Investment Treaties

Views and Experiences from Developing Countries

SOUTH CENTRE

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Published in 2015 by
South Centre
17-19 Chemin du Champ d'Anier
1209 Petit Saconnex, Geneva
Switzerland
www.southcentre.int

Cover design: Lim Jee Yuan

Printed by
Jutaprint
2 Solok Sungai Pinang 3
11600 Penang
Malaysia

ISBN: 978-92-9162-046-3

THE SOUTH CENTRE

In August 1995 the South Centre was established as a permanent intergovernmental organization of developing countries. In pursuing its objectives of promoting South solidarity, South-South cooperation, and coordinated participation by developing countries in international forums, the South Centre has full intellectual independence. It prepares, publishes and distributes information, strategic analyses and recommendations on international economic, social and political matters of concern to the South.

The South Centre enjoys support and cooperation from the governments of the countries of the South and is in regular working contact with the Non-Aligned Movement and the Group of 77 and China. The Centre's studies and position papers are prepared by drawing on the technical and intellectual capacities existing within South governments and institutions and among individuals of the South. Through working group sessions and wide consultations, which involve experts from different parts of the South, and sometimes from the North, common problems of the South are studied and experience and knowledge are shared.

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Chapter 1

A Summary of Public Concerns on Investment Treaties and Investor-State Dispute Settlement

Martin Khor

I. Introduction

In recent years there has been a great amount of discussion on the problems surrounding international investment treaties, specifically bilateral investment treaties (BITs) as well as the investment chapter in many free trade agreements (FTAs). The increased discussion has seen the issues reach the point of controversy and even brought these investment treaties into a crisis of credibility. Intense discussions on the investment issues have been held at various venues including at the UN Conference on Trade and Development (UNCTAD), the UN Human Rights Council, the European Parliament, at numerous civil society meetings and in various national fora. There is now a search, internationally as well as regionally and nationally, for solutions to the manifold problems associated with these investment treaties.

A similar model exists in many of the BITs and many of the investment chapters of free trade agreements, especially those that involve the United States and European Union. The controversial aspects include the provisions of these treaties and the investor-state dispute settlement (ISDS) system. Under

ISDS, foreign investors can bring the host government to an international arbitration tribunal, and if an award is given against the government, it has to pay monetary compensation or face the prospect of its assets being seized abroad. There have been many cases of huge awards being granted by tribunals to foreign investors, and this may be the main reason why the investment treaties have become so controversial, as the affected host governments and the public in their countries have often been upset and even outraged by the tribunal decisions and the awards. However, it is not only the arbitration system but also the provisions of these treaties that are a major part of the problem. Indeed, these provisions may be the root of the problem.

This chapter gives a summary of the problems that countries have encountered with international investment treaties, and the actions that some of them have taken in response, as well as some of the responses of civil society, academics, the media and some international organizations. This chapter is by no means comprehensive as it only intends to give a broad picture of the controversy. Other chapters in this book provide a lot of information on various aspects of the issue.

II. Controversial Provisions of the Investment Treaties

There are several provisions of the BITs and the investment chapters of FTAs that give rise to problems, including those that relate to ISDS. The relevant provisions of the BITs which an investor can cite as the basis of an ISDS claim are very broad and the definitions and interpretations can be considered favourable to and biased towards the investor's rights vis-à-vis the host state. As a result, the host government's possible (and natural) defence that its behaviour or action was in accordance with national laws and objectives or social and public policies is not likely to be sufficient. The following are among the problematic provisions:

- The **definition and scope of "investment"** is very broad; it covers all kinds of assets including direct investment, portfolio investment, credit, derivatives, contracts, intellectual property rights (IPRs), and expectations of future gains and profits. Thus legal cases can be taken if an investor feels aggrieved about how any of these "investments" are affected. Most notably, an investor who feels that his or her "expectations of future profits" are affected by a new policy or regulation or even by a non-renewal of a contract, could bring a case against the host state.
- **National treatment.** The foreign investor has the right to be treated "no less favourably" than local investors, i.e., similar to or better than local investors. The foreign investor can claim to be discriminated against if the local investor is given a preference or other advantage. However, foreign investors can be treated more favourably. Indeed, the fact that only foreign investors can take ISDS cases against the state is a most favourable treatment giving great advantages to foreign investors vis-à-vis local investors.
- **Fair and equitable treatment.** This provision has been interpreted by some tribunals as the investor having a stable legal and business framework or predictable investment environment. Investors have sued on the ground of non-renewal or change in the terms of licences or contracts, and changes in policies or regulations (including economic, health or environmental measures) that the investors claim will reduce their expectations of future profits. The claims of unfair treatment can be "practically limitless" in scope, according to a study by UNCTAD. This provision is used in many ISDS cases, sometimes in combination with other provisions. This is a popular provision with investors that take up an arbitration case; "fair and equitable treatment" has been found to have been violated in 81% of cases won by investors when they allege a violation of FET, according

to a paper by Public Citizen on disputes under US trade or investment treaties.[1]

- **Expropriation.** Under this provision, "expropriation" is usually defined as direct expropriation (e.g., government takeover of property) as well as indirect expropriation, in which tribunals have ruled in favour of investors that claimed losses (including reduced expectations of future profits) due to changes to existing policies or the introduction of new government policies, measures and regulations.
- **Pre-establishment rights.** Many BITs and FTAs have this provision, which grants rights to the investors of the partner country to enter and establish themselves in the host country on terms no less favourable than what it accords to its local investors, as well as to acquire, expand, manage, operate and dispose of their property. This makes it more difficult for the host state to screen and reject the entry of investments and investors from the other country or countries signing the agreement.
- **Performance requirements.** Some investment treaties also prohibit the host country from imposing performance requirements such as limits on equity ownership, establishing joint ventures with local investors, technology transfer and the use of local content. The host country would thus not be able to enjoy the benefits of these policies.
- **Freedom of capital flows.** The foreign investor is enabled to freely transfer capital into and out of the country as well as repatriate its profits. This places limits on the regulation and control over capital flows by the host state.
- **"Survival clause."** Many BITs have a clause that prolongs the practical effect of the treaties, even after withdrawal by a party or expiry of the BIT. It is thus difficult to "escape" from a BIT. If a country finds it has made a mistake by signing a BIT and wishes to withdraw from it, or to not

1 http://www.citizen.org/documents/MST-Memo.pdf

renew the BIT upon expiry, it will still have to abide by the rules of the BIT for many years. This is because of a provision (often called the survival clause) that the treaty's provisions will still be in force for a specified period (for example, 10 or 15 years) after withdrawal or expiry. Also, if a party to a BIT does not give a notice of withdrawal upon expiry, the BIT is deemed to roll over and continue, usually for another similar period.

- **Dispute settlement system.** A major problem is that most BITs and some FTAs contain an investor-state dispute settlement system. Details are provided below.

III. Problems with the Investor-State Dispute Settlement System

ISDS is a mechanism in most BITs. It enables the foreign investors of BITs countries to directly bring a case against the host government for arbitration in an international tribunal. In most BITs, a few tribunals are mentioned (the most used being the International Centre for Settlement of Investment Disputes (ICSID) based at the World Bank in Washington) and the investor is often given the right to choose the specific tribunal.

ISDS provides a powerful system for enforcement of the rules of the BITs. Any foreign investor from countries in a BIT can take up a case claiming that the government has not met its relevant BIT obligation or obligations. If the claim succeeds, the tribunal could award the investor financial compensation for the claimed losses. If the payment is not made, the award can potentially be enforced through the seizure of assets of the government.

The ISDS system of arbitration has come under heavy criticism, including:

- The decision of the tribunal is final, as there is no appeal mechanism. Thus a country involved in an arbitration case has to accept the decision including the award, if any, even if it is dissatisfied with the decision and the reasoning behind it.
- One major criticism is that some of the tribunal decisions are often seen to be arbitrary and have been known to contradict decisions of other tribunals in similar cases. There is no system of precedence or accountability to a higher court, unlike in the national judicial system of most countries.
- There exists a serious conflict-of-interest situation in the arbitration system and in some specific cases. A few lawyers (mainly American or European) monopolize the investment arbitration business, and they act as lawyers in one case and as arbitrators in other cases. Many of their firms are also known to seek and encourage investors to take up cases. In one known case, one of the arbitrators was a member of the board of directors of the parent company of the investor that took up the case.
- There is a perception, at least by many academics and civil society groups, that many of the tribunals have shown a pro-investor bias, taking the view that the treaties are mainly or solely to protect investor rights, whilst the governments' rights are considered of lesser value.

Public interest groups have criticized the BITs for preventing or discouraging governments from introducing health, environmental and pro-development policies.

A small group of lawyers, working either for investors or as arbitrators, and who are mainly based in Europe and North America, have been benefitting from the boom in litigation linked to investment agreements, and some of them also encourage companies to sue governments, according to a 2012 report by

two European groups, Transnational Institute and Corporate Europe Observatory. The following are among the findings and conclusions of the report, *Profiting from Injustice*:

- Only 15 arbitrators, nearly all from Europe, the US or Canada, have decided 55% of all known investment-treaty disputes. This small group sit on the same panels, act as both arbitrators and counsel and call on each other as witnesses.
- Many arbitrators show a clear bias towards investors. Several prominent arbitrators have been members of the board of major multinational companies, including those which filed cases against developing countries.
- A few law firms have been encouraging investors to sue governments as a weapon to weaken or prevent laws on public health or the environment. These investment lawyers are the new "ambulance chasers" and have fuelled an increase in cases from 38 in 1996 to 450 known cases in 2011.
- Countries have to pay exorbitant legal and arbitration costs averaging over $8 million per dispute, and exceeding $30 million in some cases. The Philippines spent $58 million defending two cases against a German firm.
- Lobbying by arbitration law firms and arbitrators succeeded in stopping reform of investment agreements in the EU and US in recent years.
- In one case, the chair of a tribunal that ruled in a case against Argentina was later found to be a board member of the parent company of the firm that sued and won. Yet the review panel ruled that the decision would remain and that there was no need for the case to be heard again by another panel.
- Fairness and independence of investment arbitration is an illusion.

IV. High Claims and Awards

Many of the ISDS claims have tended to be very high in recent years, running to even billions of dollars, hundreds of millions or many millions. Awards are usually lower, but some recent ones have also been very high, such as the $2.3 billion award granted to an American oil company against Ecuador. The ability to enforce these awards through seizure of assets owned by the government and located abroad makes ISDS a very powerful instrument. Cases include:

- An award by ICSID to US oil company Occidental against Ecuador for $2.3 billion (main award $1.7 billion and interest $0.6 billion). The tribunal recognized that Ecuador cancelled its contract because the company violated a key clause (i.e., it sold 40% of the concession to another company without permission), but nevertheless gave the huge award.
- A case was taken against South Africa by a European mining company making use of the provisions of fair and equitable treatment and expropriation, claiming that it was affected by the government's black empowerment programme. The lessons of this case prompted a South African Cabinet review and decision to withdraw from the country's existing investment treaties.
- A $2 billion claim was made against Indonesia by UK-based oil company Churchill, after its contract with a provincial government was cancelled because it was not in line with the law.
- Australia has been sued for billions of dollars by the tobacco company Philip Morris because of its regulation on cigarette plain packaging, i.e., the boxes cannot promote the logo and brand names. This strengthened the Australian government's policy at that time, not to have ISDS in its future FTAs or other investment treaties. A case has also been taken against

Uruguay by the same company for alleged breaches of the Uruguay-Switzerland BIT for requiring cigarette packs to display graphic health warnings. The company claims that the packaging requirements in both countries violate its investment, including its trademark which, as an intellectual property, is an investment asset.

- A Swedish company brought two cases against Germany for its environmental policies requiring tighter regulations on coal-fired power plants to reduce carbon emissions, and to phase out nuclear power following the Fukushima nuclear disaster.
- An American company Renco sued Peru for $800 million because its contract was not extended after the company's operations caused massive environmental and health damage.

V. Some Implications of BITs and ISDS

The implications of the ISDS mechanism have been considered by analysts and policy makers as several and serious. These include:

- Acceptance of the BITs rules can carry very onerous implications because a government can be sued in an international court, and thus it will be **constrained when formulating its future policies or implementing existing policies.**
- It is difficult for a government to make new policies, as it **cannot predict whether certain policies it wishes to introduce or change are allowable,** since it is uncertain or unpredictable how a tribunal will view this, i.e., the view of a particular tribunal can differ from that of another tribunal.
- **A wide range of policy areas that lie at the core of socio-economic development will be affected,** including

investment policy, equity shares, financial flows, capital controls and financial stability; health, safety and environmental policies; intellectual property and prices of or access to medicines and educational materials; and government procurement policies. There may be a "chilling effect" in being discouraged from certain policies because of the possibility or fear of being sued.

- The country's **judicial sovereignty will be affected.** Investors will choose to take up cases in the international tribunal, where their chances of success are higher and the payout higher, rather than local courts; or if they lose a case in the local court, they can take up the case again and win in the international tribunal. Local courts would consider the case on the basis of national laws, while the tribunal will instead refer to and interpret treaty provisions and international law.
- Likewise policies made by the government and **laws or policies adopted by Parliament** can be challenged by foreign investors and the decisions will be made by a tribunal outside the country.
- The country will become **vulnerable to million-dollar and billion-dollar legal suits** taken by private foreign investors. Potentially this may cost the government a lot of financial resources.
- The constraints on policy space as a result of investment treaties **adversely affect the fulfilment of human rights** (including the right to health) of the people in the host countries.

An interesting letter (in April 2015) signed by eminent American legal and economics experts, including Prof. Laurence H. Tribe of Harvard Law School (US President Barack Obama's law professor when he studied at Harvard), argues that ISDS undermines the US justice system. "ISDS weakens the rule of law by removing the procedural protections of the legal system and using a system

of adjudication with limited accountability and review. It is antithetical to the fair, public, and effective legal system that all Americans expect and deserve," stated the letter.

VI. Tide Turning Against Investment Treaties

The problems associated with investment treaties and ISDS have led to a serious rethinking about their benefits and desirability, or lack thereof. Strong criticism has come from civil society, academics and public intellectuals as well as policy makers in both developing and developed countries.

The developing countries are generally more vulnerable to the adverse effects of investment treaties because most of them are net importers of foreign investment, and they also have less resources and legal expertise to fight the arbitration cases. Many of these countries have become disillusioned with the agreements, especially if they face cases brought by investors. Some developing countries have taken measures to terminate their BITs, usually by not renewing them when they expire, or are considering withdrawal. Some countries are also formulating their own model BITs, which would not contain some of the controversial provisions of traditional BITs. Some countries have also withdrawn from membership of ICSID.

South Africa undertook a Cabinet review of its BITs after a case taken against it in relation to its black empowerment programme, as mentioned above. It decided to withdraw from its BITs when each of them expires. It also introduced a national law on investment in which the rights of investors are balanced with the right of the state to make and implement policies in the national interest. Namibia is also considering a similar move.

Indonesia has announced a policy to withdraw from its BITs upon their expiry. It is also in the process of developing its own model BIT.

Bolivia, Venezuela and Ecuador have withdrawn their membership of the ICSID Convention. Bolivia has also withdrawn from its BITs. Ecuador established a commission to analyze its existing BITs, and its findings are expected to lead to a withdrawal from many of them.

India has formulated a model BIT which is more balanced than the traditional BITs. It may make use of this model for negotiating future agreements and renegotiating existing ones.

Also most interesting is the disillusionment with investment treaties that has become increasingly evident in recent years in developed countries, their institutions and their media. The term "toxic" has been used by leading Western politicians and financial media to describe the ISDS system.

The German government announced a few years ago that it did not want the ISDS system to be inside the Transatlantic Trade and Investment Partnership (TTIP) that the European Commission is negotiating with the United States. This is a remarkable turnaround since Germany has been one of the main advocates of BITs. One reason for this could be the two cases taken against the country because of two of its environmental policy measures.

Germany was not the first developed country to turn around. Earlier, the Australian government decided not to enter any new BITs or FTAs that contain ISDS; this could have been influenced by the Philip Morris case against its measure for plain packaging for cigarettes. The government that succeeded it has

watered down this ban by considering membership of FTAs with ISDS on a case-by-case basis.

Two of the top officials of the European Commission, the President Jean-Claude Juncker and the Trade Commissioner Cecilia Malmstrom, when they were newly appointed, made known their scepticism if not opposition to ISDS. The Trade Commissioner even recognized ISDS as “a very toxic issue”. Both officials hinted that they would make it difficult for future EU trade deals to contain ISDS in its normal form. They were partly responding to the European Parliament, many of whose members are strongly opposed to having ISDS in TTIP. The Socialists and Democrats in the European Parliament issued a statement (21 January 2014) that accepting ISDS would open the door for big corporations to enforce their interests against EU legislation, and they requested the European Commission to drop ISDS within TTIP altogether.

European non-governmental organizations (NGOs) are also up in arms against ISDS, accusing the international tribunals that hear the cases of being heavily biased in favour of investors and against the states, and also of being riddled with conflict-of-interest situations. Over a million people in Europe signed petitions against TTIP, with the main focus of popular concern being the inclusion of ISDS in TTIP.

The Secretary-General of the rich-country grouping the Organization for Economic Cooperation and Development (OECD) wrote an opinion piece on the “increasing problems” of the investment treaties. The *Financial Times* and the *Economist*, two of the most prominent pro-free-enterprise newspapers in the Western world, also joined in the onslaught against BITs. The *Financial Times* even published a full-page article on what it headlined as “toxic deals.”

The winds of change were also evident when representatives of many governments and organizations spoke in favour of urgent reform of the whole ISDS system at the World Investment Forum organized by UNCTAD. Although there were also defenders of the system, there were many criticisms against ISDS, including that the provisions of the treaties are problematic, the arbitration system is biased and flawed, and that national laws, Parliaments and government policies are being seriously undermined by allowing foreign investors to bypass them by taking up cases in international tribunals that do not take account of the national laws when making their decisions.

In the United States, whose government is the staunchest supporter of the traditional investment treaties whether in BITs or in FTAs, there has been a strong NGO, trade union and academic movement against these treaties, and especially ISDS. Some Congress members have also spoken up critically against the investment chapter of US FTAs, particularly the Trans-Pacific Partnership (TPP) Agreement. Some 120 legal scholars from the US and Europe signed a statement opposing ISDS in the TPP.

VII. Conclusion

Given the problematic provisions, the flaws in the arbitration system, the survival clause and the many risks, developing countries should be very cautious about signing on to a BIT of the normal type. The risks and potential costs can be seen to outweigh the benefits, especially for developing countries.

There are interesting options for developing countries that would like to rethink their participation in BITs or even to withdraw from the BIT system. Following the experience of the developing countries, these options include conducting a review of the country's BITs to assess their costs and benefits; withdrawing from the ICSID Convention; and attempting to

renegotiate the BITs with its partners. If it has concluded that the BITs are inappropriate and pose serious risks, the country can withdraw from its BITs, including by non-renewal when the treaties expire. Dealing with the survival clause is a challenge, but renewing the BITs for yet another period would prolong the time that the country has to bear the risks. Some countries also draw up their own model BIT, which then can be used to renegotiate the existing treaties or to negotiate new ones. Some countries also formulate a national law on investor protection that balances investor rights with the rights of the state to regulate investments and to make policies in the national interest. Countries that have lost faith in the traditional BITs should also be very cautious about negotiating free trade agreements that contain an investment chapter with the traditional provisions and ISDS.

At the international level, the raging debate on what to do about the investment agreements will continue. Supporters of the system continue to insist there is nothing wrong with it. Some acknowledge there are flaws in the system, particularly in the ISDS mechanism, and they propose some small changes (for example, establishing an appellate body to deal with appeal cases), whilst maintaining the provisions. Yet others believe that the system is fundamentally flawed and that a thorough revamp is required. For them, the alternative would be a very well-balanced agreement which recognizes the legitimate rights of foreign investors but that this cannot be excessive and has to be balanced with the rights of the state to regulate investors and to have laws and policies in the national and public interest. It will take some time to move from the present system to the alternative one, or alternative ones, but this movement is required to correct what is one of the most unfair economic treaties in the world.

Chapter 2

Foreign Direct Investment, Investment Agreements and Economic Development: Myths and Realities

Yılmaz Akyüz[1]

I. Foreign Direct Investment and Development

Foreign direct investment (FDI) is perhaps one of the most ambiguous and least understood concepts in international economics. Common debate on FDI is confounded by several myths regarding its nature and impact on capital accumulation, technological progress, industrialization and growth in emerging and developing economies (EDEs). It is often portrayed as a long-term, stable, cross-border flow of capital that adds to productive capacity, helps meet balance-of-payments shortfalls, transfers technology and management skills, and links domestic firms with wider global markets.

However, none of these are intrinsic qualities of FDI. First, FDI is more about transfer and exercise of control than movement of capital. Contrary to widespread perception, it does not

1 This is an abridged version of a South Centre Research Paper with the same title. An earlier version was presented at the 8th Annual Forum of Developing Country Investment Negotiators organized by the International Institute for Sustainable Development and the South Centre, 5-7 November 2014, Montreux, Switzerland. I am grateful to the participants of the Forum, and Nathalie Bernasconi, Humberto Campodonico, Lim Mah Hui and Sanya Reid Smith for comments and suggestions. The usual caveat applies. Last revision: 18 February 2015.

always involve flows of financial capital (movements of funds through foreign exchange markets) or real capital (imports of machinery and equipment for the installation of productive capacity). A large proportion of FDI does not entail cross-border capital flows but is financed from incomes generated on the existing stock of investment in host countries. Equity and loans from parent companies account for a relatively small part of recorded FDI and an even smaller part of total foreign assets controlled by transnational corporations (TNCs). In 2008, retained earnings constituted 60% of outward FDI stock for non-bank affiliates of US non-bank corporations. In the same year, total assets controlled by US affiliates were 8.6 times the net external finance from US sources. Globally, in 2011, retained earnings accounted for 30% of total FDI flows. In the same year, half of the earnings on FDI stock in EDEs were retained, financing about 40% of total inward FDI in these economies. Thus, the notion that FDI is functionally indistinguishable from fresh capital inflows and represents a flow of foreign resources crossing the borders of two countries has no validity.

Second, an important part of FDI involves transfer of ownership of existing firms. Only the so-called greenfield investment makes a direct contribution to productive capacity and involves cross-border movement of capital goods. But it is not easy to identify from reported statistics what proportion of FDI consists of such investment. In particular, statistics provide almost no information on how retained earnings and loans from parent companies, two of the three sources of finance for FDI, are used. Furthermore, even when FDI is in bricks and mortar, it may not add to aggregate investment because it may crowd out domestic investors, as shown by most studies on the effects of FDI on domestic investment. Evidence also shows widespread association between rising FDI and falling gross fixed capital formation (GFCF) in the developing world. All these suggest that the economic conditions that attract foreign enterprises

may not always be conducive to faster capital formation and that the two sets of investment decisions may be driven by different considerations.

Third, what is commonly known and reported as FDI contains speculative components and creates destabilizing impulses which need to be controlled and managed as any other form of international capital flows. Many of the changes in financial markets that have facilitated international capital movements have not only increased the mobility of FDI, but also made it difficult to assess its stability. FDI inflows to EDEs are subject to boom-bust cycles and closely correlated with non-FDI (portfolio) flows as they are also influenced by global liquidity conditions and risk appetite. Surges in FDI inflows could generate unsustainable currency appreciations in much the same way as surges in other forms of capital inflows. FDI in property is often motivated by speculative capital gains and subject to severe bubble-and-bust cycles. More importantly, financial transactions can accomplish a reversal of FDI. What may get recorded as portfolio outflows may well be outflows of FDI in disguise: a foreign affiliate can borrow in the host country in order to export capital. Furthermore, foreign banks established in EDEs can be a major source of financial instability. They tend to contribute to build-up of fragility in host countries and transmit shocks from home countries, as seen during the eurozone crisis.

Fourth, the immediate contribution of FDI to the balance of payments may be positive, since it is only partly absorbed by imports of capital goods required to install production capacity. But its longer-term impact is often negative because of profit remittances and the high import content of production and exports by foreign firms. Many countries with a long history of involvement with TNCs face negative net transfers on FDI; that is, their new FDI inflows fall short of profit remittances on the

stock of inward FDI. Again, in a large majority of EDEs, export earnings by foreign companies do not cover their import bills and profit remittances. This is true even in countries highly successful in attracting export-oriented FDI such as China.

Finally, superior technology and management skills of TNCs create an opportunity for the diffusion of technology and ideas. However, spillovers are not automatic but need to be extracted through policy guidance and interventions. Foreign firms invest in EDEs in order to exploit their existing competitive advantages such as rich natural resources and cheap labour and infrastructure services rather than to move them up on the technological ladder. TNCs resist passing their technological and managerial know-how to host countries since these give them a competitive edge. The high productivity and competition they bring could help improve the efficiency of local firms, but these can also block entry of these firms into high-value product lines or drive them out of business. They can prevent rather than promote infant-industry learning unless local firms are supported and protected by deliberate policies. They may help EDEs integrate into global production networks, but participation in such networks also carries the risk of getting locked into low-value-added activities.

To sum up, contrary to what is maintained by the dominant corporate ideology, FDI is not a recipe for rapid and sustained growth and industrialization in EDEs. However, this does not mean that FDI does not offer any benefits to EDEs. Rather, policy in host countries plays a key role in determining the impact of FDI on industrialization and development. A laissez-faire approach could not yield much benefit. It may in fact do more harm than good. Successful examples are found not necessarily among EDEs that attracted more FDI, but among those which used it in the context of national industrial policy designed to shape the evolution of specific industries through

interventions. In this respect the experience of successful late industrializers, notably in East Asia, yields a number of policy lessons:

- Encourage greenfield investment but be selective in terms of sectors and technology;
- Encourage joint ventures rather than wholly foreign-owned affiliates in order to accelerate learning and limit foreign control;
- Allow mergers and acquisitions (M&A) only if there are significant benefits in terms of managerial skills and follow-up investment;
- Do not use FDI as a way of meeting balance-of-payments shortfalls. The long-term impact of FDI on external payments is often negative even in EDEs attracting export-oriented firms;
- Debt financing may be preferable to equity financing when there are no significant positive spillovers from FDI;
- FDI contains speculative components and generates destabilizing impulses which need to be controlled and managed as any other form of international capital flows;
- No incentives should be provided to FDI without securing reciprocity in benefits for industrialization and development;
- Performance requirements may be needed to secure positive spillovers including employment and training of local labour, local procurement, domestic content, export targets and links with local firms;
- Domestic firms should be nurtured to compete with TNCs;
- Linking to international production networks organized by TNCs is not a recipe for industrialization. It could trap the economy in the lower ends of the value-chain.

II. Multilateral and Bilateral Constraints on Investment Policy

The experience strongly suggests that policy interventions would be necessary to contain adverse effects of FDI on stability, balance of payments, capital accumulation and industrial development and to activate its potential benefits. Still, the past two decades have seen a rapid liberalization of FDI regimes and erosion of policy space in EDEs vis-à-vis TNCs. This is partly due to the commitments undertaken in the World Trade Organization (WTO) as part of the Agreement on Trade-Related Investment Measures (TRIMs). However, many of the more serious constraints are in practice self-inflicted through unilateral liberalization or bilateral investment treaties (BITs)[2] signed with more advanced economies (AEs) – a process that appears to be going ahead with full force, with the universe of investment agreements reaching 3,262 at the end of 2014 (UNCTAD IPM, 2015). Although there is considerable diversity in the obligations contained in various BITs, the constraints they entail are becoming increasingly tighter than those imposed by the WTO regime.

