breach of international law. Typically, an investment treaty provides that it will stay in force for a given period of time, often 10 or 15 years. Usually, it will continue to stay in force until either party gives written notice of termination. Thus, after the fixed period of time, a party is often free to terminate the treaty. However, it is important to keep in mind that the provisions of the agreement will continue in effect for another given period for existing investments. Often this period extends another 15 to 20 years. Several intra-EU BITs are currently being terminated. Certain developing countries have also begun to terminate their BITs.

A second option is for a state to pursue the amendment of the treaty. This requires that all of the parties to the treaty agree to renegotiate, then reach an agreement on the amended text. Some treaties contain explicit provisions on procedures for their amendment. Yet even in the absence of such provisions, treaty parties can agree to amend the language. Countries currently undergoing this process are EU member states, which are requesting renegotiations with their partner countries to bring their BITs into conformity with a 2009 decision by the European Court of Justice regarding the free transfer of capital clause.<sup>70</sup> Although the attempt to reopen the agreements was driven by a need to amend a particular provision, it presents an occasion to also renegotiate other clauses that have been recognized as problematic by either treaty party.

Implementing either of those steps will have to be done with the broader background of the investment treaty “system” in mind. For one, countries will need to take into account and address the possible threat that broad definitions of “investors” enabling potential claimants to “treaty shop” can harm the effectiveness of reforms if a country only terminates or amends some of its agreements. Moreover, and related to the issue raised frequently in this handbook regarding uncertainty about the meaning of the treaty obligations, there is a risk that if state parties open up their treaties to expressly narrow one provision, tribunals may later infer that those state parties were in agreement with the broad interpretations of other clauses that had been left untouched. For example, if treaty parties decide to amend the free transfer of capital provision, but do not similarly take steps to tighten language in the FET or expropriation provisions notwithstanding tribunals’ broad interpretations of those obligations, tribunals may subsequently view the parties’ selective amendment as evidence that they did not contest the more expansive readings that have been given of the FET and expropriation articles.

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70 Case C-205/06, *Commission v. Austria* [2009] ECR I-1301; Case C-249/06, *Commission v. Sweden* [2009] ECR I-1335; Case C-118/07, *Commission v. Finland*, of November 19, 2009.

## 5.2. HOW CAN STATES CLARIFY TERMS IN INVESTMENT TREATIES?

Parties can clarify their understanding of broad and vaguely formulated terms used in investment treaties. These clarifications or interpretations will guide and direct arbitrators that will interpret the treaty in the future. According to the Vienna Convention on the Law of Treaties (VCLT) interpretative statements can be made both before and after the treaty enters into force (Articles 31 (2) and 31 (3) of the VCLT). The process for interpretation is easier than that for amendment since it will not require any form of ratification process or the like. Interpretative statements have been issued by the NAFTA parties relating to the scope of the FET clause; transparency in investor–state proceedings, and with respect to non-disputing parties. The interpretations were later accepted and applied by NAFTA tribunals.<sup>71</sup>

One further possibility is for one party to make a unilateral statement on interpretation. This most probably would arise as an option where the other parties to the treaty are not interested in making a joint interpretative statement. The International Law Commission has recognised that it is possible for one or more parties to a treaty to issue a unilateral statement regarding the interpretation of a treaty’s provisions, as long as the statement is not opposed by other parties to the treaty and not inconsistent with the treaty’s object and purpose.<sup>72</sup> Additionally, some multilateral treaties such as the NAFTA explicitly allow state parties to the treaty to provide tribunals information on interpretation of the treaty in pending investor-state disputes even in cases in which those states are not party to the dispute. In other words, when Canada is a respondent in an investor–state dispute, the United States and Mexico may each unilaterally make submissions to the tribunal on matters of NAFTA interpretation.<sup>73</sup>

Joint or unilateral interpretations can be an easier and less drastic approach than that of termination or amendment. And in at least certain cases it seems to be a more appropriate approach than those other options given that many of the issues countries are facing are arguably due more to issues of interpretation and the need to clarify areas of uncertainty rather than the fact that the treaties actually dictate an obligation that the treaty parties wish to change or terminate.

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71 See, e.g., *Glamis Gold v. United States*, UNCITRAL, Award, June 8, 2009, para. 599. *But see Pope & Talbot v. Canada*, Award in Respect of Damages, May 31, 2002, para. 47 (taking the view in the award on damages that the NAFTA parties’ interpretation of the FET provision seemed more akin to an amendment of the provision).

72 See Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations, Text adopted by the International Law Commission (ILC) at its Fifty-eighth session, in 2006, and submitted to the General Assembly as a part of the Commission’s report covering the work of that session (A/61/10), published in Yearbook of the International Law Commission, 2006, vol. II, Part Two. See also Guide to Practice on Reservations to Treaties, adopted by the ILC at its Sixty-third session, in 2011, and submitted to the General Assembly as a part of the Commission’s report covering the work of that session (A/66/10, para. 75), para. 1.6.3 (“The interpretation resulting from an interpretative declaration made in respect of a bilateral treaty by a State or international organization party to the treaty and accepted by the other party constitutes an authentic interpretation of that treaty.”).

73 NAFTA, Art. 1128.

## 6. Concluding Remarks

This handbook started from the basic proposition that investment is critically important to achieving sustainable development. Investment is so important, in fact, and with such palpable impacts on individuals and societies, that the aims of appropriately attracting and protecting it should not be left to the deficient, flawed and fragmented framework that now exists.

The current agreements and relevant institutions lack some of the basic characteristics we would expect from a good regime of governance, including predictability of results, certainty about commitments, balance between treatment of investment and other public goods, appearance of impartiality, transparency and openness. The most important message of this handbook is that there are viable options for addressing at least some of the problems raised by the current system. None of them is overly complex, none is pioneering in the sense that they have not been used successfully in other contexts, but all require a good measure of political will. In fact, many countries have already taken initial steps towards addressing some of the problems. We can only hope that the urgent need for investment as a driver for sustainable development, coupled with the need to ensure that the costs of investment treaties to governments do not outweigh the benefits of increased investment flows, will spur that will to successful efforts.

# ANNEX: Selected Organizations and Resources Focusing on Investment Treaties and Investor–State Dispute Settlement

## INTER-GOVERNMENTAL ORGANIZATIONS

### **GLOBAL**

International Centre for Settlement of Investment Disputes (ICSID)

The ICSID is a World Bank agency dedicated to handling disputes between foreign investors and their host governments. The Centre administers arbitrations and conciliations, with the vast majority of its cases related to alleged violations by governments of international investment agreements.

<http://icsid.worldbank.org/ICSID/Index.jsp>

Permanent Court of Arbitration

The Permanent Court of Arbitration (PCA) is an intergovernmental organization established by treaty in 1899. It provides dispute resolution services, including facilities for resolution of treaty-based investor–state arbitrations under the UNCITRAL arbitration rules. Some information regarding the arbitrations it conducts is available on its website.

[http://www.pca-cpa.org/showpage.asp?pag\\_id=363](http://www.pca-cpa.org/showpage.asp?pag_id=363)

South Centre

An intergovernmental organization based in Geneva, the South Centre, was established as a think tank for developing countries to raise their capacity to deal with complex international trade and investment negotiations. Through its briefing papers and periodic workshops, the Centre educates and trains government officials from developing countries.

<http://www.southcentre.org>

United Nations Commission for International Trade Law (UNCITRAL)

The signature arbitration rules of UNCITRAL offer a popular alternative to arbitration under the ICSID rules. Although the UNCITRAL has responsibility for drafting its arbitration rules, and revising them periodically, the body does not administer arbitrations in the manner of ICSID. As a consequence, usage of the UNCITRAL rules to resolve investment treaty disputes is a difficult phenomenon to measure.