There are two main sources of WTO disciplines on investment-related policies: the Agreement on TRIMs and specific commitments made in the context of the General Agreement on Trade in Services (GATS) negotiations for commercial presence of foreign enterprises (the so-called mode 3) in the services sectors. In addition to these, a number of other agreements provide disciplines, directly or indirectly, on investment-related policies, such as the prohibition of investment subsidies linked to export performance in the Agreement on Subsidies and Countervailing Measures.

2 In this chapter BITs is used as a shorthand for all international agreements signed outside the multilateral system that contain provisions on foreign investment and investors, including free trade and economic partnership agreements.

The TRIMs Agreement does not refer to foreign investment as such but to investment generally.[3] It effectively prohibits attaching conditions to investment in violation of the national treatment principle or quantitative restrictions in the context of investment measures. The most important provisions relate to prohibition of domestic content requirements whereby an investor is compelled or provided an incentive to use domestically produced rather than imported products, and of foreign trade or foreign exchange balancing requirements linking imports by an investor to its export earnings or to foreign exchange inflows attributable to investment. By contrast, in TRIMs or the WTO more broadly, there are no disciplines restricting beggar-my-neighbour investment incentives by recipient countries that are just as trade-distorting. Such incentives provide an effective subsidy to foreign investors and can influence investment and trade flows as much as domestic content requirements or export subsidies, particularly since a growing proportion of world trade is taking place among firms linked through international production networks controlled by TNCs (Kumar, 2002).

The obligations under TRIMs may not affect very much the countries rich in natural resources, notably minerals, in their earlier stages of development. FDI in mineral resources is generally capital-intensive and countries at such stages depend almost fully on foreign technology and know-how in extractive industries and lack capital good industries. Linkages with domestic industries are usually weak and output is almost fully exported. Domestic content of production by foreign companies is mainly limited to labour and some intermediate inputs. The main challenge is how to promote local processing to increase domestic value-added. However, over time, restrictions over domestic content requirements can reinforce the "resource curse syndrome" as the country wants to nourish

3 This is provided by a subsequent interpretation by a panel on a TRIMs dispute; for a detailed discussion, see Das (1999, chap. 3.6) and Bora (2002).

resource-based industries, to transfer technology to local firms and establish backward and forward linkages with them.

Domestic content requirements are particularly important for investment in manufacturing in countries at intermediate stages of industrialization, notably in automotive and electronics industries – the two key sectors where they were successfully applied in East Asia. Most industries of EDEs linked to international production networks have high import content in technology-intensive parts and components while their domestic value-added mainly consists of wages paid to local workers. Raising domestic content would not only improve the balance of payments but also constitute an important step in industrial upgrading. Restrictions over domestic content requirements would thus limit transfer of technology and import-substitution in industries linked to international production networks.

However, TRIMs provisions leave certain flexibilities that could allow EDEs to make room to move in order to increase benefits from FDI. First, the domestic content of industrial production by TNCs is not independent of the tariff regime. Other things being equal, low tariffs and high duty drawbacks encourage high import content. Thus, it should be possible to use tariffs as a substitute for quantity restrictions over imports by TNCs when they are unbound in the WTO or bound at sufficiently high levels. Similarly, in resource-rich countries, export taxes can be used to discourage exports of unprocessed minerals and agricultural commodities as long as they continue to remain unrestricted by the WTO regime.

Second, as long as there are no commitments for unrestricted market access to foreign investors, the constraints imposed by the TRIMs Agreement could be overcome by tying the entry of foreign investors to the production of particular goods.

For instance, a foreign enterprise may be issued a licence for an automotive assembly plant only if it simultaneously establishes a plant to produce engines, gearboxes or electronic components used in cars. Similarly, licences for a computer assembly plant can be tied to the establishment of a plant for producing integrated circuits and chips. Such measures would raise domestic value-added and net export earnings of TNCs and would not contravene the provisions of the TRIMs Agreement.

Third, export performance requirements can be used without linking them to imports by investors as part of entry conditions for foreign enterprises. This would not contravene the TRIMs Agreement since it would not be restricting trade (Bora, 2002, p. 177). Finally, the TRIMs regime does not restrict governments in demanding joint ventures with local enterprises or local ownership of a certain proportion of the equity of foreign enterprises. In reality, many of these conditions appear to be used widely by industrial countries in one form or another (Weiss, 2005).

Since the TRIMs Agreement applies only to trade in goods, local procurement of services such as banking, insurance and transport can also be set as part of entry conditions of foreign firms in order to help develop national capabilities in services sectors. This would be possible as long as EDEs continue to have discretion in regulating access of TNCs to services sectors. The existing GATS regime provides considerable flexibility in this respect, including for performance requirements. However, the kind of changes in the modalities of GATS sought by AEs, including the prohibition of pre-establishment conditions and the application of national treatment, could shrink policy space in EDEs a lot more than the TRIMs Agreement.[4]

4 Cho and Dubash (2005) discuss the implication of adopting national treatment in GATS in relation to the electricity sector while Rasiah (2005) provides an illustrative account of it for policy space in Malaysia.

The constraints exerted by most BITs signed in recent years on policy options in host countries go well beyond the TRIMs Agreement because of wide-ranging provisions in favour of investors. These include broad definitions of investment and investor, free transfer of capital, rights to establishment, the national treatment and the most-favoured-nation (MFN) clauses, fair and equitable treatment, protection from direct and indirect expropriation and prohibition of performance requirements (Bernasconi-Osterwalder et al., 2012). Furthermore, the reach of BITs has extended rapidly thanks to the use of the so-called Special Purpose Entities (SPEs) which allow TNCs from countries without a BIT with the destination country to make the investment through an affiliate incorporated in a third-party state with a BIT with the destination country.[5] Many BITs also provide unrestricted arbitration, freeing foreign investors from the obligation of having to exhaust local legal remedies in disputes with host countries before seeking international arbitration. This, together with lack of clarity in treaty provisions, has resulted in the emergence of arbitral tribunals as lawmakers in international investment. These tend to provide expansive interpretations of investment provisions, thereby constraining policy further and inflicting costs on host countries (Bernasconi-Osterwalder et al., 2012; Eberhardt and Olivet, 2012; UNCTAD TDR, 2014).

Only a few EDEs signing such BITs with AEs have significant outward FDI. Therefore, in the large majority of cases there is no reciprocity in deriving benefits from the rights and protection granted to foreign investors. Rather, most EDEs sign them on expectations that they would attract more FDI by providing foreign investors guarantees and protection, thereby

5 For example, if country A has no BIT with country B and a TNC from A wants to invest in country B, it can create an affiliate in country C which has a BIT with country B and make the investment through that affiliate in order to benefit from the BIT between B and C. This creates "transit FDI" and leads to double-counting in reported FDI figures – see UNCTAD WIR (2014, Box I.1).

accelerating growth and development. However, there is no clear evidence that BITs have a strong impact on the direction of FDI inflows. More importantly, these agreements are generally incompatible with the principal objectives of signing them because they constrain the ability of host countries to pursue policies needed to derive their full potential benefits.

While in TRIMs investment is a production-based concept, BITs generally incorporate an asset-based concept of investment whether the assets owned by the investor are used for the production of goods and services, or simply held with the prospect of income and/or capital gain. This is largely because BITs are fashioned by corporate perspectives even though they are signed among governments. Typically, agreements are prepared by the home countries of TNCs and offered to EDEs for signature. The coverage of BITs includes a broad range of tangible and intangible assets such as fixed-income claims, portfolio equities, financial derivatives, intellectual property rights and business concessions as well as FDI as officially defined by the Organization for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF). This implies that all kinds of assets owned by foreigners could claim the same protection and guarantees independent of their nature and contribution to stability and growth in host countries.

It also opens the door to mission creep. Investment agreements may be granted jurisdiction by tribunals over a variety of areas that have nothing to do with FDI proper, further circumscribing the policy options of host countries. Indeed, the expansive scope of investment protection in the North American Free Trade Agreement (NAFTA) has already given rise to claims that patents are a form of investment and hence should be protected as any other capital asset, thereby threatening the flexibilities left in the Agreement on Trade-Related Aspects of Intellectual

Property Rights (TRIPS) and access to medicines (Correa, 2013). Similarly, there have been claims by Argentinian bond holders that such holdings should be protected as any other investment under the Italy-Argentina BIT, thereby intervening with the restructuring of sovereign debt (Gallagher, 2012).

The combination of expansive interpretations of investment and "free transfer of capital" provisions of BITs seriously exposes host EDEs to financial instability by precluding controls over destabilizing capital flows. This is also recognized by the IMF. In its Institutional View on the Liberalization and Management of Capital Flows, the IMF (2012) notes that "numerous bilateral and regional trade agreements and investment treaties … include provisions that give rise to obligations on capital flows" (para. 8) and "do not take into account macroeconomic and financial stability" (para. 65) and "do not allow for the introduction of restrictions on capital outflows in the event of a balance of payments crisis and also effectively limit the ability of signatories to impose controls on inflows" (Note 1, Annex III). The Fund points out that these provisions may conflict with its recommendation on the use of capital controls and asks for its Institutional View to be taken into account in the drafting of such agreements.

Although the IMF's Institutional View focuses mainly on regulating capital inflows to prevent build-up of financial fragility, prohibitions in BITs regarding restrictions over outflows can also become a major handicap in crisis management. It is now widely agreed that countries facing an external financial crisis due to an interruption of their access to international capital markets, a sudden stop of capital inflows and rapid depletion of reserves could need temporary debt standstills and exchange controls in order to prevent a financial meltdown (Akyüz, 2014). However, such measures could be illegal under "free transfer of capital" provisions of BITs.

Where rights of establishment are granted, the flexibilities in the TRIMs Agreement regarding entry requirements noted above would simply disappear. The national treatment clause in BITs requires host countries to treat foreign investors no less favourably than their own national investors and hence prevents them from protecting and supporting infant industries against mature TNCs and nourishing domestic firms to compete with foreign affiliates. It brings greater restrictions than national treatment in TRIMs because it would apply not to goods traded by investors but to the investor and the investment.

Further, provisions on expropriation and fair and equitable treatment give considerable leverage to foreign affiliates in challenging changes in tax and regulatory standards and demanding compensation. In particular, the concept of indirect expropriation has led states to worry about their ability to regulate. The fair and equitable treatment obligation has also been interpreted expansively by some tribunals to include the right of investors to a stable and predictable business environment.

The large majority of outstanding BITs do not make any reference to performance requirements of the kind discussed above, but a growing number of them signed in recent years incorporate explicit prohibitions (Nikièma, 2014). Some BITs go beyond TRIMs and bring additional prohibitions for performance requirements both at pre- and post-establishment phases. Others simply refer to TRIMs without additional restrictions. Still, this narrows the ability of governments to move within the WTO regime because it allows investors to challenge the TRIMs-compatibility of host-country actions outside the WTO system. This multiplies the risk of disputes that host countries can face since corporations are much more inclined to resort to investor-state arbitration than the states do in the WTO system. The MFN clause could entail even greater loss

of policy autonomy in all these areas, including performance requirements, by allowing foreign investors to invoke more favourable rights and protection granted to foreign investors in agreements with third-party countries.[6]

While investment agreements entail a considerable loss of policy autonomy, they do not appear to be serving the intended purpose and accelerating the kind of FDI inflows sought by policy makers in host countries. Evidence suggests that BITs are neither necessary nor sufficient to bring significant amounts of FDI. Most EDEs are now wide open to TNCs from AEs through unilateral liberalization or BITs or free trade agreements (FTAs), but only a few are getting FDI with significant developmental benefits and most of these countries have no BITs with major AEs. Econometric studies on the impact of BITs on FDI flows are highly ambivalent. While a few studies contend that BITs affect FDI flows, they do not examine whether BITs have led to the kind of FDI inflows that add to industrial dynamism in host countries. The majority of empirical studies find no link between the two (UNCTAD, 2009, Annex and UNCTAD TDR, 2014, Annex to Chapter VI). Similarly, survey data show that the providers of political risk or in-house counsel in large US corporations on investment decisions do not pay much attention to BITs (Yackee, 2010).

III. Conclusion

Policy space in several key areas affecting the contribution of FDI to the pace and pattern of industrialization might be somewhat constrained by the WTO Agreement on TRIMs, but it is still possible for EDEs to encourage positive spillovers without violating the WTO commitments. However, many of the more serious constraints are in practice self-inflicted

6 For a more detailed account of various provisions of BITs, their interpretation by tribunals and impact on policy space, see Bernasconi-Osterwalder et al. (2012).

through investment and free trade agreements. There are strong reasons for EDEs to avoid negotiating the kind of BITs promoted by AEs. They need to turn attention to improving their underlying economic fundamentals rather than pinning their hopes on BITs in attracting FDI. Where commitments undertaken in existing BITs seriously impair their ability to use FDI for industrialization and development, they can be renegotiated or terminated, as is being done by some EDEs, even if doing so may entail some immediate costs.

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Chapter 3

Modelling Patent Law Through Investment Agreements

Carlos M. Correa[1]

I. Introduction

Recent complaints based on bilateral investment treaties (BITs) demanding compensation for the alleged damage caused by anti-tobacco policies adopted in Uruguay and Australia have illustrated the pervasive implications that such treaties may have on public policies. If successful, these complaints will undermine states' right to adopt measures to protect public health.[2]

The North American Free Trade Agreement (NAFTA), like other free trade agreements (FTAs) signed in the last 20 years, includes a detailed chapter on investment protection with a scope and obligations similar to those found in BITs. The notification of a complaint against Canada under this chapter in connection with the invalidation of patents raises new concerns about the power given to investors under investment agreements (IAs). Eli Lilly, a major US pharmaceutical company, has notified

1 This chapter is partially based on Carlos Correa, "Investment Agreements: A New Threat to the TRIPS Flexibilities?", *South Bulletin*, No. 72 (13 May 2013).

2 See South Centre, "Trade and Investment Agreements - Barriers to National Public Health and Tobacco Control Measures", Policy Brief No. 12 (November 2012).

an investment complaint following Canadian Federal Court decisions to invalidate two patents it had obtained in Canada. In accordance with generally accepted principles of international law, the courts of the country of grant of a patent enjoy *exclusive* jurisdiction to address issues of invalidation.[3] Eli Lilly, however, wants an arbitral tribunal that will operate outside the Canadian jurisdiction and whose decision would not be appealable before Canadian courts, to award it an economic compensation for the alleged losses caused by the patent invalidations. Eli Lilly claims it has suffered damages of at least 100 million Canadian dollars.[4]

Significantly, in both cases of invalidation Eli Lilly exercised its right to appeal the lower court decisions, and both appeals were heard. It argued, however, a violation of the "minimum standard of treatment" provided for in Article 1105 of NAFTA, which obliges governments to ensure due process in dealing with investors' rights. It also argued that its "expectations" have been frustrated by the introduction of a standard (the "promise doctrine") to assess the utility of its claimed inventions which did not exist under Canadian law at the time the patents were applied for.

II. Patents as an Investment

The broad definition of "investment" typically contained in IAs is the starting point of Eli Lilly's complaint.

3 See, e.g., International Law Association, Sofia Conference (2012), Intellectual Property and Private International Law, First Report. Available from http://www.ila-hq.org/en/committees/index.cfm/cid/1037.

4 See Public Citizen, "U.S. Pharmaceutical Corporation Uses NAFTA Foreign Investor Privileges Regime to Attack Canada's Patent Policy, Demand $100 Million for Invalidation of a Patent", March 2013, available from http://www.citizen.org/eli-lilly-investor-state-factsheet; Henning Grosse Ruse-Khan, "Investor-State Arbitration to Challenge Host State Compliance with International IP Treaties?", available from http://worldtradelaw.typepad.com/ielpblog/2012/12/investor-state-arbitration-to-challenge-host-state-compliance-with-international-ip-treaties.html.

NAFTA, as well as BITs and the investment chapters in other FTAs, incorporate an all-encompassing concept of "investment" that includes any kind of tangible or intangible asset. All assets of an enterprise, such as movable and immovable property, equity in companies, claims to money, contractual rights, intellectual property rights (IPRs), mining concessions, licences and similar rights, are generally included.

Some IAs refer to IPRs generally, while others explicitly indicate the types of intellectual property rights covered, such as copyrights and related rights, patents, rights in plant varieties, industrial designs, rights in semiconductor layout designs, trade secrets, trade and service marks, and trade names. In some IAs reference is also made to "technical process" or "knowhow" and "goodwill".

NAFTA does not explicitly mention IPRs. However, according to Article 1139(g), "investment" includes "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes". A patent and other IPRs would fall under the category of "intangible" property.

In addition to the broad definition of "investment", a particular feature of IAs is that, unlike in the case of World Trade Organization (WTO) disputes, IAs grant "investors" the right to directly sue the state where the investment was made. Eli Lilly's decision to sue the Canadian government thus follows its own assessment of the pros and cons of engaging in litigation. It would be interesting to know whether the US government would have shared the company's opinion.

The US government was sued under Chapter 11 of NAFTA by Apotex, a Canadian company which claimed that wrong decisions by US courts in applying federal law violated NAFTA

Article 1102 (national treatment) and Article 1105 (minimum standard of treatment under international law), and that the decisions amounted to an expropriation of the company's investments under NAFTA Article 1110. The US Department of State indicated its intention to "vigorously" defend against this claim,[5] which was finally rejected on other grounds.[6]

Data on patent invalidation in the USA shows a growing tendency by the courts to invalidate patent claims. US District Courts invalidated patent claims in 86% of the cases they decided in 2007-2011; between 2002 and 2012 the Federal Circuit confirmed 70% of the invalidation decisions by lower courts.[7]

This means that, if Eli Lilly were successful, the USA (as well as other countries party to IAs) may face an increasing risk of being sued and eventually obligated to pay compensation when their courts invalidate wrongly granted patents. This may be particularly troublesome in the light of the large number of sub-standard patents granted as a result of lax patentability requirements or the poor quality of the examination conducted by patent offices.[8]

5 See http://www.state.gov/s/l/c27648.htm.

6 The rejection was substantially based on the lack of sufficient investment-like behaviour to trigger NAFTA protections and on Apotex's failure to exhaust its domestic remedies. See, e.g., Julian Davis Mortenson, "The Futility Exception to the Exhaustion Requirement: Apotex v. United States", available from http://kluwerarbitrationblog.com/blog/2014/08/25/the-futility-exception-to-the-exhaustion-requirement-apotex-v-united-states/.

7 See White Paper Report, United States Patent Invalidity Study 2012, available from http://www.morganlewis.com/~/media/files/publication/presentation/speech/smyth_uspatentinvalidity_sept12.ashx.

8 See Carlos Correa, "Beyond 'patent quality': Basic concepts of the patent system need to be reviewed", *South Bulletin*, No. 62 (28 May 2012).

III. Patent Invalidation

States grant patents to achieve certain objectives including, in the case of WTO members, to comply with the obligation imposed by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Patents are granted as a result of a deliberate policy decision, and not because inventors enjoy a "natural" right over the invention. Thomas Jefferson, fervent advocate of the patent system, observed, in a famous letter to an inventor in 1813, that inventions "cannot, in nature, be a subject of property. Society may give an exclusive right to the profits arising from them, as an encouragement to men to pursue ideas which may produce utility, but this may or may not be done, according to the will and convenience of the society, without claim or complaint from anybody".

A patent is generally granted after an examination by the patent office to establish whether the claimed invention meets the patentability standards (novelty, inventive step and industrial applicability or utility).[9] The decision to grant a patent is often based on incomplete information, or on incorrect judgments. For instance, a publication that anticipated the invention and hence destroys its novelty may be found after the patent was granted, particularly when competitors affected by the patent undertake detailed patent searches with tools more sophisticated than those available to the patent office.

Given the limitations inherent to examination, a patent only provides a precarious title to the invention. Although patents are generally presumed to be valid, some patent laws clarify that patents are issued without any guarantee by the state. Even the US Federal Trade Commission has alerted against a strong presumption of validity. It noted that "[o]nce an application is

9 In some countries, such as South Africa, patents are granted without prior substantive examination.

filed, the claimed invention is effectively presumed to warrant a patent unless the PTO [US Patent and Trademark Office] can prove otherwise ... The PTO's procedures to evaluate patent applications seem inadequate to handle this burden".[10] The report concluded that "[t]hese circumstances suggest that an overly strong presumption of a patent's validity is inappropriate … It does not seem sensible to treat an issued patent as though it had met some higher standard of patentability".[11]

As a result, revocation (by the same patent office) or invalidation of a patent by a court is not something exceptional or that would be unexpected to patent owners. Claiming that invalidation implies a loss of an "investment" suggests a gross misconception on the fundamentals and operation of the patent system. An invalid patent only has an appearance of validity; a finding of invalidity means that a legitimate right over the invention never existed. An invalid patent cannot be "expropriated" (directly or indirectly) in terms of IAs' rules since, by definition, there is no "property" or asset involved. Whatever the coverage of the invalidated patent claims, the described knowledge remains in the public domain.

Significantly, Article 32 ("Revocation/Forfeiture") of the TRIPS Agreement left wide room for member countries to determine the grounds and conditions for the revocation or forfeiture of a patent, including situations of invalidity. During the negotiations that led to the Agreement, India had proposed to establish that a patent could be revoked when "used in a manner prejudicial to the public interest". The USA, on its part, wanted to permit revocation only where the invention was found to

10 Federal Trade Commission, *To Promote Innovation: The Proper Balance of Competition and Patent Law and Policy* (October 2003). Available from https://www.ftc.gov/sites/default/files/documents/reports/promote-innovation-proper-balance-competition-and-patent-law-and-policy/innovationrpt.pdf, p. 9.
11 Id., p. 8.

be non-patentable.[12] The adopted text simply stipulates: "An opportunity for judicial review of any decision to revoke or forfeit a patent shall be available."

IV. The Revoked Patents: Examples of "Evergreening"

"Evergreening" is a strategy through which companies, notably in the pharmaceutical sector, apply for patents on derivatives, formulations, new uses, etc. of existing products in order to extend patent protection well beyond the expiry of the original patent. This strategy aims at delaying or blocking generic competition and the fall in prices (and profits) that normally follows the introduction of cheaper versions of the off-patent product.

Many countries have adopted anti-evergreening measures, including specific provisions in the patent law (e.g., India, the Philippines), patent offices' guidelines (e.g., Argentina) and penalties for baseless litigation (e.g., Australia).[13] Two typical modalities of evergreening patents are "selection patents" and patents on a new use of a known medicine.

A "selection patent" is a patent under which a single element or a small segment within a large known group is "selected" and independently claimed based on a particular feature not mentioned in the large group. Often, selection patents are applied for when a patent that covers a large number of compounds that are functionally equivalent[14] has expired or is about to expire. If allowed by the patent offices and the courts,

12 See Holger Hestermeyer, *Human Rights and the WTO. The Case of Patents and Access to Medicines* (Oxford University Press, Oxford, 2007), p. 254.

13 See Carlos Correa, "Tackling the Proliferation of Patents: How to Avoid Undue Limitations to Competition and the Public Domain", Research Paper 52 (South Centre, Geneva, 2014).

14 Patent claims comprising multiple possible realizations of a general chemical formula are known as "Markush claims". They may cover millions of compounds under one single patent.

these patents may enable significant extension of the monopoly granted by patent rights in relation to a particular medicine. One of the patents (on the drug olanzapine) revoked by the Canadian Federal Court is of this type. In applying for it, Eli Lilly claimed that it had discovered that olanzapine had a "marked superiority in the treatment of schizophrenia"[15] compared with other compounds of the larger group it had previously patented. However, according to the Canadian statement of defence in the arbitration, "[e]vidence at trial revealed that Claimant had claimed the second monopoly on the basis of studies which failed to establish any particular treatment advantage of olanzapine over the already-patented class to which it belonged".[16] Moreover, it was found that Eli Lilly

> filed at least 29 other Canadian patent applications relating to olanzapine, purporting to have invented at least 16 distinct new and surprising uses for the compound, ranging from sexual dysfunction to autism. The majority of these other patent applications contained no reference to actual research conducted, or contained an ambiguous reference to clinical studies that may or may not have been conducted before the filing of the corresponding patent applications.[17]

The second revoked patent also provides an example of evergreening, based on the alleged discovery of a new use for a known drug. Patents of this type can only be granted on the basis of a fiction on novelty, as the product is already known. A new use of a medicine lacks industrial applicability; it is a

15 See Government of Canada, Statement of Defence, in the Matter of an Arbitration under Chapter Eleven of the North American Free Trade Agreement and the UNCITRAL Arbitration Rules (1976) Between: Eli Lilly and Company and: The Government of Canada, June 30, 2014, para. 3.

16 Id.

17 Id., para. 67.

method of medical treatment.[18] Despite this, many countries – Canada among them – have accepted patents on the "second use" of a medicine. In applying in 1996 for a patent relating to atomoxetine, Eli Lilly asserted that it had invented a new use for this well-known compound, relying on evidence that was considered flawed and inconclusive by the Canadian court.[19] Significantly, the equivalent patent obtained by Eli Lilly was invalidated, at first instance, by a US court.[20] In addition to the revoked patent, the company had filed in Canada at least 10 patents for the use of atomoxetine "for the treatment of ten other pathologies, ranging from stuttering, to anxiety disorders, to tic disorders, to hot flashes".[21]

Although the decision on Eli Lilly's claim against Canada will most probably focus on the application of investment rules, it may also contribute to calling attention to the abusive practices that companies often follow to unjustifiably extend their monopolies over drugs that have fallen in the public domain.

V. The Promise Doctrine

In the Eli Lilly case, the Canadian court held that the patented invention had failed to deliver the benefits promised when the application was made. Eli Lilly questions the so-called "promise doctrine" developed by the Canadian courts, and argues that this new, more stringent approach to patent invalidation applied after 2005 is contrary to the company's expectations "at the time of its investment". The company also argues that the "promise doctrine" has become a national standard as a result, for instance, of its recognition in the guidelines issued

18 See, e.g., Carlos Correa, "Patent Examination and Legal Fictions: How Rights Are Created on Feet of Clay", Research Paper 58 (South Centre, Geneva, 2014).

19 Government of Canada, op. cit., para. 4.

20 Id., para. 64.

21 Id., para. 55.

by the Canadian Intellectual Property Office[22] and, therefore, questions Canada's right to determine how "utility" is defined for the purpose of deciding whether to grant a patent. Eli Lilly contends that the questioned judicial practice is inconsistent not only with various obligations provided for in Chapter 11 of NAFTA, but also with the TRIPS Agreement.[23]

However, as noted, the only obligation the TRIPS Agreement imposes in relation to revocation relates to the availability of a judicial review. No substantive conditions are provided for. Further, members can determine how they define and apply the patentability standards set out in Article 27.1 of the Agreement. This is, in fact, one of the most important flexibilities in the TRIPS Agreement: it determines which standards need to be applied to establish patentability, but *does not define* them. Hence, WTO members can adopt the criteria they consider appropriate to implement such standards, including rigorous requirements to prevent the proliferation of patents on minor developments that, as is the case in pharmaceuticals, may unduly block legitimate competition and increase prices for consumers. Section 3(d) of the Indian Patents Act is one example of how this flexibility can be used. Another one is the set of guidelines for the examination of pharmaceutical patents adopted by the Argentine government in 2012.[24]

The admissibility of Eli Lilly's claims under NAFTA may find an additional obstacle in NAFTA Article 1110.7. Under this article, the provision mandating compensation in cases of direct or indirect nationalization or expropriation "does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights, or to the revocation, limitation or

22 See http://www.cipo.ic.gc.ca/eic/site/cipointernet-internetopic.nsf/eng/wr03153.html.

23 Public Citizen, op. cit.

24 See Joint Resolution of the Ministry of Industry, Ministry of Health and Instituto Nacional de la Propiedad Industrial 118/2012, 546/2012 and 107/2012.

creation of intellectual property rights, to the extent that such issuance, revocation, limitation or creation is consistent with Chapter Seventeen (Intellectual Property)". This means that, in principle, an investor's compensation cannot be claimed in cases of invalidation of a patent. This is, as noted above, a logical consequence of the nature of the rights conferred. Such a claim could only be made in cases of inconsistency with the rules contained in NAFTA Chapter 17.

NAFTA's Article 1709.8 stipulates, in this respect, that a Party "may revoke a patent only when: (a) grounds exist that would have justified a refusal to grant the patent; or (b) the grant of a compulsory license has not remedied the lack of exploitation of the patent".

The Canadian Federal Court decisions are based on one of the grounds that would have justified the rejection of the patent applications (lack of utility); hence, it seems consistent with paragraph (a) of Article 1709.8. It would be difficult for an arbitration tribunal to ignore this provision, even in the light of Eli Lilly's argument that the "promise doctrine" was not applied prior to 2005 when its alleged "investment" took place.

Interestingly, the USA Model BIT contains a provision that carves out an exception for compulsory licences – reflecting the US government's interest in protecting its extensive use of these measures – as well as for revocation. Article 6.5 on "Expropriation and Compensation" stipulates that this provision "does not apply to the issuance of compulsory licenses granted in relation to intellectual property rights in accordance with the TRIPS Agreement, or to the revocation, limitation, or creation of intellectual property rights, to the extent that such issuance, revocation, limitation, or creation is consistent with the TRIPS Agreement". The TRIPS Agreement, as noted, does not provide for any substantial standard for revocation;

inconsistency could only be found if an opportunity for judicial review were not offered.

It is worth noting, finally, that the Canadian patent law does not set a very high standard of utility to obtain a patent. The "promise doctrine" only applies when the applicant promises in the specification that the claimed invention would have a certain utility.[25] In addition, the asserted utility does not have to be *demonstrated* but only *soundly predicted*[26] at the time of the patent application. With this interpretation, Canadian courts have in fact, since the late 1970s, relaxed the utility requirement for pharmaceutical inventions.[27]

VI. Changing National Laws

According to the Canadian statement of defence, Eli Lilly is wrong in arguing that the "promise doctrine" is new, established after its "investment" was made.[28] If, hypothetically, this were not true, could a company be entitled to compensation if the state where it has sought patent protection decides to change how the patentability requirements or other conditions are applied?

For instance, the US Supreme Court objected in *KSR Int'l Co. v. Teleflex, Inc.* (550 U.S. 398 (2007)) to the way in which the so-called "teaching-suggestion-motivation" test was applied

25 Government of Canada, op. cit., paras. 24-25.

26 In *Monsanto Co. v. Commissioner of Patents* [(1979), 42 C.P.R. (2nd), 161 (S.C.C.)], the court held that "[i]f it is possible for the patentee to make a sound prediction and to frame a claim which does not go beyond the limits within which the prediction remains sound, then he is entitled to do so. Of course, in so doing he takes the risk that a defendant may be able to show that his prediction is unsound or that some bodies falling within the words he has used have no utility or [...] that some promise he has made in his specification is false in a material respect".

27 Government of Canada, op. cit., para. 31.

28 Canada states that the doctrine was established as early as 1959, and endorsed by the Supreme Court of Canada in 1981. See Government of Canada, op. cit., para. 23.

by the US Patent and Trademark Office (USPTO) and courts, thereby elevating the level of non-obviousness required for an invention to be patentable. As a result, the USPTO introduced new guidelines for the examination of patent applications under that test.[29]

In another groundbreaking decision, the US Supreme Court in *Association for Molecular Pathology v. Myriad Genetics* (569 U.S. 12-398, 2013) ruled that naturally occurring genes, even if isolated, are not a valid patentable subject matter.[30] The case referred to a set of patents on "BRCA genes", the presence of which is associated with an increased risk of hereditary breast and ovarian cancer. The USPTO had granted thousands of patents based on an artificial differentiation between "natural" and "isolated" genes. It deemed the latter patentable. As a result of the court decision, all such patents could be invalidated.

Argentina and India adopted, in 2012 and 2014, respectively, guidelines for the examination of pharmaceutical patent applications aimed at curbing evergreening through salts, polymorphs, isomers, formulations, etc. of known medicines. The application of these guidelines is likely to influence court decisions on patentability.

Could a patent owner from Canada or Mexico (or from other countries linked by BITs with the USA) claim that the USA is violating "investors' rights" if his patent were invalidated pursuant to the *KSR* or *Myriad* rulings? Could a patent owner in Argentina or India whose patent is revoked following the new guidelines, argue that his expectations have been frustrated and his investor's rights violated?

29 See Examination Guidelines & Training Materials in view of KSR International Co. v. Teleflex Inc., available from http://www.uspto.gov/patents/law/exam/ksr_training_materials.jsp.

30 See, e.g., Laurence Gostin, "Who Owns Human Genes? Is DNA Patentable?", *JAMA* 310:791 (2013).

If the reply were in the affirmative, governments would have to abstain from any reform in law or policies that could limit the availability or scope of patent protection, or face the risk of investors' claims.[31] Investors would be able to interfere with the reform of national laws that governments may pursue to better serve the public interest. In particular, if Eli Lilly were successful in this case, governments may be deterred from introducing anti-evergreening measures needed to promote generic competition and protect public health.

Even if the arbitration tribunal found that a change in the application of the utility standard under Canadian law actually occurred after Eli Lilly's filing for the revoked patents, it would be hard for the tribunal to admit that an investor's rights may be violated when national laws evolve. It is worth noting, in this regard, that in *EDF (Services) Limited v. Romania* the arbitration tribunal noted that IAs have not been conceived "as a kind of insurance policy against the risk of any changes in the host State's legal and economic framework. Such expectation would be neither legitimate nor reasonable".[32]

VII. Unrealized Promises

A large number of developing countries entered into IAs based on the promise that the protections conferred to investors will increase FDI and boost their economies. There is no evidence, however, suggesting that such promise has been realized. The Sixth Annual Forum of Developing Country Investment Negotiators concluded, for instance, that "there was no clear correlation between the number of BITs and FDI, and that there was a need to shift towards a more balanced investment treaty regime that would take into account developing countries'

31 Of course, this argument can be generalized to other fields of public policy, e.g., the adoption of new rules for the marketing approval of pesticides, fertilizers, food, etc.

32 ICSID Case No. ARB/05/13, Award, 8 October 2009, para. 217 (RL-008).

sustainable development objectives".[33] FDI has primarily flowed to countries with large markets and attractive growth prospects. Brazil has opted not to sign any BIT but has been one of the main recipients of FDI amongst developing countries.

While IAs have not been critical in attracting FDI, they have become platforms for multi-billion-dollar compensation claims. The investors' right to directly sue the host states, in particular, has allowed unprecedented challenges to governmental action. In view of the implications of BITs and other IAs, Ecuador has decided to denounce all BITs it had entered into. South Africa decided not to sign any new BIT and will attempt to exit from or renegotiate existing ones. Australia announced that it would not agree on investor-state dispute settlement provisions in new IAs, and India is reviewing its BITs, especially their dispute resolution component.[34]

One of the worrying dimensions of Eli Lilly's complaint is that it involves matters that the TRIPS Agreement has left to the discretion of the WTO members. Deciding on which grounds a patent can be invalidated and how the patentability requirements are applied are among the important flexibilities allowed by the Agreement. If Eli Lilly prevailed in this case, investor-state litigation could become a new, possibly more friendly, venue than the WTO dispute settlement mechanism for intellectual property right holders to question the interpretation and implementation of the TRIPS Agreement. IAs may be used to penalize governments that introduce pro-competitive measures, such as those aiming at preventing or limiting evergreening practices. A decision favourable to Eli Lilly would have significant systemic implications and would

33 See Report of the Sixth Annual Forum of Developing Country Investment Negotiators held in Port-of-Spain, Trinidad and Tobago on October 29-31, 2012, available from http://www.iisd.org/pdf/2012/6th_annual_forum_report.pdf.

34 See Martin Khor, "The emerging crisis of investment treaties", *South Bulletin*, No. 69 (21 November 2012).

add to the reasons for seriously reviewing the benefits and costs of being a party to or signing new IAs.

In any event, Eli Lilly's choice of patents in respect of which it is claiming violation of its rights could end up attracting more public attention to the strategies used by this and other pharmaceutical companies to block legitimate competition from generic versions of off-patent products to the detriment of patients and social security systems. The case against Canada may induce more countries to follow the example of India, Argentina and other countries that have adopted measures to rigorously apply the patentability standards.

Chapter 4

Throwing Away Industrial Development Tools: Investment Protection Treaties and Performance Requirements

Kinda Mohamadieh and Manuel F. Montes

I. Introduction

It has become practically an article of faith in developing countries that foreign investment is essential to a successful development effort. In the case of harnessing foreign investment for development particularly, faith-based policy making can be misguided. Successful attraction of foreign direct investment (FDI) does not guarantee rapid and sustained growth and industrialization. Successful development involves structural transformation which "is only possible with substantial and sustained investment over decades in new activities and products" (Montes, 2014, p. 1). A hands-off approach to FDI, as to any other form of capital, can lead to more harm than good. FDI policy needs to be embedded in the overall industrial strategy in order to ensure that it contributes positively to economic dynamism (Akyüz, this volume). Channelling and shaping FDI and related activities to support overall industrial development objectives require that the state have sufficient space to enforce performance requirements on the operations of foreign investors.

Foreign investment can contribute to increasing the overall volume of investment, and this is often the popular justification

for welcoming policies towards foreign investment. In theory, foreign investment can contribute to both the level of investment and foreign exchange inflows. However, Akyüz (this volume) explains how foreign investment might not necessarily involve a net positive contribution to investment flows or to foreign exchange inflows because of the eventual repatriation of profits and of the original investment, and because foreign companies tend to be more dependent on imported goods and services for their operations. In fact, external transactions of foreign-owned companies can be volatile and destabilizing. Host-country authorities must consider whether the benefits outweigh the costs.

Authorities can try to obtain positive benefits through performance requirements on foreign company operations with a view towards strengthening the contributions of these operations to national development while safeguarding economic stability. But these requirements could run afoul of the country's international commitments in investment treaties and investment chapters in free trade agreements (FTAs).

Among the potential contributions of foreign investor activities are access to foreign markets, to foreign technology and management skills. However, while foreign companies have capabilities in these areas, host countries will not automatically gain these benefits unless their own policies induce investors to make these contributions as part of their operations. Treaty restrictions on performance requirements have the effect of reducing the likelihood of scenarios in which mutual benefit could accrue both to investors as well as the host state and local communities.[1]

The kinds of policy interventions that would be required to ensure positive benefits from foreign investment are those that

1 See International Institute for Sustainable Development (IISD), *Investment Treaties and Why They Matter for Sustainable Development*, p. 29.

have been historically applied by successful countries as part of their industrial policy. In the multilateral trading system, these policies are grouped under the term "performance measures."

This chapter is concerned with the implications of international investment protection treaties, including investment rules in free trade agreements, on the policy space of developing countries to undertake the kinds of policies that will ensure positive benefits from foreign investments. A major area of concern relates to investment treaty provisions that prohibit performance measures, the way these treaties have been crafted, and the way they have been interpreted in investor-state dispute settlement (ISDS) cases.

The next section of the chapter discusses the performance measures considered important to derive positive benefits from foreign investment. The third section addresses the rules of the Agreement on Trade-Related Investment Measures (TRIMs) under the World Trade Organization (WTO). The fourth section explains how investment treaties restrict the application of these policies. The fifth section reviews recent ISDS cases that involved performance measures. The chapter ends with concluding remarks based on the information provided.

II. Performance Measures

Building an efficient and internationally competitive enterprise sector is a key factor in pursuing sustainable development. Historically, states have had to play an indispensable role in building the enterprise sector. Successful practice has required that the public sector undertake policies to support and discipline both public and private enterprises to channel their activities to new and productive areas (see Studwell (2013) for an account of how the various states in East Asia undertook such policies).

Development requires the introduction of new economic activities different from existing, often traditional, already commercialized activities. These often require the introduction of new techniques of production and of never-before-used technology. The private sector tends to underinvest in and be reluctant to enter new areas or require state subsidies because of the high risk of doing so. State enterprises can undertake some of these entry activities, but eventually it will be advantageous to commercialize the new activities in private markets and operations.

State subsidies for private companies are a well-known intervention, but disciplines and restrictions are also important. For example, the use of foreign exchange to obtain imported content can be excessive, and states have found it necessary to limit access to foreign exchange. Authorities in the Republic of Korea forced their leading businessmen to invest in manufacturing, which was more risky to their profits but which also permitted labour to move into higher-skilled jobs, and restricted their investment in lucrative retail sectors, which were not the priority in the early stages of development (Studwell, 2013). Development requires the building of national capabilities, including the emergence of indigenous firms (as opposed to dependence on the activities of foreign companies).

Successful states assisted enterprises to upgrade their technology, manage the foreign exchange impact of their operations, and increase their domestic value-added (which increased demand for labour and for the output of other enterprises, and upgraded the skills of labour and indigenous businesses).

States have applied mandatory and non-mandatory performance requirements;[2] the former are usually used as conditions for entry and operation while the latter are usually linked to certain

2 See Suzy Nikièma, "Performance Requirements in Investment Treaties", IISD (December 2014).

incentives. The following is part of a long list of policies and tools that states have used historically for development (UNCTAD, 2001; Cosbey, 2015), many of which have applied not only to foreign investors but also to indigenous investors:

- **Local content and local processing requirements** – enterprises are required to purchase specific products or a minimum proportion of inputs from the domestic economy or to process a proportion of their intermediate inputs locally;
- **Trade balancing requirements** – requirement on enterprises to export as much as the value of their imports;
- **Foreign exchange restrictions** – restrictions on how much foreign exchange enterprises can purchase or, in the case of foreign investors, requirement to bring in a minimum amount of foreign exchange (which would tend to limit their taking advantage of domestic credit);
- **Export controls** – certain products are prohibited from being exported because they are critical inputs in other enterprises. These controls increase domestic value-added and domestic employment;
- **Requirements to establish a joint venture with domestic participation** – whereby foreign companies can only come in if they have a local partner. This could permit the upgrading of skills and technology in the local economy and help the state monitor operations of the foreign-related company;
- **Requirements for a minimum level of domestic equity participation** – whereby foreign companies can establish themselves only if domestic investors hold a minimum percentage of the enterprise. This can be important for specific "strategic sectors" whose outputs and operations are critical to the development of other sectors;
- **Requirements to locate headquarters in a specific region** – when a country wants to develop administrative capabilities

in a particular region, it could require the enterprise headquarters to be based in that region;

- **Employment requirements** – enterprises are required to hire a minimum number or minimum percentage of local people. This requirement could include a minimum number of nationals in management positions or on the board of directors of the enterprise. Such measures could include requirements for training local employees or building capacities in suppliers;
- **Export requirements** – enterprises could be required to export a minimum percentage or value of their production, as the Republic of Korea required for enterprises obtaining subsidized domestic credit;
- **Restrictions on sales of goods or services in the territory where they are produced or provided** – these requirements protect enterprises in subnational areas from competition from enterprises that originate elsewhere;
- **Requirements to supply goods produced or services provided to a specific region exclusively from a given territory** – this requirement restricts the marketing operations of an enterprise by restricting where goods for a locality will be supplied from;
- **Requirements to transfer technology, production processes or other proprietary knowledge** – the foreign investor is required to share/transfer their technology with nationals;
- **Research and development requirements** – whereby the enterprise is required to undertake a minimum volume of research and development activities;
- **Environmental assessment requirements** – whereby the enterprise must undertake environmental impact studies on its operations.

It is important to put the use of these measures into perspective. For example, Japanese companies investing overseas have had

to accede to local content requirements of host countries. The United States imposed a 75% local content requirement on the Toyota Camry, the UK required 90% local content on the Nissan Primera, and Italy imposed a 75% local content requirement on the Mitsubishi Pajero.

A detailed analysis of United States and Japanese FDI in a sample of 74 countries in seven broad branches of manufacturing over the 1982-1994 period found export performance requirements to be effective in increasing the export-orientation of foreign affiliates to third countries (Kumar, 2003).

Furthermore, Kumar and Gallagher (2007) indicate that countries like Australia, Canada, France, Japan, Norway, and Sweden, among others, have made extensive use of performance requirements. For example, Australia imposed 50% domestic ownership requirements in natural resource projects and employed offsets policy under which larger government contracts required new domestic activity of 30% of their import content.[3] Canada enacted a Foreign Investment Review Act in the early 1970s under which an extensive set of performance requirements were imposed.

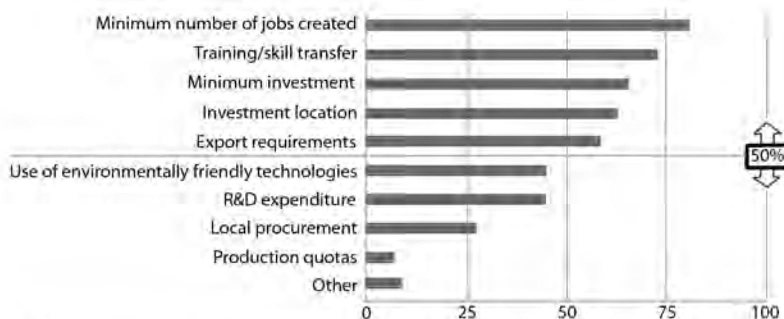
An example of a local content requirement in the services sector is the United States Merchant Marine Act of 1920, also known as the Jones Act, which requires that all goods transported by water between the United States' ports be carried on US flag ships, constructed in the United States, owned by United States citizens, and crewed by United States citizens and US permanent residents.

The United Nations Conference on Trade and Development (UNCTAD) points out that most performance requirements used by investment promotion agencies primarily relate to job

3 Kumar and Gallagher (2007), p. 17.

creation and technology and skill transfer, followed by minimum investment and locational and export requirements. This is based on a survey conducted by UNCTAD between January and April 2014 as part of its *World Investment Report 2014* (see Figure 4.1 below). The survey focused on measures taken by investment promotion agencies to promote sustainable development through investment incentives for foreign investors linked to certain performance requirements.[4]

Figure 4.1: Most important performance requirements linked to investment incentives for foreign investors (per cent)



Note: Based on number of times mentioned as one of the top five performance requirements.

Source: UNCTAD, *World Investment Report 2014*, p. 112.

III. TRIMs and Developing Countries' Call for Flexibilities

The TRIMs Agreement under the WTO restricts the ability of WTO member states to impose certain types of performance requirements mentioned above.[5] It explicitly prohibits a set

4 See UNCTAD, *World Investment Report 2014*, p. 111.

5 It is worth noting that the Uruguay Round negotiations that resulted in the TRIMs Agreement produced an illustrative list of 14 TRIMs that formed the basis of the multilateral discussions, including: investment incentives, local equity requirements, licensing requirements, remittance restrictions, foreign exchange restrictions, manufacturing limitations, transfer-of-technology requirements, domestic sales requirements, manufacturing requirements, product-mandating requirements,

of measures that are annexed in an illustrative list attached to the Agreement, including local content requirements, trade balancing requirements, import restrictions, domestic sales requirements, and foreign exchange requirements. (See indicative chart in Annex 4.1.) These measures have historically been very important for effective industrial policies and, as noted above, widely deployed by developed economies at some time or another.[6]

Other investment measures remain outside the scope of the Agreement, such as performance requirements relating to participation of local equity, research and development,[7] technology transfer, the employment of local personnel, localization in a given area, and training of personnel.

A 2007 study by UNCTAD[8] concludes that while the use of certain trade-related investment measures is no longer an option in most WTO member states, objectives such as promoting industrialization, improving the trade balance and encouraging local sourcing remain of high priority to developing-country governments.[9]

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trade-balancing requirements, local content requirements, export requirements, and import-substituting requirements. See Genest (2014), referencing the United Nations Centre on Transnational Corporations and UNCTAD, *The Impact of Trade-Related Investment Measures on Trade and Development* (1991).

6 See Kumar and Gallagher (2007).

7 Kumar and Correa (2004), cited by Gallagher (2008).

8 For more information on the history of TRIMs negotiations, see: *Elimination of TRIMs: The Experience of Selected Developing Countries* (UNCTAD publication, 2007), pp. 6-10. On the benefits from trade-related investment measures, this study notes the following: in some cases the trade-related investment measures appeared to play a role in spurring foreign companies to source locally more broadly, or enhance their exports from the host country. The effectiveness of the various trade-related investment measures has been influenced by the clarity of the set objectives, the capability of the governments to implement a given policy, the local absorptive capacity of the workforce and domestic enterprises, and the extent to which measures used have been compatible with other industrial and trade policies (see p. 9 of the study).

9 The UNCTAD study (2007) reviewed examples of countries trying to offset the limitations set by the Agreement on TRIMs by replacing these measures with others

Since 1999, developing countries at the WTO have presented proposals for flexibilities under the TRIMs Agreement and have called for removing elements that are detrimental to developing countries and making more effective the Special and Differential (S&D) Treatment principle under the Agreement. This issue is subject to an ongoing negotiation mandate under paragraph 44 of the Doha Ministerial Declaration, whereby WTO members agreed that "all special and differential treatment provisions shall be reviewed with a view to strengthening them and making them more precise, effective and operational".

Under the WTO negotiating agenda on "implementation issues",[10] developing countries have sought flexibility to implement development policies intended to address, among others, social, regional, economic, and technological concerns.[11] In this context, developing countries proposed to amend the TRIMs Agreement through an enabling provision (in Articles 2

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that are WTO-compatible. For example, Argentina partly offset the removal of WTO-notified TRIMs by using rules of origin on the regional level under the MERCOSUR automotive policy. Both the EU and NAFTA members adopted stringent rules of origin which have the same effect as local content regulations, through establishing certain levels of regional content that have to be met for a product to benefit from free trade within the economic region (i.e., to qualify as an internal product in a preferential trading agreement) (see: Kumar and Gallagher, 2007). Vietnam provides incentives to attract FDI in projects aimed at the production of supporting materials and boosting the production of high-quality components and spare parts and set up special industrial zones for both domestic and foreign enterprises producing supporting materials and components for these industries (UNCTAD 2007 study).

10 Addressing issues and concerns related to implementation challenges faced by developing countries is a core element of the negotiating mandate established by the Doha Ministerial Declaration under the WTO (2001). Paragraph 12 of the Doha Ministerial Declaration provides for the following: "We attach the utmost importance to the implementation-related issues and concerns raised by members and are determined to find appropriate solutions to them ... We agree that negotiations on outstanding implementation issues shall be an integral part of the Work Programme we are establishing…". See: https://www.wto.org/english/thewto_e/minist_e/min01_e/mindecl_e.htm.

11 See: WTO document JOB(01)/152/Rev.1 dated 27 October 2001, "Compilation of Outstanding Implementation Issues Raised by Members", Tiret 40.

and 4 of the TRIMs Agreement[12]) by which developing countries shall be exempted from disciplines on the use of domestic content requirements.[13] Developing countries have also sought another opportunity to notify existing TRIMs which they would then be allowed to maintain until the end of a new transition period.[14]

Within this context, Brazil and India presented a proposal in 2002 in which they suggested that Article 4 of the TRIMs Agreement be amended in order to provide developing countries with the necessary flexibility to implement development policies. They also proposed allowing temporary deviations from the provisions of Article 2 of the Agreement for new policies that would be used for the following objectives:

(a) promote domestic manufacturing capabilities in high-value-added sectors or technology-intensive sectors;
(b) stimulate the transfer or indigenous development of technology;
(c) promote domestic competition and/or correct restrictive business practices;

12 Article 2 of the TRIMs Agreement on "National Treatment and Quantitative Restrictions" provides that: "1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994. 2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement." Article 4 of the TRIMs Agreement provides that: "A developing country Member shall be free to deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994, the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Articles III and XI of GATT 1994."

13 See: WTO document JOB(01)/152/Rev.1 dated 27 October 2001, "Compilation of Outstanding Implementation Issues Raised by Members", Tiret 39.

14 See: WTO document JOB(01)/152/Rev.1 dated 27 October 2001, "Compilation of Outstanding Implementation Issues Raised by Members", Tiret 37.

(d) promote purchases from disadvantaged regions in order to reduce regional disparities within their territories;
(e) stimulate environment-friendly methods or products and contribute to sustainable development;
(f) increase export capacity in cases where structural current account deficits would cause or threaten to cause a major reduction in imports;
(g) promote small and medium-sized enterprises as they contribute to employment generation.

It is worth noting that certain policies of developing countries have been increasingly questioned in the WTO Committee on TRIMs, mainly by developed countries, in regard to measures they have undertaken in support of development and industrialization capacities. For example, Nigeria was interrogated on certain measures taken in the "act to provide for the development of Nigerian content in Nigeria's oil and gas". India was asked about certain preferences to domestically manufactured electronic goods. Brazil was questioned on some local content provisions in the telecommunications sector and tax preferences linked to local content conditions in several sectors. Indonesia was interrogated on certain measures addressing local content in the telecommunications sector and in the energy sector, including mining, gas, and oil.[15]

IV. Investment Treaties: Casting a Wider Prohibitive Net on Performance Requirements

Provisions under investment protection treaties prohibiting performance requirements differ in terms of scope and, accordingly, the prohibitions and limitations they establish.

Some provisions on performance requirements refer to the TRIMs Agreement, thus importing the obligations of states under

15 See: WTO document G/TRIMS/M/35, 20 December 2013.

the TRIMs Agreement into the investment agreement (see Annex 4.2 for an example: India-Singapore FTA, Article 6.23). This reference makes the obligations under the TRIMs Agreement subject to investor-state dispute sanctions.

Some provisions on performance requirements prohibit the application of performance requirements after the investment has been established in the relevant jurisdiction (see Annex 4.2 for an example: Article 4.4 of India-Kuwait bilateral investment treaty (BIT)). Other provisions expand the prohibition to the pre-establishment phase, including in relation to establishment, acquisition, and expansion[16] (see Annex 4.2 for several examples: US–CAFTA-DR agreement, Article 10.9; Article 8.1 of US model BIT; Japan-Mexico FTA, Article 65).