<http://www.uncitral.org>



#### UN Conference on Trade and Development (UNCTAD)

UNCTAD conducts research and analysis of international investment agreements, and publishes regular data on the growth of such agreements. Each year, UNCTAD publishes the World Investment Report which focuses on the impact of foreign investment on developing countries.

<http://www.unctad.org>

- UNCTAD IIA Compendium  
[http://www.unctadxi.org/templates/DocSearch\\_\\_\\_780.aspx](http://www.unctadxi.org/templates/DocSearch___780.aspx)
- UNCTAD list of BITs by country  
<http://www.unctad.org/Templates/Page.asp?intlItemID=2344&lang=1>
- UNCTAD texts of BITs  
<http://www.unctadxi.org/templates/DocSearch.aspx?id=779>

#### World Trade Organization (WTO)

Although member-governments of the WTO rejected a proposal to negotiate a multilateral agreement on investment, certain WTO agreements do apply to foreign investments, most notably, the Agreement on Trade-Related Investment Measures (TRIMs) and the General Agreement on Trade in Services (GATS).

<http://www.wto.org>

### **REGIONAL and SECTORAL**

#### Association of Southeast Asian Nations (ASEAN)

ASEAN Investment Portal

<http://www.aseansec.org/4947.htm>

#### Common Market for Eastern and Southern Africa (COMESA)

(COMESA) Regional Investment Authority

<http://www.comesaria.org/>

#### Southern African Development Community (SADC)

SADC Investment Portal

<http://www.sadc.int/investment/>

#### Organisation for Economic Co-operation and Development (OECD)

A think tank for developed economies, the Paris-based OECD conducts research on trade and investment issues, and has worked to develop further international rules governing foreign investment. The OECD's proposed Multilateral Agreement on Investment (MAI) came to particular public attention in the late 1990s when some governments and many nongovernmental groups raised concerns about that agreement's potential implications for health, environment, education, culture and human rights, and negotiations broke down.

<http://www.oecd.org/investment>

#### Energy Charter

The 1991 Energy Charter and 1994 Energy Charter Treaty (ECT) (which entered into force in 1998) are agreements establishing international rules for the energy sector. The ECT contains provisions governing foreign investment that are similar to provisions that can be found in other investment treaties such as articles on FET, national treatment, MFN treatment, and expropriation. It also contains provisions on arbitrations between foreign investors and host states.

<http://www.encharter.org>

## NON-GOVERNMENTAL ORGANIZATIONS AND THINK TANKS WITH INTERNATIONAL FOCUS

### **INTERNATIONAL FOCUS**

[Center for International Environmental Law \(CIEL\)](#)

CIEL is an active participant in debates around the regulation of international trade and investment. The organization has published a range of briefing notes and research papers that examine the interplay between trade or investment agreements and sustainable development issues. CIEL attorneys work closely with communities affected by investment projects.

<http://www.ciel.org>

[International Institute for Sustainable Development \(IISD\)](#)

The IISD produces briefings and analysis on a range of trade and investment issues. The Institute has produced a draft model investment agreement, an e-book on key cases issued from 2000–2010, and other publications relating to investment treaties and investor–state arbitrations, including an ongoing reporting service on investment law and policy developments (Investment Treaty News). IISD advises developing countries and civil society on investment issues, including the negotiation of treaties, investment codes and contracts.

<http://www.iisd.org/investment>

[Institute for Policy Studies \(IPS\)](#)

The Washington-based multi-issue think tank conducts policy and research, including in the area of investment and finance.

<http://www.ips-dc.org/>

### **DOMESTIC/INTERNATIONAL FOCUS**

#### **Web Resources**

[Bilaterals.org](#)

A web-based collective opposed to the growth of bilateral and regional trade and investment agreements. The group's web site aggregates news reports from around the world, offering a rich trove of media coverage of new and ongoing trade and investment negotiations

<http://www.bilaterals.org>

[Global Arbitration Review](#)

Global Arbitration Review (GAR) is an international arbitration law journal and news service. GAR provides news and features covering issues in international arbitration, including but not limited to investment treaty arbitration. The articles are only accessible with subscription.