Limitations on performance requirements could also result from provisions offering pre-establishment rights[17] to investors. Pre-establishment rights refer to the right of entry of investments and investors of a Party (a member country of a trade or investment agreement) into the territory of another Party. Including pre-establishment rights in an investment agreement extends national treatment and most-favoured-nation (MFN) treatment to the "establishment, acquisition and expansion" of investments. Accordingly, each Party allows investors of other Parties to establish an investment in its territory on terms no less favourable than those that apply to domestic investors (national treatment) or investors from third countries (MFN treatment). Including pre-establishment rights, with no exceptions, in an investment treaty would prohibit the host state from imposing

16 For more details, see Nikièma (2014).

17 A sample provision that extends pre-establishment rights in the areas of national treatment and MFN: "Each Party shall accord to investors of another Party treatment no less favourable than that it accords, [in like circumstances], to its own investors [or investors of another state] with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."

certain performance requirements as a condition for the establishment of an investment.[18]

While states sometimes choose to differentiate between the design of the provisions in different treaties and their scope for specific objectives, UNCTAD's analysis notes that international agreements interact with each other and with other bodies of law. Accordingly, policymakers should take into account that commitments made to some treaty partners may easily filter through to others via MFN clauses.[19] States could also face complications arising from inconsistencies in overlapping treaties. Consequently, effective rules that restrict states' behaviour and policies could become unclear, and the host country's administration could have difficulties in determining the substantive obligations in its treatment of foreign investors.[20]

States ought to consider the implications of "employment clauses" on certain performance requirements linked to local employment. Some investment treaties include broad employment clauses that guarantee the foreign investor the right to employ staff of the nationality of its choice without interference from the host state.[21]

Furthermore, national treatment obligations under investment treaties would require that foreign investors be treated no worse than domestic investors in like circumstances. Performance requirements could be challenged if they are imposed only on foreign investments and investors.

18 http://www.sice.oas.org/dictionary/IN_e.asp. Pre-establishment rights are rarely granted without exceptions since every country has sensitive sectors where foreign investment is not permitted. Parties to a trade or investment agreement usually list a number of measures (for example, laws and regulations) or entire sectors where pre-establishment rights (free entry of investments and investors) do not apply.

19 UNCTAD, *Investment Policy Framework for Sustainable Development*, p. 39.

20 See Chaisse and Hamanaka (2014), p. 14.

21 See Nikièma (2014), p. 12.

When states opt for including clauses prohibiting performance requirements in their investment treaties, they usually choose to preserve a certain level of flexibility through exceptions that allow them to maintain and amend so-called "non-conforming measures" that were in place at the time of the treaty's entry into force (see Annex 4.2 for an example: Article 1108 of the North American Free Trade Agreement (NAFTA)). This would require a capacity to identify and include such measures as exceptions under the treaty. This approach does not necessarily cover the non-conforming measures that are adopted after the treaty's entry into force, except if it explicitly identifies future measures in which regulatory discretion will be maintained.

It is also worth noting that in an ISDS case, the tribunal could always elect to question whether a certain measure falls under the scope of the non-conforming measures listed in the agreement, thus effectively reducing the scope of the reservation taken by the state (see, in the following section, more details on such an approach undertaken by the tribunal in the case *Mobil v. Canada*). Accordingly, states would always face the risk of losing the safeguard they intended to establish through the exception/reservation[22] on non-conforming measures due to the interpretative approach adopted by a future tribunal.[23]

Movements towards broader prohibitions on performance requirements

Since NAFTA, which entered into force in 1994, trade and investment agreements by the United States and Canada have contained provisions limiting the use of performance

22 The terms "exceptions" and "reservations" are often used in provisions attempting to exclude non-conforming measures from the scope of application of treaty standards.

23 See Genest (2014) and Nikièma (2014).

requirements (see Annex 4.2 for examples of provisions addressing performance requirements in the US–CAFTA-DR agreement; Japan-Mexico FTA; Canada-Croatia bilateral investment treaty).[24] Out of the 20 US FTAs that are currently in force, each includes provisions on prohibition of performance requirements under the investment chapter, except for the agreements with Bahrain and Jordan that do not include provisions on investment.[25] Other agreements by Asian countries have included similar provisions (see Annex 4.2 for an example: India-Singapore FTA, Article 6.23).

UNCTAD's *World Investment Report 2014* notes that increasingly treaties are expanding to include elements of liberalization and prohibition of certain types of government conduct previously unregulated in investment treaties, including prohibitions on additional performance requirements.[26] Indeed, the prohibitions on performance requirements under investment agreements are usually much broader than those established by the TRIMs Agreement under the WTO. It can be noted that investment rules under free trade agreements concluded by the European Union in recent years, such as under the EU-Canada FTA concluded in 2014 (also known as Comprehensive Economic and Trade Agreement (CETA)), have cast a wide net on a number of performance requirements that were not covered under the NAFTA model, such as requirements related to joint ventures, local minimum equity requirement/maximum foreign limit, entry quotas, minimum/maximum number of employees, and total number of firms or employees in a sector (for more details, and for a comparison with prohibitions under other agreements, see Table 4.1).

24 For more details, see: International Institute for Sustainable Development, *Investment Treaties and Why They Matter to Sustainable Development*, p. 28.

25 See Nikièma (2014), p. 9. See also Genest (2014), p. 8.

26 See UNCTAD, *World Investment Report 2014*, p. 118.

Table 4.1: Scope of prohibitions on performance requirements in investment treaties

Prohibitions on:	TRIMs Agreement	NAFTA (1994)	India-Singapore (2005)	ASEAN (2009)	US-Korea (2012)	EU-Canada (2014)
Export restriction	●		●	●		●
Local content	●	●	●	●	●	●
Export-import balance	●	●	●	●	●	●
Export requirement	●	●			●	●
Restriction on sales	●	●			●	●
Local management		●	●	●	●	●
Headquarters						●
Research and development requirement		●				●
Technology transfer		●			●	●
Exclusive supply		●			●	●
Joint venture requirement						●
Local minimum equity requirement/ maximum foreign limit						●
Monopoly company						●
Entry quotas of any kind						●
Numerical quotas in sectors of any kind						●
Minimum/ maximum number of employees						●
Total number of firms or employees in a sector						●

Source: Shintaro Hamanaka; Asian Development Bank 2013 – referenced by Howard Mann, presentation at 8th Annual Forum of Developing Country Investment Negotiators organized by the South Centre and IISD, 5-7 November 2014 in Montreux, Switzerland. The column on the TRIMs Agreement added by the authors.

V. Investor-State Dispute Settlement Cases Concerning Performance Requirements

Increasingly, investors are challenging governmental measures by alleging that they represent performance requirements prohibited under investment treaty protections.

Two recent cases that involved performance requirements, *Lemire v. Ukraine* (2010) and *Mobil v. Canada* (2012), have produced contradictory interpretations and outcomes with respect to the alleged violations of performance requirement prohibitions.

Consequently, these cases raise issues pertaining to the predictability of international investment law.[27] The decisions by the arbitral tribunals also exhibited significantly different approaches to state sovereignty and investors' rights. Moreover, the case of *Mobil v. Canada* demonstrated how the interpretative approach adopted by arbitral tribunals could effectively limit reservations adopted by states to carve out certain measures from the scope of prohibitions on performance requirements (specifically the exception under Article 1108 of NAFTA).[28]

Details of the the two cases, in addition to others which also deal with performance requirements, are included in Table 4.2.

27 Genest (2014), p. 4.
28 Id., p. 4.

Table 4.2: ISDS cases challenging performance requirements

Explanatory note: The table presents summary information on ISDS cases related to performance requirements. The authors referred to IAReporter and Public Citizen's reviews of the cases. Other sources used are referenced in the footnotes.

Parties to the dispute	Arbitration rules	Treaty basis of the claim	Arguments by the claimants and findings by the tribunal
Archer Daniels Midland (ADM) & Tate & Lyle Ingredients Americas (TLIA) v. Mexico	ICSID No. ARB(AF)/04 /5 (Case registered in 2004. Award rendered in 2007.)	Chapter 11 of NAFTA	— The claimants challenged a new tax (31 December 2001) of 20% that was approved by the Mexican Congress on soft drinks and syrups sweetened with sweeteners other than sugar. — The tax was repealed by Mexico at the outset of 2001 in order to comply with a WTO ruling in a case initiated against Mexico by the US government. However, ADM and TLIA persisted with their NAFTA Chapter 11 claim, seeking damages for losses during the period when the tax was in effect.[29] — Mexico[30] was found to have discriminated against a joint venture, ALMEX, owned by ADM and TLIA, and to have imposed impermissible "performance requirements" to the detriment of that joint venture. The ICSID tribunal awarded the claimants $33.5 million.

29 As part of this strategy, the claimants asked the ICSID tribunal for a supplementary decision – which would provide for further compensation. The claimants also filed an application with a Canadian court seeking the same objective.

30 Mexico argued that it could not be held responsible for any such breaches given that the tax measure in dispute was a legitimate "countermeasure" under customary international law, and imposed in response to a breach by the US government of its obligations under Chapter 20 of NAFTA (Mexico accused the US of blocking its efforts to convene a Chapter 20 state-to-state dispute tribunal to evaluate alleged US violations of NAFTA). Source: Luke Eric Peterson, "Award in ADM & TLIA v. Mexico Finds Discrimination and Imposition of Performance Requirements, But No Expropriation", IAReporter, 16 July 2008.

Mobil Investments Canada Inc and Murphy Oil Corporation v. Canada [31]	ICSID's Additional Facility rules No. ARB(AF) /07/4 (Proceedings commenced in November 2007.)	Chapter 11 of NAFTA	— The claimants had argued that measures adopted by the Canadian province of Newfoundland under a 2004 set of guidelines, obliging them to invest a minimum amount in research and development activities within the province, constituted performance requirements in violation of Article 1106 of NAFTA. [32] — Canada contended that the new obligations were merely part of longstanding obligations exempted under Article 1108, by means of a "grandfathering" reservation that Canada entered under NAFTA at its commencement in 1994. [33] — Moreover, Canada contended that research and development activities did not constitute "services", and so Article 1106 did not apply in that case. The tribunal determined that, while Article 1106 did not expressly refer to research and development and education and training in the list of prohibited requirements, the ordinary meaning of the term "services" used in Article 1106.1 was broad enough to encompass research and development and education and training.[34] — The tribunal held that the guidelines were not covered by the reservation under Article 1108. — The liability award was decided in May 2012,[35] in which the tribunal's majority

31 Copies of the case's legal documents are available at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/mobil.aspx?lang=eng

32 Source: Jarrod Hepburn, "Mobil v. Canada Award Sets High Bar for NAFTA Art. 1105 Breach and Offers Reading of Performance Requirements Rules", IAReporter, 22 November 2012.

33 Id.

34 UNCTAD, "Recent Developments in Investor-State Dispute Settlement (ISDS)", IIA Issues Note No. 1 (May 2013).

35 The calculation of the compensation was not undertaken until 2015. The tribunal calculated the losses of the investors since the promulgation of the guidelines in 2004, awarding C$13.9 million to Mobil and C$3.4 million to Murphy (source: IAReporter).

			ruling of 22 May 2012 found Canada responsible for breaching NAFTA's provisions on performance requirements in Article 1106. — A dissenting opinion by arbitrator Philippe Sands considered that the guidelines constituted subordinate measures to relevant legislation listed in Canada's reservation, making the guidelines therefore part of the measures covered by the reservation. Sands recognized that these expenditure requirements constituted "matters of considerable national interest" and "matters of considerable significance and sensitivity in the relations between Newfoundland and Labrador and Canada".[36]
Lemire v. Ukraine	ICSID No. ARB/06/18 (Decision on jurisdiction and liability rendered in 2010.)	US-Ukraine BIT	— The claimant alleged that Article 9.1 of a 2006 Law on Television and Radio Broadcasting in Ukraine imposed a local content requirement to the effect that 50% of the broadcasting time of each radio organization had to consist of music produced in Ukraine ("music produced in Ukraine" being any music where the author, composer, or performer is Ukrainian). — The tribunal considered the object and purpose of Article II.6 of the US-Ukraine BIT[37] (on performance requirements) based on the preamble of the agreement, which states that the BIT aims to "promote greater economic cooperation". The tribunal determined that the object and purpose of Article II.6 was to avoid imposition by states of "local content requirements as a protection of local industries against competing imports".[38]

36 See Genest (2014).

37 Article II.6 of the US-Ukraine BIT provides for the following: "Neither Party shall impose performance requirements as a condition of establishment, expansion, or maintenance of investments, which require or enforce commitments to export goods produced, or which specify that goods and services must be purchased locally, or which impose any other similar requirements."

38 See Genest (2014), p. 12.

			— The tribunal provided that Article 9.1 of the 2006 Law did not specifically impose that goods and services be purchased locally and at its face did not fall under measures prohibited by Article II.6 of the BIT. The tribunal considered that Ukraine intended to promote the country's cultural heritage and not to protect local industries and restrict imports. [39]
Mesa Power Group LLC v. Canada (2011)	UNCITRAL, Permanent Court of Arbitration Case No. 2012-17	NAFTA	— The dispute concerns Ontario's 2009 Green Energy Act, a part of the Canadian province's climate change initiative. The Act is intended to boost renewable energy production and promote job growth in the green energy sector. — Mesa's complaint centres on the Act's Feed-In Tariff Program (FIT Program), which is administered by the Ontario Power Authority (OPA), a state enterprise owned and controlled by Ontario. Under the FIT Program, OPA procures renewable energy through long-term purchase contracts with renewable energy producers. Under these power purchase agreements, wind producers selected by OPA are entitled to benefit from a preferential tariff rate fixed for a 20-year term, and guaranteed grid access for their energy production. — The Texas-based claimant complains that the design and implementation of the renewable energy programme by the Province of Ontario violate multiple provisions of NAFTA. Mesa brought the case for arbitration after its subsidiaries had applied for, but were not awarded, various 20-year fixed-price FIT contracts to sell renewable energy into the Canadian grid. [40]

39 Id.
40 Source: Lise Johnson, "Analysis: In Mesa v. Canada, focus is laid on less used performance requirements and procurement provisions, and relevance of recent WTO ruling against Canada" and "In New Filing, US Investor Alleges that Favourable Canadian Energy Pact Granted to a Korean Consortium Breaches NAFTA Chapter 11", IAReporter, 9 July 2014.

			— Mesa argues that Canada's local content requirements – which condition holders of FIT contracts to source a certain percentage of their equipment from local manufacturers – plainly violate the NAFTA Article 1106 restrictions on performance requirements, and cause Mesa to incur costs and burdens it could have avoided if allowed to freely source goods from any supplier it chose. — Mesa has also enlisted support from recent WTO case law finding that the local content mandates in Canada's FIT Program violate similar restrictions on performance requirements found in the General Agreement on Tariffs and Trade (GATT) and the TRIMs Agreement. [41]
Ethyl v. Canada	UNCITRAL	Chapter 11 of NAFTA	— The case concerned a ban undertaken by Canada in April 1997 on the import and inter-provincial transport of methylcyclopentadienyl manganese tricarbonyl (MMT), an anti-knocking agent used to improve engine performance, due to its potential hazards to human health and the environment. — Among other allegations raised by the corporation, it argued that the ban was a "performance requirement" seeking to regulate how a foreign investor operated, which is forbidden under NAFTA Article 1106. The company's logic underlying the performance requirement claim was that the law would effectively require Ethyl to build a factory in every Canadian province to comply with the transport ban if it sought to make an MMT investment in Canada. — The dispute was settled between the claimant and Canada shortly after the NAFTA panel rejected Canada's jurisdictional claims.

41 In a December 2012 decision, a WTO panel concluded that Canada's measures violated the GATT and the TRIMs Agreement. In the WTO case, Japan and the EU argued that the domestic content requirements of Ontario's FIT Program violated the national treatment obligations of the GATT and restrictions on performance requirements in the TRIMs Agreement. As part of its defence, Canada had asserted that its measures were covered by the GATT's government procurement exception, which is contained in Article III:8 of that treaty. (Source: IAReporter)

			— Canada reversed its ban on MMT, paid $13 million in legal fees and damages to Ethyl, and issued a statement for Ethyl's use in advertising, declaring that "current scientific information" did not demonstrate MMT's toxicity nor that MMT impairs functioning of automotive diagnostic systems.[42]

VI. Conclusions

This chapter has explored recent trends in investment treaty rules on performance requirements, and touched on rules pertaining to trade-related investment measures under the WTO. Such rules exhibit trends which will severely limit the ability of developing countries to manage and channel investment flows to support their industrial development objectives.

The historical record indicates that foreign investment flows are not inherently a positive influence for industrial development, and that performance requirements are indispensable to obtaining benefits from foreign investment.

The increasing incidence of enforceable disciplines limiting or prohibiting the use of performance requirements must be resisted and reversed, given that they negate the very reason developing countries seek foreign investment in the first place.

42 Public Citizen, "NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement", February 2005.

Annex 4.1: Prohibited TRIMs Contained under the TRIMs Agreement Illustrative List

Para. 1(a)	Local content requirements	The purchase or use by an enterprise of products of domestic origin or from any domestic source	Internal measure in violation of GATT Article III (national treatment)
Para. 1(b)	Trade balancing requirements	An enterprise's purchase or use of imported products is limited to an amount related to the volume or value of local products that it exports	Internal measure in violation of GATT Article III (national treatment)
Para. 2(a)	Import restrictions generally Trade balancing requirements	General import restrictions related to a product used in local production Import restrictions related to the enterprise's volume or value of local production that it exports	Border measure in violation of GATT Article XI (quantitative restrictions)
Para. 2(b)	Foreign exchange balancing requirements	Measures that restrict an enterprise's access to foreign exchange for imports to an amount related to the foreign exchange inflows attributable to the enterprise	Border measure in violation of GATT Article XI (quantitative restrictions)
Para. 2(c)	Domestic sales requirements	The exportation of products is restricted in terms of particular products, volume, or value of products or volume or value of local production	Border measure in violation of GATT Article XI (quantitative restrictions)

Source: UNCTAD (2007)

Annex 4.2: Examples of Articles in International Investment Agreements and FTA Investment Chapters Prohibiting Performance Requirements

Article 8.1 of US model BIT

"Neither Party may, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any requirement or enforce any commitment or undertaking:

(a) to export a given level or percentage of goods or services;
(b) to achieve a given level or percentage of domestic content;
(c) to purchase, use, or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory;
(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
(e) to restrict sales of goods or services in its territory that such investment produces or supplies by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
(f) to transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory;
(g) to supply exclusively from the territory of the Party the goods that such investment produces or the services that it supplies to a specific regional market or to the world market; or
(h) (i) to purchase, use, or accord a preference to, in its territory, technology of the Party or of persons of the Party; or
(ii) that prevents the purchase or use of, or the according of a preference to, in its territory, particular technology,

so as to afford protection on the basis of nationality to its own investors or investments or to technology of the Party or of persons of the Party."

India-Kuwait BIT, Article 4(4) on Protection of Investments (entered into force on 28 June 2003)

"Once established, investment shall not be subjected in the host Contracting State to additional performance requirements which may hinder or restrict their expansion or maintenance or adversely affect or be considered as detrimental to their viability, unless such requirements are deemed vital for reasons of public order, public health or environmental concerns and are enforced by law of general application."

US–CAFTA-DR, Article 10.9

"1. No Party may, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment of an investor of a Party or of a non-Party in its territory, impose or enforce any of the following requirements, or enforce any commitment or undertaking:

(a) to export a given level or percentage of goods or services;
(b) to achieve a given level or percentage of domestic content;
(c) to purchase, use, or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory;
(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
(e) to restrict sales of goods or services in its territory that such investment produces or supplies by relating such sales in

any way to the volume or value of its exports or foreign exchange earnings;

(f) to transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory; or

(g) to supply exclusively from the territory of the Party the goods that such investment produces or the services that it supplies to a specific regional market or to the world market.

2. No Party may condition the receipt or continued receipt of an advantage, in connection with the establishment, acquisition, expansion, management, conduct, operation, or sale or other disposition of an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:

(a) to achieve a given level or percentage of domestic content;

(b) to purchase, use, or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory;

(c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or

(d) to restrict sales of goods or services in its territory that such investment produces or supplies by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

3. (a) Nothing in paragraph 2 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, 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.

(b) Paragraph 1(f) does not apply:

(i) when a Party authorizes use of an intellectual property right in accordance with Article 31 of the TRIPS Agreement, or to measures requiring the disclosure of proprietary information that fall within the scope of, and are consistent with, Article 39 of the TRIPS Agreement; or

(ii) when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal, or competition authority to remedy a practice determined after judicial or administrative process to be anticompetitive under the Party's competition laws.

(c) Provided that such measures are not applied in an arbitrary or unjustifiable manner, and provided that such measures do not constitute a disguised restriction on international trade or investment, paragraphs 1(b), (c), and (f), and 2(a) and (b), shall not be construed to prevent a Party from adopting or maintaining measures, including environmental measures:

(i) necessary to secure compliance with laws and regulations that are not inconsistent with this Agreement;

(ii) necessary to protect human, animal, or plant life or health; or

(iii) related to the conservation of living or non-living exhaustible natural resources.

(d) Paragraphs 1(a), (b), and (c), and 2(a) and (b), do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs.

(e) Paragraphs 1(b), (c), (f), and (g), and 2(a) and (b), do not apply to procurement.

(f) Paragraphs 2(a) and (b) do not apply to requirements imposed by an importing Party relating to the content

of goods necessary to qualify for preferential tariffs or preferential quotas.

4. For greater certainty, paragraphs 1 and 2 do not apply to any requirement other than the requirements set out in those paragraphs.

5. This Article does not preclude enforcement of any commitment, undertaking, or requirement between private parties, where a Party did not impose or require the commitment, undertaking, or requirement."

India-Singapore FTA, Article 6.23

"The Parties reaffirm their commitments to WTO Agreement on Trade-Related Investment Measures ('TRIMs') and hereby incorporate the provisions of TRIMs, as may be amended from time to time, as part of this Agreement."

Japan-Mexico FTA, Article 65 (signed 17 September 2004; entered into force 1 April 2005)

"1. Neither Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its Area:

(a) to export a given level or percentage of goods or services;
(b) to achieve a given level or percentage of domestic content;
(c) to purchase, use or accord a preference to goods produced or services provided in its Area, or to purchase goods or services from persons in its Area;

(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
(e) to restrict sales of goods or services in its Area that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
(f) to transfer technology, a production process or other proprietary knowledge to a person in its Area, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with multilateral agreements in respect of protection of intellectual property rights. A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with this paragraph. For greater certainty, Articles 58 and 59 shall apply to the measure; or
(g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

2. Neither Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its Area of an investor of a Party or of a non-Party, on compliance with any of the following requirements:

(a) to achieve a given level or percentage of domestic content;
(b) to purchase, use or accord a preference to goods produced in its Area, or to purchase goods from producers in its Area;
(c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or

(d) to restrict sales of goods or services in its Area that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

3. Nothing in paragraph 2 above shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its Area of an investor of a Party or of a non-Party, on compliance with a requirement to:

(a) locate production;
(b) provide a service;
(c) train or employ workers;
(d) construct or expand particular facilities; or
(e) carry out research and development

in its Area.

4. Paragraphs 1 and 2 above shall not apply to any requirement other than the requirements set out in those paragraphs.

5. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment activities, nothing in subparagraph 1(b) or (c) or 2(a) or (b) above shall be construed to prevent any Party from adopting or maintaining measures:

(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
(b) necessary to protect human, animal or plant life or health; or

(c) necessary for the conservation of living or nonliving exhaustible natural resources."

Canada-Croatia BIT, Article VI

"Neither Contracting Party may impose any of the following requirements in connection with permitting the establishment or acquisition of an investment or enforce any of the following requirements in connection with the subsequent regulation of that investment:

(a) to export a given level or percentage of goods;
(b) to achieve a given level or percentage of domestic content;
(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
(e) to transfer technology, a production process or other proprietary knowledge to a person in its territory unaffiliated with the transferor, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority, either to remedy an alleged violation of competition laws or acting in a manner not inconsistent with other provisions of this Agreement."

NAFTA, Article 1106: Performance Requirements

"1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion,

management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:

(a) to export a given level or percentage of goods or services;
(b) to achieve a given level or percentage of domestic content;
(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
(d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
(e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
(f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
(g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.

2. A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 and 1103 apply to the measure.

3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory

of an investor of a Party or of a non-Party, on compliance with any of the following requirements:

(a) to achieve a given level or percentage of domestic content;
(b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
(c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
(d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.

5. Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:

(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
(b) necessary to protect human, animal or plant life or health; or
(c) necessary for the conservation of living or non-living exhaustible natural resources."

NAFTA, Article 1107: Senior Management and Boards of Directors

"1. No Party may require that an enterprise of that Party that is an investment of an investor of another Party appoint to senior management positions individuals of any particular nationality.

2. A Party may require that a majority of the board of directors, or any committee thereof, of an enterprise of that Party that is an investment of an investor of another Party, be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment."

NAFTA, Article 1108: Reservations and Exceptions

"1. Articles 1102, 1103, 1106 and 1107 do not apply to:
(a) any existing non-conforming measure that is maintained by
(i) a Party at the federal level, as set out in its Schedule to Annex I or III,
(ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or
(iii) a local government;

(b) the continuation or prompt renewal of any non-conforming measure referred to in subparagraph (a); or
(c) an amendment to any non-conforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.

2. Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing nonconforming measure maintained by a state or province, not including a local government.

3. Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.

4. No Party may, under any measure adopted after the date of entry into force of this Agreement and covered by its Schedule to Annex II, require an investor of another Party, by reason of its nationality, to sell or otherwise dispose of an investment existing at the time the measure becomes effective.

5. Articles 1102 and 1103 do not apply to any measure that is an exception to, or derogation from, the obligations under Article 1703 (Intellectual Property National Treatment) as specifically provided for in that Article.

6. Article 1103 does not apply to treatment accorded by a Party pursuant to agreements, or with respect to sectors, set out in its Schedule to Annex IV.

7. Articles 1102, 1103 and 1107 do not apply to:
(a) procurement by a Party or a state enterprise; or
(b) subsidies or grants provided by a Party or a state enterprise,

including government supported loans, guarantees and insurance.

8. The provisions of:
(a) Article 1106(1)(a), (b) and (c), and (3)(a) and (b) do not apply to qualification requirements for goods or services with respect to export promotion and foreign aid programs;
(b) Article 1106(1)(b), (c), (f) and (g), and (3)(a) and (b) do not apply to procurement by a Party or a state enterprise; and
(c) Article 1106(3)(a) and (b) do not apply to requirements imposed by an importing Party relating to the content of goods necessary to qualify for preferential tariffs or preferential quotas."

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Chapter 5

Rethinking Investment-Related Dispute Settlement

Nathalie Bernasconi-Osterwalder

I. Introduction

Investors are increasingly turning to investor-state arbitration to challenge a wide range of government measures, including laws, regulations and administrative decisions in all economic sectors. Less than 20 years ago this form of dispute settlement between foreign investors and host states was rarely used. Now it is used frequently, and the number of cases is increasing rapidly. It is not that states have embraced arbitration. Rather, it is the investors (and their lawyers) who discovered a dormant legal tool that was elaborated in the 1980s in the early investment treaties, which included a provision allowing for disputes between the host state and the investor of the home state to be resolved in international arbitration. After the first known tribunal accepted jurisdiction under such an investment treaty provision in 1990,[1] it has become common for subsequent tribunals to accept jurisdiction, and by 2013 investors are known to have brought 568 cases (the number

1 *Asian Agricultural Products Ltd. v. Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Final Award, 27 June 1990. Retrieved from http://www.italaw.com/sites/default/files/case-documents/ita1034.pdf.

of actual cases is likely to be significantly higher).[2] By 2014, a total of 98 states across the globe have faced claims launched against them based on treaties signed in an era when treaty-based investment arbitration was largely unknown.[3]

Many states arguably did not anticipate that the treaties would lead to the number and variety of claims brought based on a clause allowing any investor of the other state parties to bring a claim under the relevant treaty. This is highly unusual to the concept of arbitration, which builds on agreement and consent between the parties who are in disagreement about a specific situation or who decide in a specific contract to resolve future disputes arising out of that particular relationship through arbitration. The terms of a treaty, by contrast, are decided and negotiated by states, while the dispute is between one of the treaty parties and an outside party (the investor), unidentified at the time the treaty is signed. Perhaps because states could not predict the manner in which the investor-state provision would be used by existing and future investors (ranging from nuclear companies to bond holders and minority shareholders, among others) to challenge an unpredictable and wide range of measures (including measures to protect public health and the environment, tax measures, supreme court decisions, etc.), the role and structure of investment-related dispute settlement was never properly discussed. This has led to a system shaped through practice, controlled primarily by the claimants (the investors) and their lawyers, and arbitrators.[4] In past years, states have been mainly at the receiving end, more or less condemned to accepting a system that was designed and that evolved without their active involvement, but under which they are exceedingly vulnerable.

2 United Nations Conference on Trade and Development (UNCTAD) (2014, p. 1).

3 UNCTAD (2014, p. 7).

4 See Van Harten (2013) investigating how investment arbitrators have exercised their authority in recent case law.

This state of affairs is rapidly changing, however. Several states, especially emerging and developing economies, want to move into the driver's seat and take part in the scope and design of investment-related dispute settlement. They want to redefine the current rules under which states alone carry obligations and are vulnerable to legal challenges, while investors are granted guarantees without being subject to internationally enforceable obligations. Advanced economies too, particularly in Europe, are now also reassessing the role of investor-state arbitration, its relationship to democratic decision-making and its impact on policy space. We are entering an era of change.

Under the current system, it is typically left to the investor resorting to arbitration against a state to choose the arbitral rules from the options specified in the investment treaty. This impacts whether the arbitration will be conducted in an arbitral institution and, if so, in which one. Under most treaties, investors can bring a claim under the Rules of the International Centre for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Law (UNCITRAL), or other commercial arbitration rules, including those of the International Chamber of Commerce (ICC), the Stockholm Chamber of Commerce (SCC) and the London Court of International Arbitration (LCIA), among others. Cases brought under the UNCITRAL Rules are either conducted on an ad hoc basis or administered by an institution like the Permanent Court of Arbitration (PCA), ICSID or the SCC.[5]

Even those who are not against investor-state dispute settlement in theory have nonetheless expressed concern over how it is conducted in practice, and are calling for reform. Issues of concern include the lack of transparency, questions surrounding the impartiality and independence of arbitrators, the predictability and consistency of interpretation, and the high costs involved,

5 See Bernasconi-Osterwalder and Rosert (2014).

to name a few. Several states, academics, and even practitioners and the private sector are proposing different types of reform to existing rules and institutions, such as ICSID. Some reforms of rules, such as the UNCITRAL Rules, have already begun, with new transparency rules for investor-state dispute settlement[6] and a related draft convention[7] adopted in 2014.[8] Certainly, these reforms are not negligible, and further reforms are to be supported. However, the starting point for these reforms will continue to be based on a system that was not designed to deal with the types of disputes arising today.

A better, parallel approach could be to ask what investment-related dispute settlement mechanisms at the international level should look like if they were to be built anew. This would allow us to go back to basics and ask some fundamental questions, such as: What types of investment-related disputes are amenable to international dispute settlement? What stakeholders should be involved? Under what circumstances? And with a view to what types of remedies? There is a real need to rethink the starting point for engaging international law and international dispute settlement in relation to investment disputes. Foreign and domestic investment alike can create distinct relationships between the investor or investment and the government, the investment and the local community, the government and the local community, and individual relationships between the investment and local people employed by or living in the vicinity of the investment. These relationships are based on rights, responsibilities and obligations that may run in both directions between the parties involved, not just one. For example, investors owe a number of obligations to the host state, as well as having

6 United Nations Commission on International Trade Law (UNCITRAL) (2014a).
7 UNCITRAL (2014b). See also United Nations Information Service (UNIS) (2014).
8 See earlier work by the International Institute for Sustainable Development (IISD) on the issue of transparency in investor-state arbitration under UNCITRAL Rules: Johnson and Bernasconi-Osterwalder (2013a); Johnson and Bernasconi-Osterwalder (2013b); Bernasconi-Osterwalder (2011).

certain rights in their favour from the state.[9] However, in the current system, the focus is on one singular and uni-directional relationship, namely, that between the investor and the host state, with generally only the investor able to bring a challenge.

There are several ways forward to reform the current system. One way forward consists in reforming the investment treaties themselves through renegotiation or termination, where necessary. A second way forward consists in reforming individual existing processes and institutions. But as mentioned, a parallel, more holistic approach should also be initiated to deal with investment-related disputes in a broader sense.

II. Reforming Existing Governing Structures Through Individual Treaties

Several states have begun modernizing specific provisions of their investment treaties through renegotiation, termination or binding interpretation. Some are replacing their treaties and international dispute settlement through domestic laws and procedures. Others are developing their own investment treaty models with novel elements. These can include:

- Moving the focus away from investor protections to investment promotion for sustainable development
- Excluding or redefining certain substantive obligations (most-favoured-nation (MFN) treatment, fair and equitable treatment (FET), expropriation, etc.)
- Including investor responsibilities and obligations
- Limiting dispute settlement under the treaty to state-state dispute settlement

9 These issues were discussed at an expert meeting held in Montreux in October 2014. For more information see International Institute for Sustainable Development (IISD) (2015).

- Subjecting dispute settlement to specific consent between the investor and the state to resolve a specific dispute
- Focusing on mediation rather than arbitration
- Considering appeals mechanisms

Redefining the substantive obligations in treaties is essential for reform, as these underpin international investment law. But insofar as the treaties continue to rely and build on existing procedural mechanisms for the settlement of disputes, reform will remain incomplete. Improving substance without improving the system that interprets the substance is an incomplete fix. Some amendments to process and dispute settlement can be made through individual investment treaties but the impact may be limited in a bilateral context because it is difficult and sometimes impossible to change existing frameworks, such as ICSID, through a bilateral treaty. Still, from a negotiation perspective, this approach is more feasible, since it is easier for two parties to agree on a way forward, rather than 50, 100, or more, as is the case in multilaterally agreed frameworks like ICSID. For instance, Canada and the United States introduced transparency in investor-state arbitration through their treaties over a decade ago, thereby complementing UNCITRAL and ICSID rules. Yet a bigger impact and broader application was achieved when UNCITRAL adopted its transparency rules applicable to treaty-based investor-state arbitration, which require access to information and hearings. Furthermore, an important opportunity for multilateral change is now possible through the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration, which opened for signature in March 2015.[10] This treaty will extend the reach of the transparency standards under the UNCITRAL transparency

10 UNIS (2014).

rules to any investor-state arbitration under pre-existing treaties, whether or not initiated under UNCITRAL Rules.[11]

While bilaterally agreed reforms may be easier than multilateral agreements, they are not without their challenges. This is exemplified by the European Union's attempt to address the problem of inconsistencies and contradictions in the interpretation of key concepts by investment tribunals through a new appellate system. In its most recent and ongoing negotiations with other countries, the European Union has included explicit provisions on a possible appellate mechanism under which arbitral decisions could be challenged and rectified. The United States had also included similar provisions in past treaties. However, the US provisions were never implemented, and it is unclear when, if and how the European Union will implement its own provisions. The problem the European Union is facing, along with all other states who recognize the need for some type of appellate process, is that the current arbitration rules and structures, such as ICSID, UNCITRAL, or the New York Convention, are not equipped or designed to accommodate an appellate mechanism. Unlike the regular arbitration system, the appellate system is not readily available by simple reference and needs to be established first. Unfortunately, instead of setting up a workable process first, the European Union has decided to move ahead with the current arbitration system as it tries to fix

11 The UNCITRAL Transparency Rules are an integral part of any UNCITRAL arbitration proceeding initiated under an investment treaty concluded on or after 1 April 2014, the date when the UNCITRAL Transparency Rules came into effect. However, for treaties concluded before that date, the states or disputing parties need to "opt in" to the new transparency rules for them to apply. To facilitate the opt-in process, UNCITRAL adopted a convention under which states commit to applying the new UNCITRAL Rules on Transparency to *all* treaty-based investor-state arbitrations under treaties concluded before 1 April 2014, even when those treaties do not refer to the UNCITRAL Arbitration Rules. On 10 December 2014, the UN General Assembly adopted and authorized the opening for signature of the convention at a ceremony in Port Louis, Mauritius, on 17 March 2015.

the problems identified.[12] This further solidifies a flawed system, rather than promoting reform.

III. Reforming Governing Arbitration Rules and Processes

A further option is to reform the institutions and processes to which the treaties refer. The impact would be greater because reforms could apply across the board to all the relationships arising even under existing treaties, as will be the case with the UNCITRAL transparency convention. However, this reform process carries its own challenges.

At ICSID, UNCITRAL and the PCA, the governing bodies are composed of the institutions' respective contracting state parties or member states. Where a state is not satisfied with the applicable arbitral rules and processes, it will have different degrees of influence for change depending on the target institution. The three intergovernmental institutions arguably provide the best opportunities due to their structures, though each forum presents its own challenges and limitations. Although significant reforms of the ICSID rules were in fact achieved in 2006, it might be difficult to move ICSID towards further reform, given its extensive state membership. The impact of reforms would be rather limited at the PCA given that it most often acts merely as an administrator of investment arbitrations conducted under UNCITRAL Rules. UNCITRAL, on the other hand, offers opportunities to reform its rules, but its absence from an administrative function in investment arbitration makes it less opportune to push for institutional changes, such as creating an appellate mechanism, for example.

12 See, for example, Chapter 10, Section 6, of the current text of the Comprehensive Economic and Trade Agreement between the European Union and Canada (CETA), available at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

ICSID unites the rule-making and administrative functions and therefore provides the best opportunities for reform at both levels. However, focusing on reform only at ICSID might limit opportunities to "think outside the box" given the extent to which ICSID is already engrained in how investment arbitration functions today. It is worth noting that, despite the governmental structures of ICSID, UNCITRAL and the PCA, the influence of private practitioners, arbitrators, arbitration associations and "experts" in the revision processes is significant. These stakeholders may have incentives to maintain the status quo, due to their business models. The remaining arbitral institutions (SCC, ICC, LCIA and the Cairo Regional Centre for International Commercial Arbitration (CRCICA)) are governed by private bodies (in most cases boards) that are composed of individuals from the private sector such as directors of private companies, private lawyers, arbitrators or professors. States' influence and state considerations will be less important in these contexts.

Despite these challenges, there are at least three potential areas for reform in existing processes and institutions, some of which have been alluded to earlier: transparency, arbitrator independence and impartiality, and consistency and correctness of awards.

In terms of transparency, progress has been made in some areas, but much remains to be done. Investment arbitration proceedings are typically not public and can remain secret from beginning to end, depending on the applicable arbitration rules. While some states have supplemented those rules through treaties, most treaties remain silent on transparency. The reformed 2006 ICSID Arbitration Rules include the obligation to register all new disputes, to publish the outcome and legal reasoning of the award and to set up a process to allow for *amicus curiae* submissions. While this was an important step, the progress on transparency remains incomplete. The 2014 UNCITRAL Rules on Transparency in Treaty-based Investor-

State Arbitration provide for more openness throughout the proceedings.[13] They already apply to UNCITRAL arbitrations under treaties concluded after the Transparency Rules came into effect, and each state can extend their application to *all* of its treaty-based investment arbitrations by adopting the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration. All other arbitration rules remain secretive, although many have been revised recently (for example, the SCC in 2010, and the ICC and PCA in 2012). They continue to emphasize confidentiality, while disregarding the public interest at stake. The main reform opportunity for states to promote transparency in investment arbitration lies in adopting the transparency convention.

The perceived lack of arbitrator independence has become another major subject of criticism of the current investment arbitration system. Disputing parties in investment treaty arbitration typically appoint their own arbitrators, and the president is either chosen by the arbitrators, by the disputing parties themselves, or, failing agreement, by an appointing authority (such as the President of the World Bank (traditionally a US citizen) or the PCA Secretary-General (traditionally a Dutch citizen)). This system raises the question whether arbitrators can be truly impartial or independent. Supposedly, a party will select a particular arbitrator because of his or her likeliness to rule in this party's favour. Even if the arbitrator is not actually biased, there remains an appearance of partiality. The same entities and persons responsible for designating the president of a tribunal are also in charge of deciding on the possible disqualification of an arbitrator who may be challenged by a disputing party with respect to impartiality or independence concerns or other reasons. This seems highly problematic because the deciding arbitrators might themselves be challenged in the future, and

13 UNCITRAL (2014a); Johnson and Bernasconi-Osterwalder (2013a); Johnson and Bernasconi-Osterwalder (2013b).

might therefore be influenced by personal considerations when deciding the challenge. The option of having an organ consisting of several persons decide on the challenge, when those persons are appointed by business representatives and include mostly arbitrators and practitioners, seems equally inadequate for disputes involving states and public interest issues. The standards applicable in the various rules for deciding a challenge are broad enough to allow for ample interpretation by the person or entity deciding the challenge, which is why it is integral that the decision maker him- or herself be impartial and independent.

Another issue of concern is that arbitrators sitting on investor-state tribunals can simultaneously serve as counsel or expert in other such disputes (the "dual role" or "multiple hat" issue). None of the arbitration rules relating to arbitrator independence or arbitration institutions explicitly disallow arbitrators from simultaneously making investor-state arbitration their main economic activity as counsel. The combination of "flexible" rules on arbitrator challenges and leaving the decision making to persons who may themselves wear multiple hats does not seem to promote impartiality and independence. One alternative is to introduce a tenured roster of permanent arbitrators. Another is to have institutions appoint all arbitrators and to disallow arbitrators from also serving as counsel in investment treaty arbitrations for a certain period of time. Here, appointing institutions and their members should first be required to fulfil standards of independence, representativeness, accountability, etc. Finally, another approach would be to move away from arbitration towards a more judicialized system of tenured judges or decision makers.[14]

Finally, investor-state arbitration provides governments with minimal avenues for challenging awards and resisting their

14 See Van Harten (2007) outlining a detailed proposal and justification for an international investment court.

enforcement in case of errors of law or fact. Both the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention") and the 1965 ICSID Convention give arbitral awards the force of finality, providing for only limited review opportunities. This is not adequate when considering the public policy issues often at stake and the high amounts claimed. The limited scope of review of awards also leads to inconsistency in the interpretation of the law.

In terms of reform opportunities, given that ICSID already has a kind of internal review process in the form of annulment, ICSID might be most open and best-placed for a discussion on expanding the annulment process to a proper appeals process.[15] However, should states prefer deeper reform of dispute settlement in the area of investment, the idea of an appeals process might better be discussed outside pre-existing arbitration frameworks, especially if they wish to move away from an arbitration-based system to a more judicial type of dispute settlement.

IV. Thinking Outside the Box: Reform Through New Processes and Mechanisms

While working towards reform on different tracks is important, there is also a need for new thinking and exploring alternative models for settling investment disputes at the international level to supplement or replace the existing mechanisms. Given the wide range of relationships and stakeholders involved in or affected by investment activities, a new mechanism should go beyond resolving disputes involving state actors, or investors and states, and extend to other stakeholders, such as individuals and communities. The systems in place, such as the International Court of Justice (ICJ) or arbitration tribunals under ICSID,

15 The possibility of an ICSID Appeals Facility was discussed in 2004 with the involvement of the ICSID Secretariat. See ICSID Secretariat (2004) and Mann, Cosbey, Peterson and von Moltke (2004).

UNCITRAL or other arbitration rules, are not designed to meet this objective of broad access.

A new mechanism could ensure not only broad access to justice, but its function could also be more multifaceted. For example, it could set up a wider range of "services," such as mediation and conciliation. Mediation would differ from what is currently referenced in some investment treaties, which typically foresee mediation between the state and investor.[16] A new mechanism could propose a mediation process involving a wider range of stakeholders, including communities affected by the investment, for instance. Beyond mediation, a newly created mechanism could also incorporate an investigation and fact-finding function, inspired by existing processes such as the inspection panels known in some of the development banks.

Further, moving away from the arbitration approach adhered to in the majority of investment treaties, a new mechanism could set up a judicial or quasi-judicial process, modelled on and inspired by different existing processes such as the ICJ, the dispute settlement system of the World Trade Organization, the International Criminal Court, or the regional human rights courts, to name just a few. This would help address some of the problems discussed above, such as arbitrator independence and predictability.[17]

An investment dispute resolution facility would not necessarily have to be linked to a certain body of substantive law. Like at the ICJ, jurisdiction could be based on a specific agreement amongst all the parties involved to submit a given dispute to the international dispute resolution facility. Unlike in the ICJ, personal jurisdiction would be broader and could be based on agreement to resolve a dispute amongst states, investors,

16 In this context, see International Bar Association (2012), the IBA Rules for Investor-State Mediation.

17 Global Arbitration Review (2015).

individuals, local communities and other interested groups. In addition, jurisdiction could be based on a treaty, contract or other instrument. Instruments such as investment contracts and treaties, community development agreements, or any future binding instrument on business and human rights, for instance, could refer disputes to such a dispute resolution facility.

Different alternatives for financing such a mechanism would have to be explored with contributions from states, the private sector, or both. In particular, it would be important to guarantee access to justice for all, including the most disadvantaged.

V. Conclusion

There is a growing consensus that the current system of investment arbitration is flawed and needs to be "fixed" or redesigned. One way forward is through renegotiation or termination of the investment treaties that contain state consent to investment arbitration. Another option is to reform the arbitration rules that apply to the disputes. Both approaches build on an existing framework that developed decades ago without much debate or discussion. In this context, this chapter identifies some areas for reform, but concludes that the opportunities to redesign investment-related dispute settlement remain limited. As a third option, this chapter proposes to go further and think outside the box, by asking, "What should investment-related dispute settlement look like if we were to start anew?" This would allow designing a system that would be more responsive to the range of today's complexities, interests and needs. It could be developed parallel to the reforms taking place elsewhere, and result in providing innovative alternatives to resolve investment-related disputes in the future, reaching beyond the existing state-state and investor-state arbitration models to extend to more judicialized mechanisms open to other actors, such as individuals and communities affected by investment activities.

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Chapter 6

Gender Issues and the Reform of Investment Liberalization, IIAs and BITs

Mariama Williams

Undeniably, the rising epidemic of investor-state dispute settlement cases is creating a great deal of discomfort for many developing countries' governments, who are exposed to high losses arising from the cost of defending themselves in such suits as well as the exorbitant awards granted to foreign investors. This raises serious questions about the benefits of foreign investment as a contributor to development, returning the discussion once again to a debate that used to preoccupy many development economists: the role of foreign capital in the development process. Underlying this debate in the contemporary era are issues about: the right to development, governmental measures, and the right to regulate both for promoting economic development as well as in the public interest, whether this is on the grounds of basic public health concerns or involves wider social development issues, such as access to essential public services and universal access provisions, and technology transfer for the future growth and development of the society and climate protection.

Thus there is global attention on reforming the processes and mechanisms of international investment agreements (IIAs) and

bilateral investment treaties (BITs), especially on transforming the destructive investor-state dispute settlement (ISDS) provisions that allow investors to sue states under various arbitrational mechanisms and outside the purview of the national courts of the host countries. These provisions, which have become unhealthy for both democracy and human and social development, are far too ubiquitous in such agreements. In this context (as discussed in the contributions to this volume), many developing countries are reforming their investment approach and policies and tools. A critical element in this renewed attention to foreign direct investment (FDI) and development must include proactive attention paid to its gender and social dimensions. From the perspective of economic development, gender and social equity, there have been and remain quite persistent and critical issues with regard to the relationship between investment liberalization, FDI, gender equality and women's empowerment.

I. Gender Issues in the Reform of Investment Liberalization, IIAs and BITs

Gender concerns arise in discussions of investment liberalization, IIAs/BITs and the reform of foreign investment regimes in the context of the impacts of FDI, changes in government rules on FDI and their implication for gender equality, women's rights[1] and women's empowerment and gender-based outcomes. Changes in policy directions, instruments and targets have the potential to affect women and men in their multi-dimensional involvements in economic and social activities as individuals, household members, heads of household, entrepreneurs and workers. There at least five broad aspects for these interlinkages involving foreign investment, broadly, and foreign direct investment, more narrowly, that should guide a government's

1 Women's rights can be measured in terms of access to education (i.e., educational attainment), sex-related education disparities, women's economic rights (i.e., freedom from workplace or wage discrimination), and women's political rights (Blanton and Blanton, 2011).

review and reform of its foreign investment policies and operations: 1) the nature of foreign investment, its gendered employment patterns and contributions to poverty eradication in the economy; 2) the impact of foreign investment on production and resource allocation for pre-existing gender dynamics; 3) foreign investment and exchange and interest rate effects on the economy; 4) policy measures around fiscal incentives, labour and land policies vis-à-vis foreign investors and their impact on access to basic services and other tangible as well as intangible resources and the differentiated gender pathways of these impacts; and 5) the environmental impacts of foreign investments on the quality of life and the health consequences for men, women and children in the communities most directly affected by the operations of FDI. These potential impacts of FDI, of course, depend on the type of FDI – extractive, low-skilled manufacturing, high-skilled manufacturing (industrial or agro-industry) or services – and the policies and regulations that govern its operations in developing countries.

Attention should also be paid to the chilling effects of BITs/IIAs' ISDS provisions on social and gender equity approaches through which many governments in developing countries seek to implement gender equality and non-gender equality intervention to offset historical disadvantages and to reduce gender-discriminatory gaps. Another dimension of the reform process on gender and social dynamics has to do with the regulatory chilling effects of investors activating ISDS provisions by suing or threatening to sue governments on the grounds of indirect expropriation and violation of the "fair and equitable treatment" guarantee, which may negatively impact a government's environment, social and other policy directives and direction with adverse consequences for the lives of men and women.

FDI – The employment dimension and gender in brief

FDI is generally expected to absorb labour, provide income and hence help to reduce poverty.

However, the reality has been that while, depending on the sector, there may be pronounced positive employment impacts, there have been persistent issues about the quality of employment and working conditions, the nature of the remuneration (wages/ persistence of male-female wage gaps[2]) and the less-than-stellar human capital impact of FDI (in terms of education and job training, contribution to knowledge and skill upgrade) on male and female workers. There are also issues about informal employment and sub-contracting. The recent emphasis on global value chains lends complexity as well as contradictory texturing to the narrative of FDI and employment and entrepreneurship in developing countries.

The employment contribution of FDI to development varies across different agricultural and industrial sectors with a distinctive gender interface.

The agricultural sector. The topic of the impacts of foreign investment in the agricultural sector in developing countries is well-researched. Transnational corporations (TNCs) have a long history of involvement in the agricultural sector in many developing countries. Initially, this involvement focused on primary exports (tea, coffee, bananas etc.). Later on there was a trend towards non-traditional exports such as specialty products, semi-processed food and cut flowers. Increasingly there is a move towards what have been identified as "new forms of agricultural investments" such as the acquisition of land, production of animal feed and the development of a "looser

2 Ratio of female to male wages after adjusting for worker characteristics (Aguayo-Tellez, 2011).

type of association between local farmers and TNCs such as supermarket chains from developed countries" (FAO, 2013). Case studies undertaken by the Food and Agriculture Organization (FAO), the International Fund for Agricultural Development (IFAD) and the Institute for Poverty, Land and Agrarian Studies (among others) show that "agricultural investments operated under diverse business models (including plantations, contract farming, outgrower schemes or joint ventures) create gender-differentiated labour and income-generating opportunities for local farmers, agricultural workers and the rest of the rural population". Additionally, a recent conference on the issue of land and agricultural investment in developing countries notes that the outcomes of both domestic and foreign investment in developing countries depend on many factors, "including the prevailing agricultural and rural development model; the institutional, policy and regulatory framework in place; the type and degree of inclusiveness of the business models adopted; and the extent to which social relations and gender equity issues are considered" (Hall and Osorio, 2014). These findings point to the importance of integrating gender and anti-poverty lens in policy formulations around FDI and other forms of investment that directly impinge on sectors with serious implications for food security and livelihoods in developing countries.

The manufacturing sector. TNCs/multinational enterprises (MNEs) have historically tended to hire women more than men in low- and semi-skilled industrial sectors. Hence, there is a high share of female employment particularly in export-intensive labour-oriented assembly and manufacturing (Starnberg Institute, 1989; ILO, 2009; UNCTAD, 2009; Moran, 2011). These firms have demonstrated an express preference for hiring younger, unmarried women in electronics, and older and married women in other areas (textiles and garments). However, as capital-labour intensity ratchets upwards, researchers have noted a tendency towards female-to-male reversal with a focus

on the hiring of men. So high-skilled manufacturing is less reliant on women's labour. In fact, a kind of "defeminization" occurs in the transition from low- to high-skilled labour (Seguino, 2010; Blanton and Blanton, 2011).

The service sector. The services in which FDI tend to dominate have experienced an increasing share of women workers, both in the wholesale trade services and as entry-level workers in the finance sub-sector. The service sector is noted for having both high and low levels of skill demands (for example, call centres and tourism) that attract women more than the other sectors. It is also the sector that relies more on the acquisition of general skills as opposed to firm-specific skills, which sometimes works to the disadvantage of women.

The extractive sector. Here the extractive sector excludes forests, fishing, agriculture and animal husbandry etc. The MNEs in this sector tend to be resource-seeking firms; they are low-value-added and contribute very little to national development, and are also less reliant on women's labour. The overall impact on women's employment is not clear. Ross (2008) and Tolonen (2014) argue that there are no straightforward studies that show whether exploitation of natural resources harms women's employment. Research points to gender disparity in favour of males in access to employment and work. In some cases, extractive activities can displace women's labour, while in other cases, they can monetize women's traditional skills and activities. Thus women may gain jobs in the service sub-sector in administration, accounts, restaurants and bars and transportation and as cleaners, cookers, hairdressers and weavers. Women may also play active roles in small-scale mining (performing tasks such as grinding and sieving). However, as noted by Tolonen, the gain in direct jobs from the sector is not proportionate to the loss of women's activities and livelihoods. What is clear is that in almost all cases extractive activities in mining tend to displace women artisanal

miners. This was generally found to be the case in South-East Asia (Dhaatri Resource Centre/RIMM, 2013). Some research also points to a high level of discrimination with regard to jobs, training for certification and licences for technical positions. There is also persistent wage inequality to the disadvantage of women in the extractive sector.

Additionally, the activities of extractives disadvantage women in a number of other ways. Through land acquisition, concessions and mining licences, extractive firms can adversely impact land and natural resources, with adverse impacts for women's ownership and usufruct rights. In many cases, women and families lose land and homes with little or no compensation for their lost assets. The operation of extractives, such as mines, can degrade forests and lands, creating loss of access to lands, forests and forest resources, including food, and other natural resources. Extractive operations can also adversely impact fisheries as well as create challenges for subsistence agricultural production and food security due to runoffs and contamination. These polluting activities contribute to reducing crop yields. Ultimately, for poor and rural women and many indigenous men and women, there can be heightened insecurity of livelihoods due to both the environmental hazards the sector creates and the boom-and-bust syndrome associated with some extractives such as mining.