<http://www.globalarbitrationreview.com>

[International Investment Arbitration and Public Policy \(IIAPP\)](#)

The IIAPP website offers a searchable database of materials in known arbitrations under investment treaties. Developed by a research team under the coordination of Professor Gus Van Harten of Osgoode Hall Law School, the website allows users to identify cases that engage policy areas such as agriculture, environmental protection, health, industrial policy, public contracting, and taxation.

[www.iiapp.org](http://www.iiapp.org)

#### Investment Arbitration Reporter

This website provides extensive information and updates on investor–state arbitrations. Its headlines and some articles are freely accessible. Most articles are only accessible with a subscription.

<http://www.iareporter.com/>

#### Investment Treaty Arbitration

A website maintained by Prof. Andrew Newcombe of the University of Victoria, Canada, that offers free access to any investment arbitration rulings which have entered the public domain.

<http://italaw.com/>

#### Investment Treaty News

ITN is a quarterly publication that produces news and analysis on international investment law and its implications for sustainable development. The publication also summarizes recent arbitration decisions in an accessible format.

<http://www.iisd.org/itn/>

#### Transnational Dispute Management

<http://www.transnational-dispute-management.com/>

### **Additional Websites with Relevant Information on Investment Treaties and Investor–State Arbitration**

American Society of International Law

<http://www.asil.org/>

British Institute of International and Comparative Law - Investment Treaty Forum (and related links)

<http://www.biicl.org/itf/>

Canada Foreign Affairs and International Trade

<http://www.international.gc.ca/commerce/index.aspx?view=d>

Council of Canadians

<http://www.canadians.org/trade/index.html>

Focus on the Global South

<http://www.focusweb.org/>

Forum on Democracy & Trade

<http://www.forumdemocracy.net/>

ICSID Reports—Lauterpacht Centre for International Law

[http://www.lcil.cam.ac.uk/publications/icsid\\_reports.php](http://www.lcil.cam.ac.uk/publications/icsid_reports.php)

Institute of Advanced Legal Studies

<http://ials.sas.ac.uk/>

International Chamber of Commerce

<http://www.iccwbo.org/policy/arbitration/id2882/index.html>

International Law Institute ADR Center Research Guide

<http://www.ili.org/centers-of-expertise/alternative-dispute-resolution/205-research-guide-for-international-commercial-and-investment-arbitration.html>

<http://www.haplaw.de/investmentarbitration/index.html>

Investment Claims: Orders and Awards—Chronological

<http://www.investmentclaims.com/oa1.html>

Iran–United States Claims Tribunal

<http://www.iusct.org/index-english.html>

Journal of World Investment & Trade

[http://www.wernerpubl.com/frame\\_inves.htm](http://www.wernerpubl.com/frame_inves.htm)

Kluwer Arbitration

<http://www.kluwarbitration.com/arbitration/arb/default.asp>

Multilateral Investment Guarantee Agency (World Bank)

<http://www.miga.org>

NAFTA Claims

<http://www.naftaclaims.com>

New York Convention 1958

[http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII\\_1\\_e.pdf](http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf)

REDES

[www.redes.org.uy](http://www.redes.org.uy)

SOMO

<http://somo.nl/>

Southern and Eastern African Trade Information and Negotiations (SEATINI)

<http://www.seatini.org/>

Seattle to Brussels Network

<http://www.s2bnetwork.org/>

SICE the OAS foreign trade information system

<http://www.sice.oas.org/>

Third World Network (TWN)

<http://www.twinside.org.sg/>

Transnational Institute (TNI)

[www.tni.org/](http://www.tni.org/)

US State Department

<http://www.state.gov>

<http://www.state.gov/e/eeb/ifd/bit/>







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