Extractives also complicate women's lives through the creation of additional health burdens. Their operations can create or exacerbate illnesses such as silicosis, tuberculosis, radiation, chronic reproductive illness, chronic respiratory illnesses, skin problems, diarrhoea and stomach infections from pollutants in rivers and streams. Mining and logging activities are also associated with more accidents and injuries than other sectors. Other health and social issues arise from the broader environmental impacts such as environmental toxins and the increasing exposure and prevalence of HIV/AIDS. Extractive

activities are also increasingly associated with conflict situations, with particular negative impacts on girls' and women's health and personal security due to gender-based violence.

These impacts of FDI across sectors point to the need to reform investment policies, in particular with regard to IIAs and BITs, to develop and specify policies that enforce greater beneficial effects at the country and local levels. For example, as noted by Aragon and Rud (2013), this can involve measures that seek to foster better local linkages such as local procurement of goods. Reform of investment approaches must also include more directly issues of compensation and rehabilitation as well as other social and gender-sensitive regulatory and social mechanisms. Policies on compensation (for damage to property and homes and loss of land) and rehabilitation of community natural assets are important for protecting women's lives and livelihoods. Safeguards to prevent and mitigate damage, such as environmental impact assessments, periodic water testing and monitoring, and the enforcement of prior informed consent and the United Nations Declaration on the Rights of Indigenous Peoples (UNDRIP), are also essential to protect women and men in rural and forest communities. Ultimately, there need to be policies and regulations geared to promoting gender parity and that enable access to training and skill development for ensuring women's equal opportunities with men for jobs in technical areas (Dhaatri Resource Centre/RIMM, 2013).

Foreign investment, production, resource allocation and gender in brief

At the macro level, fiscal incentives such as tax holidays and tax-free concessions impact central and local government budgets and have trade-off effects for the social budget which is relied upon more by women. FDI's impact on taxation/tax revenue

has implications for public expenditure and hence may distort allocations to the social sector.

At the meso level, there are issues of transaction cost, imperfect information, gender biases, market interlinkages, and asymmetry of property rights. Thus, for example, the expansion of investment opportunities due to the infusion of foreign investment may not be available to women entrepreneurs due to gender biases that either lock women into or lock them out of particular markets. Research points to the importance of the right kind of FDI that will enable "knowledge spillover" and which supports the growth of women's micro, small and medium enterprises (MSMEs), which tend to be under-capitalized and have poor access to machineries, fertilizer and extension services and credit (Enterprise Surveys, World Bank).

FDI and foreign investment overall impact on the nature, size and growth potential of women-owned and -operated small and medium-sized firms in host countries. Here it is important to also include the enhanced involvement of women-owned MSMEs in global value chains. This will require proactive policies to increase MNEs' sourcing, spillover and linkages from global value chains to local small and medium-sized enterprises (SMEs), particularly women-owned firms (Christian et al., 2013).

Cross-border land acquisition is another form of resource reallocation that can have adverse impacts on women. Recently, there have been issues around land policies that encourage land acquisition by foreigners for a variety of reasons including food production, biofuel production and carbon offsetting purposes. As with extractives, these so-called "land grabs" impact agricultural production for the domestic market and for subsistence and can greatly disadvantage poor and rural women, women's groups and indigenous men and women.

Foreign investment, exchange/interest rate effects and gender in brief

FDI can have a strong impact on local investment/credit markets if MNEs seek local funding. The economic effects of both trade and investment work through macro policy and exchange/interest rate policies. The link between foreign capital inflows and the real economy of the host country also operates via a two-way transmission mechanism – the exchange rate and the interest rate. It may be either growth-inducing or growth-inhibiting. Capital account surplus and capital inflows are both associated with pressure on the exchange rate. This pressure may be exacerbated by actions of the central bank, which may seek to keep the exchange rate stable by controlling domestic liquidity and/or through sterilization measures such as raising the domestic interest rate. Such actions have important consequences for domestic investment. Either way, there are adverse employment and purchasing-power effects (and hence distributional consequences for different groups of economic actors in the society). In the case of currency devaluation or depreciation or inflationary shocks which may arise, particular effects are likely to be deep, traumatic and longer-lasting for the marginalized and the poor who have little resources to offset such economic shocks. Women tend to predominate in these groups.

Given women's responsibility for social reproduction, gender biases in accessing credit and declining government services in the context of rising budget shortfalls and declining purchasing power imply an increased burden for seeking and providing alternative food and care services as well as income generation. A high interest rate is also likely to crowd out female entrepreneurs seeking credit for initiating or expanding businesses. The literature on structural adjustment provides ample evidence in this regard.

Other areas where foreign investment policy may have some strong effects for women include strong enforcement or reinforcement of intellectual property rights, which has both trade and domestic investment implications and may have negative impacts on women in their multiple roles as farmers, healers, developers and conveyors of traditional knowledge and technology.

Indirect impacts of foreign investment on gender equality include FDI's impact on the availability of different types of infrastructure (roads and electrification etc.) and social services if expenditures are diverted from providing, say, agricultural feeder roads towards projects that only focus on securing the foundational infrastructure – transportation, energy and communication – for attracting FDI.

Given the centrality of investment in agricultural, manufacturing, infrastructural and services development for both employment/livelihoods and economic and social development, there is clearly a need for a sustainable approach to enhancing investment, both domestic and foreign. As argued in the Monterrey Consensus adopted by the 2002 International Conference on Financing for Development, investment should first and foremost serve sustainable development in developing countries, including bringing water, electricity, education and health services to the population, particularly the poor (para. 68).

II. Considerations for a Gender-Sensitive Approach to Reviewing and Reforming IIAs/BITs including ISDS

From gender equality and women's empowerment perspectives, it is important that the review process of investment and IIAs/BITs focuses on improving the gender-based outcomes of foreign investment, including supporting individual women workers, business owners, wellbeing at household level, closing gender

gaps and promoting long-term productive and sustainable growth, both locally and nationally. This can only occur in a context in which there is a focus on foreign investment playing a role in securing sustainable, inclusive growth and development. For this developing countries' governments themselves must articulate and elaborate an alternative framework and narrative for investment, both foreign and national, that is grounded in promoting development that is sustainable, gender-sensitive, poverty-eradicating and pro-human development. Such a framework should be developed through a process of reviewing past experiences with FDI in consultation with key stakeholders, including targeted and potential beneficiaries and affected communities such as women's groups, farmers, MSMEs and community-based organizations. Women's groups in their various formations, gender advocates, researchers, non-governmental organizations (NGOs) and MSMEs must be part of the decision-making around the role and nature of foreign investment, in particular, FDI, in the economy. (See Annexes 6.1 and 6.2 for snapshots of some gender dimensions in investment-related decision-making.)

Nurse (2004) argues that an alternative investment framework must be biased towards the strengthening of indigenous capabilities and ensure sustainable development. It must also be grounded in a framework and an approach along the following lines:

- Industrial upgrading and deepening calls for innovation in product and production technologies and distribution methods. The aim is to improve competitiveness in domestic markets, to penetrate new export markets and increase value-added shares of global commodity chains.
- In the agricultural sector it is important to integrate provisions from the Principles for Responsible Investment in Agriculture and Food Systems (2014) approved by the

Committee on World Food Security. And for gender, Principle 3 ("Foster gender equality and women's empowerment") is most important.

- Invest more in women and men addressing their different gender constraints, especially in terms of health, education and other social infrastructure. This must be supported by the use of appropriate technologies, indigenous and imported where necessary.
- Reforms in the social structure of accumulation (e.g., land reform, improved access to credit). This involves making some markets truly competitive and responsive to local demands. In other cases, it calls for greater state involvement where there is market failure.

These must also be the plank for rethinking and re-engaging IIAs. But for IIAs to be effective and work for gender-sensitive development, there must be ring-fencing of gender equality interventions and elimination or serious reworking of ISDS provisions in the agreements. There must also be the creation of greater policy space to enable governments to implement policies that ensure that FDI works for the achievement of gender-sensitive and sustainable development.

Undeniably, foreign investment, particularly FDI, is an important component in the export-promotion growth strategy of developing countries. On the positive side, inflows of FDI generate new sources of employment and likely increased incomes for households and government revenues that will enable better individual and national standards of living. But at the same time the privatization of state-owned entities, deregulation of labour and commodity markets and the elimination of restrictions/ limitations which many governments have undertaken as part of their strategy for attracting FDI may have offsetting and adverse impacts on employment, wages, working conditions and access to public services. Thus, while the intent behind

attracting FDI is to increase the level of competition and decrease the level of protection, such a policy agenda often translates into adverse consequences for local small and medium-sized businesses that often cannot compete with the big, well-endowed multinationals.

Due to these issues, there is no automatic and unambiguous beneficial predisposition of FDI to development. Therefore developing countries' governments must proactively work to ensure balance between domestic and foreign investment in the context of national strategies at sectoral level and macro-level policies to promote the sustainability of the development process. The ability of developing countries' governments to ensure economic development depends on their capacity to maximize technological transfer through such measures as performance requirements and technology transfer requirements. Developing countries' governments must also work to ensure positive spillovers and increase the linkages between local firms/suppliers and FDI. They also need to ensure an expansion of the local technological frontier, industrial upgrading and extensive local linkages via technological transfer. It is only in this manner that a country is able to ensure that it does not simply become a site for assembly operations of TNCs and that the inherent destabilizing effects of FDI on the balance of payments are mitigated.

Annex 6.1: African Women's Recommendations on Financing for Development

The recommendations, issued by African women's rights groups on the occasion of the Third International Conference on Financing for Development held in Addis Ababa in July 2015, called, among others, for:

- Policy measures to protect women's businesses and share of markets, for protection of infant industries, female-job-intensive sectors and women's traditional knowledge
- Ex ante and periodic human rights impact assessments of trade and investment policies
- Assessment of FDI and its impacts on climate change, with particular attention to policies that often result in large-scale forced eviction, land grabbing and loss of livelihoods and violence against women
- FDI should complement and be aligned with sustainable development and equitable development strategies
- Export-oriented "extractivism", in particular mining, has led to increased conflict and continued to devastate the environment and livelihoods by displacing smallholder producers, including women farmers and small-scale miners
- FDI should support the creation of decent work by eliminating the gender pay gap, providing technology transfer, promoting links with small and medium-sized enterprises and fostering territorial decentralization and productive diversification
- FDI extractive activities, especially mining, should be directed to addressing structural issues including funding small-scale miners to have them engage effectively in policy agreements, formulation, apply technology, address environmental issues, prompting backward and forward linkages

- Give voice and space to communities so the issue of compensation can be decided by women and men at community and national level.

(Drawn from sections a, b and n of the set of recommendations)

Annex 6.2: Gender and Women's Participation in BITs Arbitration Decision-making – A Snapshot

There have been attempts recently to examine through gender analytical lens the decision-making and representation in the international investment arbitration process. Gus Van Harten (2012) found that in the 249 known investment treaty cases until May 2010, only 41 (16 state, 7 investor, 13 presiding, 5 unknown) of the 631 appointments of arbitrators were women – just 6.5% of all appointments.

Of the 247 individuals appointed as arbitrators across all cases, only 10 were women. Women thus comprised merely 4% of those serving as arbitrators. Two women captured 75% of the appointments of women whereas, contrastingly, the two most frequently appointed men accounted for just 5% of the 593 appointments of male arbitrators. States appeared to have driven most of the appointments of women arbitrators. These include Argentina (5 women out of 29 appointments), Turkey (2 of 6), the United States (2 of 9), Bolivia (1 of 2), and Georgia (1 of 2).

(Data were collected from all known investment treaty cases that had led, by 1 May 2010, to a confirmed award on jurisdiction or, in the case of the North American Free Trade Agreement, to the filing of a notice of claim.)

Van Harten argues that in general in international and domestic judiciaries women tend to have higher participation rates. For example, he cites the following:

- European Court of Human Rights appointees: women 32% (26 of 82 judges) since 1995
- WTO Appellate Body members: women 19% (4 of 21 members) in WTO history.

Van Harten argues that a solution to remedying the gender and other social equity imbalances in the present arbitration system lies in the adoption of a mandatory roster system, which "would improve quality, if based on an open and merit-based process, including consultation with investor organizations and other interest groups". "This would permit a publicly accountable and deliberative process of appointments, free from the strategic pressures that arise after a dispute has been registered. It would also enable more detached attention by states to representation, including ways to overcome possible barriers to participation by women, such as the concentration of men in major law firms or differential family responsibilities of women."

(Source: Gus Van Harten, "The (lack of) women arbitrators in investment treaty arbitration", Columbia FDI Perspectives, No. 59 (6 February 2012))

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COUNTRY EXPERIENCES

Chapter 7

International Investment Agreements and Africa's Structural Transformation: A Perspective from South Africa

Xavier Carim[1]

I. Introduction

At a time of great change in the global economy, there is an intensifying and widening debate on the implications of international investment agreements (IIAs) (including bilateral investment treaties or BITs) for sustainable development. This debate is both overdue and relevant. It is overdue because the principles that underpin IIAs, conceived as they were in the immediate post-colonial period and in the context of the Cold War, are increasingly at odds with new and emerging challenges confronting the international community.[2] The debate is particularly relevant in Africa as the continent's new economic development programme to effect structural transformation and achieve sustainable development may well be constrained by the terms and conditions imposed by IIAs.

1 Xavier Carim is the Ambassador of South Africa to the World Trade Organization (WTO) in Geneva. At the time of writing this chapter (November 2014), Mr. Carim was Deputy Director General of the Department of Trade and Industry in South Africa. All views and judgments expressed in this paper are the responsibilities of the author alone and should not be ascribed to the South African government.

2 H. Mann, "Reconceptualising International Investment Law: Its Role in Sustainable Development", *Lewis & Clark Law Review*, Vol. 17, 2013, pp. 521-544.

This chapter aims to draw lessons from that debate for Africa's economic development strategy and objectives. To this end, it outlines the broad features of alternate policy approaches to foreign direct investment (FDI) and the policy perspectives embedded in IIAs. The chapter then provides a critique of IIAs with respect to their structure and core provisions, particularly in respect of investor-state dispute settlement provisions. It continues by providing an overview of the results of studies on the relationship between IIAs and FDI flows. The penultimate section outlines how governments around the world are responding to the challenges. It pays particular attention to South Africa's experience with and policy approach to IIAs. The final section draws out the main lessons of the paper as they relate to Africa's emerging economic development strategies for structural transformation and sustainable development. It concludes by proposing some recommendations for consideration by African policymakers.

II. Policy Perspectives on FDI and IIAs

FDI can play an important role in economic development, as it is associated with a long-term commitment to the host country that generates inflows of capital and finance, technology, managerial best practice and access to global markets. Nevertheless, two paradigms broadly shape government policy towards FDI. One perspective tends to assume that all investment is good, and that all investment promotes growth and development. The derived policy implications are that governments should attract FDI by providing strong protection to foreign investors, liberalize investment regimes, reduce or limit regulations and conditions on investors and, in so doing, realize the benefits of FDI. This policy perspective is embedded in the structure and content of existing IIAs, certainly those to which South Africa has been party.

The alternate view recognizes that FDI may indeed contribute to sustainable development but that the benefits to host countries are not automatic. It posits that regulations are needed to balance the economic requirements of investors for protection with the need to ensure that investments make a positive contribution to sustainable development in the host state. The associated spillover benefits of FDI as they relate to technology transfer, managerial best practice, skills development, research, as well as building beneficial linkages to the national economy need to be purposefully built into the regulatory regime, and not taken for granted. In this view, benefits are measured by the degree to which FDI supports national development strategies and objectives.

While there are certainly many examples of FDI contributing positively to economic development, there is also evidence of the risks FDI can pose to the balance of payments, environment or distorted enclave-type development etc. IIAs are not designed to address such issues, as their overriding focus is to protect foreign investment. In fact, IIAs are structured in a manner that primarily imposes legal obligations on governments to provide wide-ranging rights protection to investment by the countries that are party to the treaty. This pro-investor imbalance can constrain the ability of governments to regulate in the public interest. Under the dispute settlement provisions, only investors can initiate disputes, and governments have no recourse under IIAs to challenge errant behaviour by investors.

Furthermore, under the current regime, IIAs open the way for foreign investors to challenge any government measure that an investor views as diminishing "expectations" of returns on the investment. The current regime can thus impose a "chill" on government policy-making, and legislative and regulatory authority. Rebalancing the relationship between investor protection and government's right to regulate in the public

interest has moved to the centre of the debate on the future of IIAs. The problems are, however, deep-seated.

III. Growing Risks with IIAs and International Investor-State Arbitration

It is now widely acknowledged that IIAs, particularly early-generation treaties, contain provisions that are vague and imprecise and, when subjected to international arbitration, leave wide scope for inconsistent and unpredictable outcomes. Typical provisions in IIAs, covering definitions of "investor" and "investment", and standards of protection such as "fair and equitable treatment", protection against "expropriation" and indirect expropriation have all been the subject of extensive legal wrangling, varying interpretations and conflicting arbitration awards.[3]

Expansive definitions of "investment" provide protection to any "asset" in the other treaty partner's territory, whether it is intended to be a productive enterprise (traditional FDI) or not. Against that broad definition, arbitral tribunals continue to interpret the provision on "fair and equitable treatment" in a manner that imposes broad limits on government authority by granting investors the right to a "stable and predictable regulatory environment." This interpretation has been used successfully to challenge changes to regulations, including taxation. Similarly, the definition of "expropriation" is interpreted to include not only direct expropriation, such as takeovers of property, but also so-called "regulatory takings" which can cover any new policy measures that affect investors. These provisions, along with broad readings of, for example, the "fair and equitable treatment" provision, act to limit scope for government policy.

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3 N. Bernasconi-Osterwalder, A. Cosbey, L. Johnson and D. Vis-Dunbar, *Investment Treaties and Why They Matter to Sustainable Development: Questions and Answers* (Winnipeg, Canada, International Institute for Sustainable Development, 2012).

The investor-state dispute settlement (ISDS) system itself is fragmented with various venues on offer for arbitration, each with its own rules of procedure, history and culture. Arbitrators are chosen in an ad hoc manner and, in the absence of an appellate process that ensures consistency and the correct application of international law, the system is prone to inconsistent and diverging interpretations in cases addressing the same provisions and similar facts. Recurring inconsistent awards and interpretations by panels deepen the uncertainty about the meaning of key treaty obligations and compound the problems of the unpredictability of treaties. There is also growing evidence of dissenting views amongst members of panels.[4]

Questions are also raised as to whether arbitration processes conducted by three individuals appointed on an ad hoc basis possess sufficient legitimacy to assess acts of states, particularly on sensitive public policy issues. The system lacks an institutional framework that enshrines the principles of judicial accountability or the independence of arbitrators, and arbitrators can award damages without having to apply the various limitations on state liability that have evolved in domestic legal systems.

A new billion-dollar industry has emerged out of this system. The number of investment arbitration cases, as well as the sum of money involved, has surged in the last two decades. Legal and arbitration costs average over $8 million per investor-state dispute, exceeding $30 million in some cases. The industry appears to be dominated by a small group of law firms and arbitrators that rotate between representing claimants, respondents as well as sitting on arbitration panels, raising concerns of conflict of interest.[5]

4 UNCTAD, "Recent Developments in Investor-State Dispute Settlement", IIA Issues Note No. 1 (Geneva, 2013).

5 P. Eberhardt and C. Olivet, *Profiting From Injustice* (Brussels/Amsterdam, Corporate Europe Observatory and the Transnational Institute, November 2012).

These risks are amplified by the rapid growth in investor claims around the world that are challenging a widening ambit of government measures.[6] There has been a dramatic increase in the number of claims brought by foreign investors against governments, with the first in 1987, growing cumulatively to 50 by 2000, and 514 by 2012. In 2012, 62 claims were initiated, representing the highest number of claims for one year. A total of 95 governments have faced challenges under the ISDS system, of which 61 (nearly two-thirds) were developing-country governments. The success rate for claims is growing: In 2012, 75% of all awards were in favour of investors. In 2009/2010, 151 investment arbitration cases involved corporations claiming up to $100 million from states, and one of the largest awards in favour of investors was delivered in 2012 against Ecuador for an amount of $2.4 billion. Importantly for Africa, 25% of all reported investor-state arbitrations involve mining, oil and gas investments, all critical sectors for the future development of African economies.

Claims have been brought against government measures related to revocations of licences (in mining, telecommunications, tourism), alleged breaches of investment contracts, alleged irregularities in public tenders, changes to domestic regulatory frameworks (gas, nuclear energy, marketing of gold, currency regulations), withdrawal of previously granted subsidies (solar energy), direct expropriations of investments, tax measures and others. Several cases have their origin in the recent financial crisis and are aimed against the austerity measures certain governments have had to introduce including as part of international financial support conditions. States have also continued to face investor claims concerning measures of general application introduced on environmental grounds.

6 UNCTAD, op. cit.

In short, concerns about IIAs and the investor-state dispute settlement system are deep-seated and varied. The system is perceived as being biased towards the interests of investors over governments and the wider concerns of society. Imprecise provisions in IIAs combined with an arbitration process that lacks an institutional framework to safeguard legal certainty, correctness and predictability, suggest a crisis of legitimacy.

IV. IIAs and FDI Flows: A Grand Bargain?

If the concerns over inherent imbalance in IIAs are legitimate, it would be logical to ask what the benefits of signing IIAs are. The central argument advanced by proponents is that by granting the strong legal protection sought by investors, countries will receive greater inflows of FDI. In other words, in exchange for giving up policy space and some measure of regulatory autonomy, host states can expect or hope to receive increased flows of investment. What does the evidence show?

A 1998 United Nations Conference on Trade and Development (UNCTAD) analysis found a weak correlation between the signing of BITs and increased FDI inflows.[7] After conducting a cross-sectional data analysis for 133 countries between 1993 and 1995, the study found that the impact of BITs on FDI is non-existent or small and secondary to the effects of other determinants, especially market size.

Looking at data on FDI from 20 Organization for Economic Co-operation and Development (OECD) countries flowing to 31 developing countries from 1980 to 2000, Hallward-Driemeier finds that treaties act more as complements rather than substitutes for good institutional quality and local property rights.[8] He

7 UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (Geneva, 1998).

8 M. Hallward-Driemeier, "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit…and They Could Bite", World Bank Policy Research Working Paper 3121 (Washington D.C., World Bank, 2003). Available from http://

points out that the rights given to foreign investors may exceed those enjoyed by domestic investors and expose policymakers to potentially large-scale liabilities that curtail the feasibility of different reform options. Over the 20-year period of analysis, the report found little evidence that BITs stimulated investment. The empirical evidence especially highlighted how countries with weak domestic institutions had not received significant benefits following the signing of a BIT. Rather, countries with strong domestic institutions had the most to gain, with the BIT acting as a complement to, as opposed to a substitute for, broader domestic reform. Consequently, the report found "those that are benefiting from them are arguably the least in need of a BIT to signal the quality of their property rights."

This is seen most clearly in the number of countries that receive substantial FDI but do not hold BITs. Japan, the second largest source of FDI in the world, has only four BITs. The US does not hold a BIT with China, despite the latter being the largest developing-country destination for US FDI. Brazil, a receiver of substantial FDI, does not hold any ratified BITs. Meanwhile, numerous countries that have ratified BITs are having difficulties attracting FDI, particularly in Sub-Saharan Africa. Recognizing the significance of these trends, the report concludes, "a BIT is not a necessary condition to receive FDI".

The work by Tobin and Rose-Ackerman, who examined FDI for 63 countries from 1975 to 2000, finds a very weak relationship between BITs and FDI. It also finds that rather than encouraging greater FDI in riskier environments, BITs only have a positive effect on FDI flows in countries with an already stable business environment. Overall, BITs seem to have little positive effect either on foreign investment or on outside investors' perception

ideas.repec.org/p/wbk/wbrwps/3121.html.

of the investment environment in low- and middle-income countries.[9]

One study found a positive association between the adoption of BITs and FDI flows. Neumayer and Spess looked at 119 developing countries (29 of which are in Latin America) between 1970 and 2001.[10] They used as an independent variable the number of BITs a developing country has signed with OECD countries, weighted by the world share of outward FDI flow that the OECD country accounts for. They found that developing countries that sign more BITs with developed countries receive more FDI inflows.

In his 2010 study, Yackee concludes that "Countries that refuse to sign BITs, or who allow their BITs to lapse, will probably not see a meaningful reduction in investment flows ... BITs are not magic wands, the wave of which produces, with a poof and a cloud of smoke, a foreigner with pockets stuffed with cash. If developing countries wish to attract foreign investment, they probably need to do something other than sign and ratify BITs."[11]

In its more technical analysis of the impact of BITs on FDI flows, the 2014 UNCTAD *Trade and Development Report* concludes that "… the current state of the research is unable to fully explain the determinants of FDI, and, in particular, the effects of BITs on

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9 J. Tobin and S. Rose-Ackerman, "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties", Yale Center for Law, Economics and Public Policy Research Paper No. 293 (2005). Available from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=557121.

10 E. Neumayer and L. Spess, "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?", *World Development,* 33(10), 2005, pp. 1567-1585.

11 J.W. Yackee, "Do Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence", Legal Studies Research Paper Series No. 1114 (University of Wisconsin Law School, March 2010). Available from http://ssrn.com/abstract=1594887.

FDI. Thus developing-country policymakers should not assume that signing up to BITs will boost FDI …"[12]

In short, and taken together, studies are unable to demonstrate a clear relationship between signing IIAs and receiving greater flows of FDI. At best, the relationship is ambiguous, and IIAs are neither necessary nor sufficient to attract FDI.

V. How Are Countries Responding?

Most governments that were active in negotiating BITs in the 1990s have reviewed their early investment treaties, and have effected significant changes to their policy on investment treaties as they have come to recognize the shortcomings, flaws and risks inherent in those first-generation BITs. The rethink on investment treaties is largely related to considerations of the link between investment treaties and flows of FDI and the legal and policy implications of commitments made by entering into IIAs.

UNCTAD has outlined the actions countries are pursuing to address these challenges as clarifying the meaning of treaty provisions (through authoritative interpretations), revising treaties (through amendments), replacing older treaties (through renegotiation), or terminating/consolidating treaties (either unilaterally or by mutual consent).[13] Interestingly, the UNCTAD report points out that, at the end of 2013, more than 1,300 bilateral treaties would have been at the stage where they could be terminated or renegotiated at any time. Furthermore, between 2014 and 2018, at least 350 more bilateral treaties will reach the end of their initial duration. Treaty expiration offers an opportunity to address inconsistencies and overlaps

12 UNCTAD, *Trade and Development Report 2014* (Geneva, September), pp. 155-160.

13 UNCTAD, "International Investment Policymaking in Transition: Challenges and Opportunities of Treaty Renewal", IIA Issues Note No. 4 (Geneva, 2013).

in the multi-faceted and multi-layered regime of international investment treaties, and to update the investment regime in light of development paradigm shifts. Over the past decade or so, reviews have been undertaken in Australia, Canada, Norway, the United States, Sweden, South Africa and more recently in the EU, Indonesia and in India.

VI. South Africa's Review and Policy Response to IIAs

In the immediate post-apartheid era (1994-1998), South Africa concluded around 15 BITs, mainly with European countries. At the time, this was a good-faith attempt to assure investors that their investments would be secure under the new democratically-elected government. Signing these BITs was also seen as an important diplomatic signal confirming South Africa's re-entry to the international community after the years of isolation under apartheid.

However, South Africa soon became aware of challenges posed by international investment treaties. It observed the fractious debate in the OECD when its members were seeking to negotiate a multilateral investment agreement in the late 1990s. South Africa also participated in the discussions in the WTO that sought to include investment under the Doha Round negotiations, where many developmental concerns emerged in the engagements. More seriously, the spike in international investment arbitrations that followed the financial crisis in 2001 laid bare how bilateral investment agreements can pose profound and serious risks to government policy.

The experience demonstrated that there was no clear relationship between signing BITs and seeing increased inflows of FDI. This had been a motivating factor in signing BITs in the 1990s. South Africa does not receive significant inflows of FDI from many partners with whom we have BITs, and at the same time,

continues to receive investment from jurisdictions with which we have no BITs. In short, BITs have not been decisive in attracting investment to South Africa. In addition, over the last decade, South Africa had to confront several challenges, and threats of challenge, brought under various BITs. Most of the threats of challenge may be described as spurious but they all underscored the fact that BITs do not adequately take into account conditions found in South Africa, the complexities of socio-economic challenges and the broad objectives of government policy.

South Africa's post-apartheid Constitution is widely commended around the world for its strong assertion of human rights. Embedded in the Constitution is a transformation agenda that seeks to overcome deeply rooted inequities inherited from apartheid's exclusionary policies. There is little disagreement with the need to pursue this agenda to ensure an inclusive and just society. The Constitution also provides for non-discrimination between foreign and domestic investors. All investors need to undertake their activities in this context of the transformation agenda set out in the Constitution. However, as we assessed the bilateral investment treaties that we had entered into, we began to identify a range of inconsistencies with the Constitution.

This prompted South Africa's review of BITs in 2008. Extensive and intensive consultations were held in South Africa over a three-year period in which a wide range of national and international experts participated. The review identified the range of concerns associated with BITs as outlined earlier in this chapter, notably the risks associated with imprecise legal commitments. South Africa was particularly concerned about investor-state dispute provisions that open the door for narrow commercial interests to subject matters of vital national interest to unpredictable international arbitration outcomes and that may constitute a direct challenge to constitutional and democratic policymaking.

Against this background, in April 2010 the South African Cabinet concluded that South Africa should refrain from entering into BITs in the future, except in cases of compelling economic and political circumstances. Second, the Cabinet instructed that all "first-generation" BITs that South Africa signed shortly after the democratic transition in 1994, many of which have reached their termination date, should be reviewed with a view to termination, and possible renegotiation on the basis of a new model BIT to be developed. Third, the Cabinet decided that South Africa should strengthen its domestic legislation in respect of the protection offered to foreign investors. In this regard, key considerations would be to codify BIT-type protection into South African law and clarify their meaning in line with the South African Constitution. South Africa would also seek to incorporate legitimate exceptions to investor protection where warranted by public policy considerations, such as national security, health, environmental reasons or for measures to address historical injustice and/or promote development. Fourth, the Cabinet elevated all decision-making in respect of BITs to an Inter-Ministerial Committee tasked with oversight of investment, international relations and economic development matters.

VII. Recent Developments in South Africa

South Africa has initiated processes to terminate its BITs. Over the course of 2012 and 2013, South Africa formally notified those European countries with whom it had BITs that it would terminate the treaties.[14] South Africa had made its intention clear by publishing the Cabinet decision in July 2010, and in several formal engagements at multilateral meetings in UNCTAD and at the OECD. This was followed by several consultations with representatives of the affected governments through their embassies in South Africa. In addition, South Africa has engaged

14 Termination notices were served to Belgium, Luxembourg, the UK, Germany, France, the Netherlands, Spain, Sweden, Denmark, Greece, Italy and Switzerland.

with two governments in Latin America to terminate BITs by mutual consent. In Africa, South Africa has sought to develop common regional and continental approaches to BITs that may in future replace the existing BITs that South Africa has with African countries.

South Africa also actively participated in the development of a new model BIT that has been adopted at the regional level in Southern Africa.[15] The new Southern African Development Community (SADC) Bilateral Investment Treaty Model sets out provisions that mitigate the risks of earlier treaties and leaves open the option for state-to-state dispute settlement in addition to, or as replacement for, investor-state dispute settlement procedures.[16]

At the domestic level, a new Promotion and Protection of Investment Bill 2013 was published for public comment in November 2013. The Bill was the outcome of extensive intra-governmental legal and policy consultations.[17] It does not introduce any new restrictions on investment. It clarifies the non-discriminatory protections offered to all investors from all countries and confirms that South Africa remains open to FDI, providing effective protection while preserving the sovereign right of the government to pursue legitimate public policy objectives in line with constitutional requirements.

The Bill clarifies standards of protection for investors – both foreign and domestic – by setting out provisions ordinarily found in BITs in a manner that is consistent with the Constitution and the existing legal framework. The preamble confirms South Africa's commitment to an open, transparent environment for

15 See the Southern African Development Community's Investment Portal at http://www.sadc.int/opportunities/investment/.

16 Southern African Development Community (SADC) Investment Portal.

17 For a copy of the draft Bill, see http://www.tralac.org/files/2013/11/Promotion-and-protection-of-investment-bill-2013-Invitation-for-public-comment.pdf.

foreign investment that supports sustainable development and international human rights law. It defines investment to be protected under this legislation as "enterprise-based", requiring "material economic investment", and, thus, does not cover short-term portfolio investments. It provides that all foreign investors are granted the same protection as domestic investors in "like circumstances" (i.e., national treatment).

Provisions on "expropriation" and "compensation" are aligned to the Constitution and recent jurisprudence. As such, property may only be expropriated in terms of a law of general application for a public purpose or in the public interest. Expropriation is subject to compensation that is "just and equitable" as set in the Constitution. Moreover, government measures that have an incidental adverse impact on investment, where the measure is to protect legitimate public welfare objectives such as public health or safety, environmental protection or state security, would not be considered expropriation.

Under the right to regulate, the Bill specifies that the government may take measures to, amongst other things, redress inequalities, preserve cultural heritage, foster economic development and industrialization, achieve socio-economic rights and protect health and the environment. The provision on "transfer of funds" confirms the existing practice in South Africa that allows investors to freely invest and repatriate returns, subject to taxation and other applicable legislation. For "dispute settlement", should a foreign investor seek to challenge a government measure, the jurisdiction for the settlement of disputes will be with a competent South African court, statutory body or independent tribunal, with arbitration following the terms of South Africa's Arbitration Act of 1965. The Bill also provides for a dispute avoidance mechanism where an investor may engage the government in an effort to resolve any concern amicably, without resort to legal challenges.

Numerous detailed written submissions on the Bill were received by the end of the comment period. There were comments from all sectors: government, non-governmental organizations, policy think-tanks, academics, both domestic and international. Some submissions were critical in nature, noting that the Bill was too narrow in its scope, while others believed it was too broad. Some argued that it gives too wide protection for investors, for others, too little. While comments covered most aspects of the Bill, the bulk focused on: definition of investment, expropriation, levels of compensation and access to international arbitration. The South African government carefully considered all submissions and submitted a second iteration of the Bill to the Cabinet. In June 2015, the Bill was presented to Parliament for ratification.

Through all these efforts, South Africa envisions a legal and policy framework for investment that learns from the lessons of the past and is better attuned to the challenges of sustainable development and inclusive growth. Equitable relationships between investors and government, based on respect for human rights, the rule of law and due process, and security of tenure and property rights will continue to be pursued within the framework established by the South African Constitution.

VIII. Responses by Other Governments

The United States and Canada have responded to concerns over IIAs by effecting amendments to their model investment treaties, adopting interpretative statements and redrafting key provisions in subsequent IIAs, clarifying certain provisions and seeking to give greater authority to governments in interpreting the meaning of the obligations undertaken. These reforms aim to address some of the challenges raised by IIAs.

As the competence for negotiating IIAs has moved from its member states to the supranational level under the 2010 Lisbon

Treaty, the European Union (EU) has been rethinking the traditional approach to these treaties. On 21 January 2014, the European Commission (EC) announced its intention to pause investment treaty negotiations with the United States under the Transatlantic Trade and Investment Partnership (TTIP) Agreement in order to address what it termed "unprecedented public interest" in the EU on the matter of investment treaties.[18] The announcement identified some of the critical issues at stake, notably the need to reaffirm the right of government to regulate in the public interest, to "close loopholes", and to establish an arbitrator code of conduct to enhance fairness, transparency and even-handedness in the current system. At the time of writing, the dialogue in the EU continues.

Australia decided in 2012 to exclude ISDS in future IIAs, but this blanket prohibition on ISDS was later reversed. Several Latin American countries have withdrawn from the International Centre for Settlement of Investment Disputes (ICSID) and are withdrawing from IIAs. At the same time, they are seeking to establish a regional alternative for dispute settlement under the Union of South American Nations (UNASUR). In 2014, Indonesia decided to terminate its BITs. Brazil's case is interesting, as it has refused to enter into any IIAs on the basis that its Congress has seen these as unconstitutional.[19] It is instructive that Brazil still receives large inflows of FDI.

The essential lesson in all this is that many governments around the world are not at ease with the existing system of IIAs and ISDS. Differences in approach may to some extent be a function of whether the countries undertaking reform are predominantly

18 European Commission, Press Release: "Commission to consult European public on provisions in EU-US trade deal on investment and investor-state dispute settlement", Brussels, 21 January 2014.

19 Brazil recently, in 2015, signed investment agreements with Mozambique, Angola, Malawi and Mexico and is negotiating with several other countries based on a new "Cooperation and Facilitation of Investments" model.

capital-exporting or capital-importing countries and whether there is confidence that the government's right to regulate can indeed be assured through appropriate reform of the system. In all cases, new approaches to investment treaty-making aim to mitigate the risks of earlier agreements. There is some evidence of efforts to ensure IIAs support inclusive growth and sustainable development objectives, notably through strengthening the right of governments to regulate in the public interest. In some cases, there are attempts to locate investment protection within broader human rights frameworks.

IX. IIAs and Africa's Agenda for Structural Transformation: Some Recommendations

Recent changes in the global economy have been accompanied by significant improvements in Africa's economic prospects. Africa is already the second fastest-growing continent in the world, after Asia, and offers the highest return on investment among other regions. Africa's economic growth has been driven by a boom in mineral exports as well as growth in the agriculture, transport, telecommunication and retail sectors. Africa's enormous reserves include raw materials, 60% of the world's unused arable agricultural land, a young growing population, a growing middle class with considerable purchasing power, and urbanization alongside steady improvements in economic governance – these factors underpin the view that Africa could become the next leading source of global economic growth.

Africa's paramount objective, however, is to move off a growth path based on consumption and commodity exports onto a more sustainable developmental path using its natural resource base as a platform for a new strategy for economic diversification and industrialization. Indeed, African governments and leaders have committed themselves to this transformation. Achieving this objective will undoubtedly require a range of new and supportive

policies and regulations including with respect to harnessing the benefits of FDI for sustainable development.

This chapter has raised several issues that need to be considered to ensure that Africa's efforts at structural transformation are not frustrated. It was observed that IIAs are oriented in a manner that constrains the policy space of governments to implement measures in the public interest where these have a perceived negative impact on investor rights. It is further argued that the international investment regime exhibits a pro-investor bias over governments' right to regulate in the public interest.

The chapter unpacked how the shortcomings and imbalances both in the IIAs and in the ISDS system that enforces those treaties constrain policy space. It pointed out that necessary change to policy and regulation, such as the tax regimes (levies on mineral exports, for example) that may be important to redirect resources from primary sectors to support industrialization, may be challenged through international arbitration. Similarly, IIAs place constraints on government efforts to require investors to build linkages to domestic firms, upgrade skill or transfer technology. Efforts to enhance local content in production processes can also be stymied by IIAs.

In this light, it may be prudent for African policymakers and experts to consider the following. First, African governments through the African Union may consider pursuing a comprehensive review of all the IIAs African countries have entered into. This review could focus on assessing the risks of IIAs to policymaking for structural transformation in Africa.

Second, African governments may consider a pause in signing new IIAs until this assessment is complete. In doing this, it would be important to recall that there is no direct or clear link between inflows of FDI, which all African countries seek, and

signing IIAs. Indeed, investors are motivated primarily by the prospects for returns on investment, which are high in Africa, and the extent to which national legal frameworks offer adequate protection to foreign investors. This also suggests the need to focus efforts on strengthening domestic legal frameworks to protect investment.

Third, African countries may need to consider how to deal with the stock of existing IIAs that they have signed on to. As noted, termination, renegotiation, and amendments are all options that countries around the world have undertaken. The challenges with each of these options could also be a subject for the review.

Fourth, it may be useful to begin consideration of an Africa-wide investment protection framework that mitigates risks of the earlier treaties and establishes a more appropriate balance between investor protection and the rights of government to regulate in the public interest. This may include consideration of an African-based investment arbitration centre.

Finally, in initiating a dialogue within Africa on these matters, African government policymakers and experts should participate more actively in the intensifying global debate on IIAs and the ISDS system.

Chapter 8

Ecuador's Experience with International Investment Arbitration

Andres Arauz G.[1]

I. Introduction

This chapter briefly reviews Ecuador's experience with international investment treaties and arbitration. It begins by presenting Ecuador's Audit Commission on the topic. It further explains the historical and geopolitical context of the decisions Ecuador has taken, beyond the traditional criticism on rules of arbitration or the role of arbitrators. Then it reflects on some of the cases Ecuador has faced in the last decade, in light of the current criticisms against investor-state dispute settlement (ISDS). Finally, it presents a case for the way forward with a series of national, regional and global alternatives currently pursued by the Ecuadorean government.

II. CAITISA: Audit Commission on BITs and Arbitration

In light of Ecuador's experience, President Rafael Correa decided to establish, by executive decree in May 2013, a joint govern-

1 Mr. Arauz is currently Minister of Knowledge and Human Talent in the Republic of Ecuador. At the time of writing this chapter (December 2014), Mr. Arauz was serving as Deputy Secretary General, Department of Planning and Development, Ecuador. This chapter in no way compromises his institution, Ecuador's defence and sovereign decision-making, nor may it be used as an interpretation in claims, awards, award set-asides, execution procedures or any act against the Republic of Ecuador.

ment-civil society commission to study and audit its bilateral investment treaties and the international investment arbitration system. This audit commission – referred to as CAITISA for its Spanish acronym – is a sequel to the audit commission that studied Ecuador's foreign debt commitments at the beginning of President Correa's administration and that led to a selective default that saved about $8 billion in cash flow.

CAITISA intends to verify the legality, legitimacy and lawfulness of investment treaties, rules and Ecuador's commitments, and the possible inconsistencies and irregularities in the decisions of arbitration tribunals that may have caused negative impacts to the Ecuadorean state. It is organized into three working groups: bilateral investment treaties (BITs); arbitration cases; and foreign investment and development.

The first group is in charge of analyzing the historical background and geopolitical context of how Ecuador became party to BITs, fundamental clauses and their legal compatibility with other national, regional and international laws and legal defence doctrine and alternatives.

The second group is in charge of studying the legal bases and legitimacy of the current investment arbitration system including: backgrounds of arbitration cases that concern or may concern ISDS cases against Ecuador; procedures; threats; acts and decisions of foreign jurisdictions; awards and decisions by other jurisdictions; basis of consent (treaties and laws) for claims; conflicts of interest; role of law firms; legal defence strategies; costs; and consequences of the demands. CAITISA has already been criticized by Occidental Petroleum,[2] which demanded that Ecuador establish a "security" for the amount of the award in the case it brought against Ecuador on the grounds that CAITISA

2 http://www.oxy.com/Pages/default.aspx. More details on the case raised by Occidental against Ecuador are included in the following sections of the chapter.

"underscores the risk that Ecuador will not comply with the Award if its annulment application fails".[3]

The third group is in charge of analyzing the relationship between BITs, foreign direct investment (FDI) and the national development regime. The study is divided into a general component that will study whether BITs attracted investment and in what circumstances, and a specific component that will examine the behaviour of the specific companies that have brought investment arbitration claims against Ecuador.

Finally, CAITISA must deliver conclusions and recommendations and a publicly accessible information base.

III. BITs: Historical Context

The commission has so far found plenty of irregularities regarding how Ecuador entered into BITs. It was not uncommon to find documents[4] from rich countries and Bretton Woods institutions (the International Monetary Fund and World Bank) pressuring Ecuador into signing these agreements in the 1980s and the 1990s. Many of the most important treaties, including the United States-Ecuador BIT and the Washington (International Centre for Settlement of Investment Disputes (ICSID)) Convention, did not fulfil the constitutional and legal ratification processes.

The geopolitics of ICSID are intertwined with those of the Bretton Woods system because of the World Bank's power to determine the arbitrators.[5] The President of the World Bank designates the arbitral tribunal's president when the parties' arbitrators cannot

3 ITA Law (2014h)

4 Tempone (2003: 30)

5 The President of the World Bank, as Chairman of the Administrative Council of ICSID, also designates arbitrators when one of the parties refuses or omits to do so. See ICSID (2006a: Art. 5).

agree on a common name.[6] Likewise, and even more crucially, the President of the World Bank designates the three members of the Annulment Committee (a sort of last recourse of an arbitration proceeding)[7] after an award has been made. The President of the World Bank has always been a US citizen, often a former high-ranking US government official. The US has blocked World Bank loans to states that have ICSID awards pending.[8] During all of ICSID's history, the US has not lost one case as a defendant. Thus, ICSID as a forum for investor-state dispute settlement in the context of the proposed Transatlantic Trade and Investment Partnership (TTIP) between the US and the European Union is dangerous even for EU member states.

Ecuador denounced ICSID in 2009. This can be considered a de facto termination of BITs that had ICSID as their only forum for investor-state dispute settlement. Even the US State Department has admitted[9] that in these cases there is no alternative left to file claims against Ecuador. It is worth noting that under these treaties, states can rarely file international claims against investors;[10] thus, states can never "win", they can only "not lose".[11]

Geopolitics is also relevant in the decision-making process to withdraw from the BITs, especially considering recent criticism of international investment arbitration. Ecuador denounced 11 BITs between 2008 and 2010, mostly with Latin American countries whose investors had not initiated any cases against

6 ICSID (2006b: Rule 4.1)

7 ICSID (2006b: Rule 52)

8 Parks (2013)

9 US Department of State (2013)

10 There are only three known cases, but because the information is not made public, it is not possible to determine whether the BITs themselves constituted consent for this type of arbitration: *Republic of Equatorial Guinea v. CMS Energy Corporation and others* (ICSID Case No. CONC(AF)/12/2); *Gabon v. Société Serete S.A.* (ICSID Case No. ARB/76/1); *Republic of Peru v. Caravelí Cotaruse Transmisora de Energía S.A.C.* (ICSID Case No. ARB/13/24).

11 According to ICSID (2014: 30), 48% declined jurisdiction and 24% dismissed all of the investors' claims.

Ecuador and whose investment in Ecuador was insignificant.[12] Ecuador also denounced its BITs with two EU countries: Romania and Finland. The Romanian government replied with a note rejecting the denunciation and postponing effects to a later date. Finland's position is unclear. As part of its internal process, Ecuador's Constitutional Court has already declared that all BITs are unconstitutional and Ecuador's National Assembly has already approved the denunciation of BITs with Germany, France, Sweden and the United Kingdom.

During a state visit by President Correa to Germany in 2013, German Chancellor Angela Merkel publicly stated the need for "legal certainty" for German and European investments in Ecuador.[13] This was endorsed by the German ambassador in Quito.[14] Similar statements were made by the EU Trade Commissioner when South Africa denounced its BITs with European countries.[15] However, a few months after those statements, the EU and the Southern African Customs Union signed a trade agreement.[16] This is evidence that such statements do not constitute a credible threat.

The European countries' positions themselves seem to contradict these countries' statements during the current post-crisis juncture, particularly regarding the Canada-EU Comprehensive Economic and Trade Agreement and the US-EU TTIP. Besides statements by German officials, and other statements that have been reviewed elsewhere,[17] a report by a committee of the French National Assembly rejecting the Canada-EU treaty[18] is paradigmatic:

12 Save for a harsh response from Honduras, none of these countries protested. CAITISA (2014).

13 *El Telégrafo* (2013)

14 Sosa and Zeas (2013); Vela (2013).

15 Allix (2013)

16 European Commission (2014b)

17 Khor (2014)

18 Assemblée Nationale (2014a)

… la Commission européenne a suspendu les négociations sur ce point et a organisé une consultation publique. Toute décision sur l'inclusion d'une telle clause [de règlement des différends entre les investisseurs et les États] avec les États-Unis est suspendue. Quelle est alors la légitimité de prévoir de telles dispositions dans l'accord avec le Canada, préjugeant de la suite qui serait donnée à la consultation dont les résultats ne seront connus que fin octobre? Et si l'Union européenne accepte ce précédent, comment pourra-t-elle défendre autre chose au cours des négociations transatlantiques?

… la définition de l'expropriation indirecte constitue une épée de Damoclès pour la puissance publique et peut porter atteinte à la possibilité des États à réguler; …

Ce type de mécanisme qui se caractérise par le flou des motifs pour lesquels les États peuvent être mis en cause, l'opacité des procédures, le coût des litiges, le risque de conflits d'intérêts ne se justifie pas dans un accord entre des États de droit. …

(Unofficial translation is provided in the footnote for information purposes.[19])

19 "… the European Commission had suspended negotiations and had organized a public consultation on this matter. Any decision about the inclusion of such a clause [dispute settlement between investors and States] with the United States was suspended. What is then the legitimacy of laying down such provisions in the agreement with Canada, prejudging the outcome of the consultation the results of which will not be known before the end of October? And if the European Union accepts this precedent how can it defend something else during the transatlantic negotiations?

… the definition of indirect expropriation is like the sword of Damocles for public authorities and can jeopardize the capacity of States to regulate; …

This type of mechanism, characterized by vague reasons for which States could be challenged, lack of transparency in the procedures, the cost of litigation, the risk of conflict of interests is not justified in an agreement between rule of law States. …"

The French National Assembly subsequently adopted a resolution[20] which declared:

> *5. S'oppose à tout mécanisme d'arbitrage des différends entre les États et les investisseurs et demande en conséquence la révision substantielle des chapitres 10 et 33 sur la protection des investissements.*
>
> (Unofficial translation is provided in the footnote for information purposes.[21])

If one were to substitute Canada with a developing country like Ecuador, the arguments for denunciation of the Ecuador-France BIT would be readily available. Likewise, there is the statement by the French foreign trade minister, Matthias Fekl, in the French Senate[22]: "*Il faut conserver le droit des États à éditer des normes et à les voir appliquées, d'avoir une justice indépendante et impartiale et d'avoir la capacité pour les peuples de France* ***et du monde entier*** *de faire valoir leurs préférences collectives*" (emphasis added). It is worth noting that the minister refers to the right of the people of the entire world to assert their collective values.

It's worth pinpointing some further contradictions in EU investment policy. The EU had frozen negotiations and launched a public consultation regarding ISDS in TTIP. However, the consultation was based on a pre-fabricated questionnaire on only some of the issues. The European Court of Justice (ECJ) has determined that there are contradictions between several of the EU member states' BITs (including those in force with developing countries) and the Lisbon Treaty.[23] To date, these

20 Assemblée Nationale (2014b)

21 "5. Is opposed to any kind of arbitration mechanism for disputes between the States and investors and therefore requests the substantial revision of chapters 10 and 33 on the protection of investments."

22 According to EurActiv.fr (2014).

23 European Court of Justice (2009a, 2009b, 2009c)

issues have not been resolved. After Lisbon, the competence for investment negotiations now lies in the European Council but the jurisdictional issue has not been fully resolved regarding what occurs with pre-Lisbon BITs. There subsist several intra-EU (mainly West-East) BITs still in force. Justifying these treaties by referring to deficient legal systems is anachronistic if both parties share a common higher court (ECJ) and share the same laws (directives and regulations) and "Constitution" (Rome and Lisbon Treaties). There are even West-East claims based on EU-mandated directives, European Parliament laws and EU issued regulations.

This last issue has been of concern for the EU, to the point that they have issued a special Regulation[24] for managing financial responsibility linked to investor-state dispute settlement tribunals. In practice, it establishes the right for the European Commission in the execution of awards. In 2013, there was already a case involving Romania where the European Commission declared "any award requiring Romania to reestablish investment schemes which have been found incompatible with the internal market during accession negotiations, is subject to EU State aid rules [and] the execution of such award can thus not take place if it would contradict the rules of EU State aid policy."[25] This interesting practice can be brought up by developing nations when faced with execution of arbitral awards that go against their national laws, regional treaties, WTO laws and even their "collective values".

IV. Cases: Clauses and Causes

The investment chapter in the EU-Singapore free trade agreement (FTA) could set a new type of standard for negotiations worldwide. The EU acknowledges errors and omissions of trea-

24 European Parliament and Council of the European Union (2014)

25 *Micula et al. v. Romania*, in Tietje and Wackernagel (2014).

ties in force and has produced a "fact sheet"[26] on its investment provisions. It is up to developing countries to bring up this document in negotiations, after denunciation of current BITs. However, practical experience with arbitration shows that no matter how well-written a BIT is, because of the "most favoured nation" clauses and litigation revenue incentives, arbitrators tend to abuse their power and interpret these texts expansively, thus favouring investors.

These treaties begin with a risky clause: the definition of investment. While one traditionally thinks that physical assets (machinery, equipment and factories) constitute foreign investment, the lax definition basically allows anything to be considered investment. Intellectual property is included as investment,[27] limiting the possibility of countries to demand certain types of technology transfer. Even sovereign debt owned by speculators is considered investment;[28] this limits sovereign management of public finances. These "investments" (with their judicial and attachment rights) have been packaged and sold to third parties, such as the case of ICSID claims against Argentina that were sold to vulture funds.[29]

An expansive interpretation of the non-exhaustive definition of investment in the US-Ecuador BIT could include *any asset* of the investor in the host country.[30] However, the worst instances of abuse of the definition of an investment are in the cases Chevron II[31] and Chevron III.[32] In Chevron II, the tribunal defined a lawsuit in Ecuadorean courts as a kind of investment. In

26 European Commission (2014a)

27 See ITA Law (2014d, 2014i, 2014j).

28 ITA Law (2014e)

29 Ministerio de Economía y Finanzas Públicas (2013)

30 A point highly indicative of the asymmetries of the "reciprocal" bilateral investment treaties is that in the US-Ecuador BIT, there is a section reserved for financial services and the energy sector, but on the US side only.

31 ITA Law (2014a)

32 ITA Law (2014b)

Chevron III, the tribunal defined contractual rights supposedly waiving environmental contingent liability (off balance-sheet) that Chevron (formerly Texaco) might have to pay to private citizens and communities of Ecuador for its lack of remediation in the Amazon rainforest as a kind of investment. Both decisions ignore the fact that Texaco (Chevron's current subsidiary) left Ecuador in 1992 (prior to the US-Ecuador BIT's entry into force) and that it has no significant *assets* in Ecuador.

The definition of investor is also a huge risk for developing countries. The use of "special purpose entities" (shell or mailbox companies) for treaty shopping (tax or investment, or both) is a characteristic of modern cross-border investment flows.[33] This crude reality is ignored by arbitrators when making decisions on jurisdiction. They have approached interpretation expansively and allowed for "indirect" investors to initiate claims against sovereign nations, even if the company has changed jurisdiction exclusively in order to bring a claim. In this regard, the Conoco Phillips (a US company with a Netherlands mailbox subsidiary) case against Venezuela[34] is perhaps the most striking case, followed by a case – and a threat of a case[35] – against Ecuador. Perenco (1) is a company established in the Bahamas tax haven, owned by another Perenco (2) company in the Bahamas, in turn owned by another Perenco (3) company in the Bahamas, in turn owned by another Perenco (4) company in the Bahamas, in turn owned, partially, by a dead French citizen. The arbitral tribunal decided that Perenco (1) from the Bahamas could sue Ecuador under the France-Ecuador BIT.

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33 OECD (2008)

34 ITA Law (2014c)

35 Another interesting threat of a case was that notified by the Ecuadorean indirect owners of an Ecuadorean newspaper *El Universo* (itself established in the Cayman Islands tax haven), who have lived and worked in Ecuador, but who apparently have a US passport and thus could consider the local newspaper as a "foreign investment". See Procuraduría General del Estado (2014).

A much more serious and recent case saw Yukos, which had companies established in tax havens but was owned by a Russian citizen, suing Russia under the investor-state dispute settlement provision in the Energy Charter Treaty. (It is worth noting that Russia never ratified and later withdrew its signature from the Energy Charter Treaty.) This opens the door for all nationals to enjoy "foreign investor treatment" in their own country just by establishing an intermediate mailbox company (for both tax and investor rights purposes). This behaviour was found to be common in Ecuador (besides the case of Perenco), where several companies were domiciled in the US but their capital was registered in tax havens: Chevron, Burlington and City Oriente were registered in Bermuda; Noble Energy was registered in the Cayman Islands and Murphy was registered in Panama. They all invoked the US-Ecuador BIT.[36]

One of the most offensive clauses under BITs has to do with indirect expropriation. In the case of Ecuador, arbitrators awarded Occidental over $75 million[37] over a tax dispute even though taxation was explicitly excluded from the US-Ecuador BIT. In the case of Burlington (US) and Perenco (France), even though they formed one company in Ecuador, the tribunals' decisions and awards are directly in contradiction regarding the taxation issue. In Europe, the suspension of Spanish subsidies for renewable energy has been declared indirect expropriation merely because it affected companies' future cash flows. It seems highly controversial as well that a nationwide referendum in Ecuador rejecting casinos has been challenged by a Spanish gaming corporation,[38] presumably under the indirect expropriation clauses of the Spain-Ecuador BIT.

The "fair and equitable treatment" clause is the clause that is the most ambiguous and expansively interpreted by arbitrators. In

36 CAITISA (2014)

37 ITA Law (2014g)

38 Procuraduría General del Estado (2014)

the Occidental II case, the tribunal found that Occidental was guilty of violating Ecuadorean law when it transferred rights to Canadian company EnCana (formerly Alberta Energy Co), but deemed that the law that mandated the state to punish this violation was disproportionate. Occidental's penalty was a completely arbitrary 25% deduction of the amount to be compensated. Translated into dollars, Ecuador must compensate[39] Occidental $2.6 billion (including interest to date), the largest ever ICSID award.[40]

Geopolitics also played a role in the Occidental case. Both the US-Ecuador BIT as well as the concession contract renounced the use of diplomatic or consular means in specific companies' investment issues. Ecuador accused Occidental of "repeated use of diplomatic channels to put improper pressure on Ecuadorian authorities".[41] The tribunal "found no evidence [...] that the Claimants ever sought assistance from the US Government". However, two recently revealed diplomatic cables and a lobbying filing by Occidental are evidence to the contrary. In September 2004, the US Embassy informed the Department of State that "Oxy [Occidental] and Embassy officials will continue to quietly press the case with GOE (Government of Ecuador) officials and keep one another informed of developments in the matter".[42] In March 2005, the then President of Ecuador was warned by the US Embassy that "a declaration of caducity (contract nullification and seizure of assets) against Oxy would cost the GOE the support of the USG (United States Government)".[43] This can help explain why in 2006 Occidental lobbyists Ian David and Robert McGee contacted six US federal agencies (including the White House, the US Trade Representative and the Department

39 ITA Law (2014h)

40 Ecuador has since filed for annulment of the award at ICSID. See ITA Law (2014h).

41 ITA Law (2014h), para. 273.

42 WikiLeaks (2004)

43 WikiLeaks (2005)

of State) and both houses of the US Congress[44] regarding the "Ecuador – arbitration" and spent part of $8.9 million in the matter.

The tribunal was presided by Canadian lawyer and arbitrator Yves Fortier, former chairman of the board of Rio Tinto Alcan, former ambassador to the UN Security Council, current chairman of the World Bank's Sanctions Board and current high-ranking intelligence official of the Canadian government.[45] Fortier sat on the Rio Tinto Alcan board of directors with Gwyn Morgan, former President and CEO of EnCana at the time of the referred illegal transaction.[46] Fortier also chaired the three Yukos-Russia tribunals. In those cases, with the same logic, the tribunals found that Yukos did violate Russian law and double taxation treaties, but nevertheless, even though taxation issues are not covered in the Energy Charter Treaty, it was Russia who must compensate[47] the (non-foreign) former owners of Yukos by the exorbitant amount of over $50 billion (after the same arbitrary 25% deduction), the largest ever investment award.

V. There Is Always an Alternative

It would be unwise to read both these awards and interpretations without a geopolitical prism. Contrary to the dominant discourse of "there is no alternative", the world is transitioning to an alternative investment regime. In fact, Ecuador has been successful in taking a leading role with civil society and other developing nations in securing the approval of a United Nations Human Rights Council resolution (Resolution A/HRC/RES/26/9) establishing a negotiating mandate on an international legally binding instrument to regulate, in international human rights law, the activities of transnational corporations and other business enter-

44 Secretary of the Senate (2007)
45 Security Intelligence Review Committee (2014)
46 gwynmorgan.ca (2014)
47 ITA Law (2014f, 2014k, 2014l)

prises. This opens the way for enhancing the ethical behaviour of transnational corporations around the world. The results of the vote[48] for this initiative at the Human Rights Council showed the geopolitical nature of the regulation of foreign investment even in regard to universal values like human rights.

Some BRICS (the grouping comprising Brazil, Russia, India, China and South Africa) countries are moving away from the international investment arbitration regime. Brazil has not ratified any bilateral investment treaties to date and is not a part of ICSID.[49] India is reviewing all of its treaties and has signalled that it will withdraw from them. South Africa is withdrawing from all of these treaties and is not part of ICSID. Russia has withdrawn its signature from the Energy Charter Treaty and one of its largest companies, Rosneft, has announced[50] that it will not agree to arbitration in "Western" jurisdictions. Other large developing countries like Indonesia are withdrawing from investment treaties.

In South America, Bolivia withdrew from all its treaties and from ICSID. Venezuela denounced the Netherlands-Venezuela BIT that was most prone to treaty shopping and withdrew from ICSID. South America is establishing its own investment dispute settlement forum. Ecuador is leading the establishment of an international Global South observatory of transnational investment disputes, in partnership with the South Centre, which hopes to share strategic information for legal defence and motivate collective action regarding the investment regime.

Considering the reality of the links between BITs and FDI, Ecuador has determined that natural resource availability and the prospect of resolving disputes with legal certainty for all parties

48 Business and Human Rights Resource Centre (2014)

49 In 2015, Brazil launched a new model investment agreement entitled the "Cooperation and Facilitation of Investments" model.

50 Boltenko (2014)

are key determinants in attracting worthwhile foreign direct investment. Therefore, Ecuador has established a domestic law to protect investments. Ecuador now signs investment contracts which allow for regional (i.e., Latin American) arbitration, so long as it is based on national laws and regulations, excludes regulatory and tax policy space from the ambit of arbitration, and requires that domestic jurisdiction be exhausted. These contracts also include performance requirements for the investors and are balanced. They include rights and duties for both parties – unlike BITs that are blank cheques for the investor.

VI. Conclusion

The geopolitical pressures that developing countries have faced regarding investment treaties and arbitration could soon be a thing of the past. But this can only be the case if the Global South collectively seizes the moment of internal contradictions in the hegemonic North.

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Chapter 9

India's Experience with BITs: Highlights from Recent ISDS Cases

Biswajit Dhar

I. Introduction

In recent years, India has been involved in several disputes with foreign investors in which the latter have invoked the provisions of the investor-state dispute settlement (ISDS) mechanism included in bilateral investment promotion and protection agreements (BIPPAs, better known as bilateral investment treaties or BITs) to bring the host country before private arbitration panels. At the end of 2013, there were 14 disputes against India, the 10th largest number among the countries facing investment disputes.[1] But it was not until the end of 2011 that the Government of India, which has signed 82 BITs,[2] faced the challenges posed by these agreements. This was the result of a ruling made against the Government of India by a London-based United Nations Commission on International Trade Law (UNCITRAL) tribunal that adjudicated the dispute between the public sector Coal India Ltd. and the Australian firm White Industries Ltd.,

1 UNCTAD, "Recent Developments in Investor-State Dispute Settlement (ISDS)", IIA Issues Note No.1 (April 2014), Annex 2, p. 28.

2 72 of these BIPPAs are being implemented.

after the foreign firm had invoked the ISDS provisions of the Australia-India BIT.

Since the Coal India arbitration, a number of foreign investors have either served notices for arbitration or are actively preparing to invoke the provisions of the ISDS system for enforcing their rights in India. The response of the Government of India to these developments has been two-fold, although neither was explicitly linked to the challenges posed by the investor disputes. The first was to turn more foreign-investor-friendly by making the policies governing foreign direct investment more liberal. The second was to initiate an exercise to revise the model act governing the BITs, ostensibly to avoid the problems that the Government of India had faced while defending the dispute brought by White Industries Ltd. (henceforth, WIL).

This chapter looks at India's experience with the bilateral investment treaties, focusing on the developments mentioned in the foregoing. At the outset, the chapter will discuss the dispute with White Industries, in particular, the issues that the foreign investor had raised while invoking the provisions of the ISDS mechanism. The case that WIL had presented against India before the UNCITRAL arbitration panel brings out the fact that in trying to attract foreign investment into their economies, developing-country governments have gone too far in protecting investor rights. In the exercise of the rights that have been granted in these BITs, the foreign investors are able to pose serious challenges to the key pillars of the governance structure in their host countries, namely, the judiciary and the executive. As we shall discuss below, the third pillar of the democratic structure of governance, namely, the legislature, can also be challenged by the foreign investor. In the subsequent section, the recent disputes with foreign investors will be elucidated. Finally, a case for revising the model BIPPA text will be made.

II. The White Industries Dispute

The case involved an Australian firm, White Industries Ltd. (WIL), and India's largest state-owned enterprise in the coal mining sector, Coal India Ltd. (CIL), when the latter undertook expansion of its production capacity in the late 1980s. White Industries' involvement with the project began with its participation in the preparation of a feasibility report for the development of a mine. The feasibility study was being prepared by a CIL subsidiary, Central Mine Planning and Design Institute Ltd. (CMPDIL). WIL's primary interest was to negotiate a contract with CIL to supply equipment (an in-pit mobile crushing and conveying system and related technology for the proposed project).

In 1989, WIL entered into a contract with CIL for the supply of equipment related spares/exchange assemblies and to provide technical services for the development of a coal mine. The foreign firm was to be paid 206.6 million Australian dollars.

The contract provided for a production target of 2.76 million tonnes of washed and processed coal to be produced by the coal preparation plant during an initial six-month demonstration period. The contract also provided that WIL was to be entitled to a bonus if production was in excess of the target figure and, conversely, the equipment supplier was also liable to a penalty if production was below the targeted figure.

The dispute between the two parties arose over the performance of the equipment supplied by WIL and also over the quality of the washed and processed coal and the sampling process by which quality would be measured. CIL demanded a penalty because it felt that the quality of washed coal produced by the coal preparation plant did not meet the standard agreed in the contract. WIL, on the other hand, demanded a bonus on the coal handling plant

and coal preparation plant. CIL rejected this and cashed the bank guarantee amounting to 2,772,640 Australian dollars.

With the dispute remaining unresolved, WIL filed a request for arbitration with the International Chamber of Commerce (ICC) in 1999. A majority of the arbitrators ruled in favour of WIL, and consequently, WIL was entitled to an award of 4.08 million Australian dollars.

Between 2002, when CIL appealed against the ICC arbitration before the Calcutta High Court, and 2009, the case went up to the Supreme Court of India. Towards the end of 2009, WIL wrote to the Government of India contending that the actions of its courts, and CIL, were tantamount to a breach of Articles 3 (Promotion and Protection of Investments), 4 (Treatment of Investments), 7 (Expropriation and Nationalization) and 9 (Repatriation of Investment and Returns) of the Australia-India BIT. WIL asserted claims exceeding 10 million Australian dollars for loss and damages.

This case raises a number of important issues relating to the content of the BITs that India has concluded with 72 countries. The first are the definitional issues concerning these treaties. The second is the treatment of investments; the third, the issue of most-favoured-nation treatment; and the fourth, the basis for expropriation of investments.

In the following discussion, we first look at the arguments provided by WIL in support of its claims against India. We then provide the views of the UNCITRAL tribunal and its ruling on the claims made by WIL.

(i) Arguments of WIL

After putting forward arguments to justify that its involvement in the CIL project was an "investment" under the definition

provided in the Australia-India BIT, WIL claimed compensation under several other provisions of the BIT as pointed out below.

(a) *Definition and scope of investment*

India questioned the jurisdiction of the tribunal to hear WIL's claim as it held that the complainant was not an "investor" in India, and none of the "assets" on which it relied constituted "investments". WIL's argument was that its participation in CIL's project constituted an investment, since investment had been defined in the BIT in the "broadest terms". WIL contended that two definitions of investment adopted in the Australia-India BIT encompassed its rights under the contract (including the bank guarantee). These definitions were: (i) right to money or to any performance having a financial value, contractual or otherwise, and (ii) business concessions and any other rights required to conduct economic activity and having economic value conferred by law or under a contract, including rights to search for, extract and utilize oil and other minerals. WIL argued that the contract it had entered into with CIL conferred on it the "right to money" and had provided it with the right to "conduct economic activity", both of which were part of the two definitions of investment in the Australia-India BIT. WIL further argued that its provision of the bank guarantees constituted an investment under the BIT itself. The firm had committed its own funds in issuing tens of millions of Australian dollars in guarantees to CIL pursuant to the contract. These bank guarantees, according to WIL, qualified as investment as per the Australia-India BIT, since they qualified as "right to money".

A second point of contention was the temporal applicability of the investment agreement, an issue with considerable implications. This arose from the argument presented by the Government of India (GoI) that the tribunal had no jurisdiction over

the acts and omissions of CIL, because the acts and omissions that WIL had complained against had occurred prior to 1999, whereas the Australia-India BIT came into effect from 2000. Further, GoI argued that a treaty could not have retroactive effect under public international law and therefore Article 2(1), the relevant article in this case, "provides that the Host State must, from the date of entry into force of the BIT, treat pre-existing investments in accordance with the standards set out in the BIT. It does not impose those standards retroactively".[3] Contesting this view, WIL argued that the issue here was not one of retroactivity. WIL maintained that there was "nothing in the BIT which requires a dispute to have arisen after the entry into force of the BIT".[4] Article 2(1), in its view, was relevant as long as there were "investments" existing at the time of entry into force. The BIT's temporal restrictions referred to "investments" and not disputes. Thus, the BIT covered any dispute arising out of or relating to an "investment" existing at the time of its entry into force.

(b) *Favourable conditions for investors*

Article 3(1) of the Australia-India BIT gave rise to two substantial obligations for the host states. First, each Contracting Party was required to "encourage and promote favourable conditions for investors of the other Contracting Party to make investments in its territory". Secondly, each Contracting Party had to "admit such [foreign] investments in accordance with its laws and investment policies applicable from time to time".

WIL argued that Article 3(1) required each of the Contracting Parties to take concrete, positive steps in the interests of investors. In WIL's view, this provision gave rise, "at the very least, to three obligations on the part of India: (a) to create a suitable

3 Final Award, *White Industries Australia Limited v. The Republic of India*, para. 5.1.29, p. 56. Available from www.italaw.com.

4 Final Award, *White Industries Australia Limited v. The Republic of India*, para. 4.2.10, p. 35. Available from www.italaw.com.

governance framework for supervising the action of state-owned corporations, including Coal India, in their dealings with foreign investors; (b) to ensure that its arbitration laws are administered in line with India's New York Convention obligations; and (c) to take steps to reduce the backlog of cases in its courts, given the prospect that such backlog must necessarily have significant effect on domestic and international businesses, including investors, as defined under the BIT".[5]

India, on the other hand, maintained that Article 3(1) provided for two general obligations: (i) a pre-establishment obligation, which required the Contracting Parties to "encourage and promote favourable conditions" for investors; and (ii) an obligation on each Contracting Party to "admit" investments by "investors" of the other Contracting Party, in accordance with its applicable laws and investment policies.

(c) *Fair and equitable treatment*

WIL challenged GoI by invoking Article 3(2) of the Australia-India BIT, which states, "Investments or investors of each Contracting Party shall at all times be accorded fair and equitable treatment." WIL argued that despite assuring foreign investors "fair and equitable treatment at all times", GoI had failed to meet its obligations. In support of its argument, WIL claimed that "Coal India was never entitled to take or retain the bank guarantee" and that India had failed "to exercise proper supervision of Coal India and thereby correct this unlawful retention."[6]

WIL built its case regarding the violation of the provisions on fair and equitable treatment based on two tenets. The first was that its legitimate expectations of India as a place to do business in

5 Final Award, *White Industries Australia Limited v. The Republic of India*, para. 9.2.1, p. 88. Available from www.italaw.com.

6 Final Award, *White Industries Australia Limited v. The Republic of India*, para. 10.2.2, p. 92. Available from www.italaw.com.

were dented because of acts of GoI, which included the failure to return the bank guarantee. The second tenet was its point about denial of justice by Indian courts. WIL's argument was that its legitimate expectation was that the Indian courts would afford justice by allowing it to enforce the award by the ICC tribunal in the courts of India in a fair and reasonably timely manner. However, the courts in India failed to provide justice to WIL by not allowing the enforcement process and the setting aside of proceedings for over nine years without any realistic end in sight.

(d) *Treatment of investments*

WIL claimed that India had breached its obligations under Article 4(2) of the Australia-India BIT[7] because its investment was treated on a less favourable basis than the treatment afforded to investments made by investors of a third country. WIL supported its claim by quoting Article 4(5) of the Kuwait-India BIT in which India had agreed to "provide *effective means of asserting claims and enforcing rights* with respect to investments and ensure investors of the other Contracting State the right of access to its courts of justice, administrative tribunals and agencies and all other bodies exercising adjudicatory authority, and the right to employ persons of their choice, for the purpose of the assertion of claims and the enforcement of rights with respect to their investments" (emphasis added). WIL argued that India's failure to enforce the ICC award in a timely manner because of the delays caused by the judicial authorities constituted a breach of its obligation to provide "effective means of asserting claims and enforcing rights" with respect to WIL's investments. This, according to WIL, was a violation of the most favoured nation (MFN) clause of the BIT.

7 This article reads: "A Contracting Party shall at all times treat investments in its own territory on a basis no less favourable than that accorded to investments of investors of any third country."

(e) *Expropriation*

WIL made a further case against India by arguing that the "effect of the Indian courts' delays in dealing with White's application to enforce the ICC award has deprived White of the benefit of the Award and of its rights to have the Award enforced"[8] and was tantamount to expropriation and a violation of Article 7 of the Australia-India BIT. WIL thus claimed compensation for this expropriation.

(f) *Repatriation of investment and returns*

The final claim made by WIL was that CIL's improper call on the bank guarantee and the "improper retention of those funds" constituted a breach of the obligations that India had taken under Article 9 of the Australia-India BIT. Under this provision, India had agreed to "permit all funds of an investor of the other Contracting Party related to an investment in its territory to be freely transferred, without unreasonable delay and on a non-discriminatory basis".

(ii) The Tribunal's Ruling

The tribunal's main arguments revolved around two substantive issues. First, it dealt with WIL's argument that its participation in the CIL project should be considered as an "investment" in line with the definition adopted in the Australia-India BIT. The tribunal concurred with the arguments presented by WIL that its involvement in CIL's project did constitute an investment, since the BIT used a broad definition of investment.

The tribunal also supported WIL's argument that India was in breach of the MFN provisions and had indeed failed to extend

8 Final Award, *White Industries Australia Limited v. The Republic of India*, para. 4.5.3, p. 45. Available from www.italaw.com.

to the foreign firm the benefits that it should have enjoyed as under the Kuwait-India BIT, according to which India had agreed to "provide effective means of asserting claims and enforcing rights with respect to investments". The tribunal concluded that "the Indian judicial system's inability to deal with [WIL's] jurisdictional claim in over nine years, and the [Indian] Supreme Court's inability to hear [WIL's] jurisdictional appeal for over five years amounts to undue delay and constitutes a breach of India's voluntarily assumed obligation of providing [WIL] with 'effective means' of asserting claims and enforcing rights".[9]

On the critical issue of the grant of compensation to WIL in keeping with the ICC award, the tribunal ruled that the foreign firm did have the right to have the award enforced in India. The tribunal rejected the grounds for non-enforceability of the award put forth by CIL essentially because the respondent had not provided the necessary evidence in support of its position.

III. Recent Cases of Investment Disputes

These recent disputes have arisen in two broad domains: the first concerns allocation of the airwaves for telecommunication services and the second concerns tax disputes involving a number of major foreign investors. Most of the disputes in telecommunications arose from the ruling given by the Supreme Court of India in 2012 to cancel 122 second-generation spectrum licences (2G licences) allocated to mobile telephone operators, which included those granted to foreign firms. The court had ruled that the government of the day had not followed the due process while allocating the licences to the firms that had bought them.

Two of the affected firms, Axiata Group, a Malaysia-based investor having a joint venture with an Indian firm, Idea Cellular,

9 Final Award, *White Industries Australia Limited v. The Republic of India*, para. 11.4.19, pp. 118-119. Available from www.italaw.com.

and Khaitan Holdings Mauritius Limited, an investor in Loop Telecom, a UK-based telecom firm, have initiated international arbitration proceedings under the UNCITRAL rules. In addition, the Russian firm Sistema and the Norwegian firm Telenor have served notices to the Government of India invoking provisions of the BIPPAs that India had signed with Russia and Singapore respectively.

In 2012, the Switzerland-based firm Bycell Holding AG initiated international arbitration proceedings under the UNCITRAL rules complaining about the discriminatory treatment in the allocation of 2G licences. The Department of Telecommunications of GoI had withdrawn letters of intent issued to the firm to launch mobile services in 2009, ostensibly for security reasons. This step was taken after the Home Ministry (ministry of internal security) had withdrawn its security clearance to the firm due to non-availability of authentic information about its promoters. Bycell Holding AG is 97%-owned by Cyprus-based Tenoch, which is, in turn, owned by two Russian nationals. The arbitration proceedings were thus initiated using the provisions of the Russia-India and Cyprus-India BIPPAs.

A dispute involving the Indian Space Research Organisation and its commercial arm, Antrix Corporation, and Devas Group, a Mauritius-based firm, is being decided through international arbitration proceedings under the UNCITRAL rules. Devas' interests are being pursued by its two US-based private equity investors, Columbia Capital LLC and Telecom Ventures LLC, who have invoked the provisions of the Mauritius-India BIPPA. This case has its origins in 2005, when Antrix Corporation had entered into an agreement with Devas Group to construct two satellites which Devas would have provided wireless multimedia services for, using the S-band spectrum.[10] The Government

10 "Apex court rules for international arbitration between Devas, Antrix", Live Mint, 10 May 2013. Available from http://www.livemint.com/Industry/zwOlVfH-

of India annulled this agreement in 2011 after questions were raised regarding the valuation of airwaves in the deal between Antrix and Devas. Further, GoI ruled that the deal was not in the security interests of the country.

One of the most recent disputes involves Vodafone Plc, the UK-based company and world's largest telephone service provider. It had initiated arbitration proceedings under UNCITRAL rules in February 2014. It invoked the provisions of the India-Netherlands BIPPA, through its Dutch subsidiary Vodafone International Holdings BV, against the retrospective application[11] of capital gains tax introduced through the General Anti Avoidance Rule (GAAR) in the Finance Act 2012. The Finance Bill 2012 aimed at plugging a loophole in the Income Tax Act 1961, which, according to the Government, allowed Vodafone to avoid its tax liability arising from the acquisition of Indian telecom company Hutchison Essar in 2007 merely because the transaction took place in the Cayman Islands. Since the takeover deal was worked out from a tax haven, Vodafone did not have to pay the capital gains tax of $2.2 billion that would have been payable if the deal had been conducted in India. The justification used by the Government of India has been that although the deal was concluded in a foreign territory, the assets involved in the deal were located in the territory of India. In response to the move by the Government of India, Vodafone has argued that the tax liability that the firm would incur as a result would violate a number of provisions of the India-Netherlands BIPPA including fair and equitable treatment, full protection and security and indirect expropriation of investment.[12]

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grYNt8D2Wv2576M/Apex-court-rules-for-international-arbitration-between-Devas.html.

11 The proposed amendment would enable the Government of India to tax such transactions with six years' retrospective effect.

12 The case involving Vodafone has two interesting parallels, both from the United Kingdom. First, Vodafone's acquisition of Hutchison Essar, and the subsequent reports of tax evasion, are similar to the case in which the firm's home government had discovered much later that its acquisition of the German firm Mannesmann

This tax dispute is one of the several disputes that GoI is currently involved in. Some of these disputes concern cases of transfer pricing which involve major foreign firms, including Vodafone, Royal Dutch Shell and IBM. However, a recent decision by the Bombay High Court that ruled in favour of Vodafone in its transfer pricing case could alter the scenario of GoI's disputes with foreign investors.

The disputes with foreign investors are not unique to India nor are they typical of developing countries. A slew of cases have emerged recently involving countries like Germany[13] and Australia.[14] As a settlement in one case, Germany had to withdraw

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was completed in 2000 through yet another tax haven, viz. Luxembourg. The UK government initiated proceedings against the firm soon after, but the dispute could only be settled a decade later with Vodafone agreeing to pay £1.25 billion, while independent assessments of the firm's liabilities were several times higher. Lending credence to these assessments was the fact that Vodafone had made a £2.2 billion provision in its books relating to the dispute. For details, see Armitstead (2010) and Maitland (2011).

The second parallel relates to the imposition of the retrospective tax to plug the abuse of loopholes in the double taxation treaties which exist between the UK and other countries. In 2008, the UK government introduced a provision in the budget (BN66) expressly aimed at double taxation treaty abuse by its residents. BN66 was introduced with the tagline "UK residents are taxable on their income wherever it arises" and this provision was introduced with retrospective effect, from 1987. For details, see HM Revenue and Customs (2008).

13 The implementation of the Federal Government of Germany's decision to phase out nuclear power by 2022 is mired in a dispute with the Stockholm-based power generation company Vattenfall. It is one of Europe's biggest electricity-producing firms and has stakes in three nuclear plants in Germany. Of the three plants, two have not been functioning for years and would not be allowed to restart, according to the decision. The third plant will continue to function till 2021 and thereafter it will also have to shut down. The company initiated a dispute with Germany claiming more than 1 billion euros in compensation. The company had successfully challenged Germany in 2009 in another case involving certain standards set out in power generation (*Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany* (ICSID Case No. ARB/09/6)).

14 In November 2011 Australia passed two anti-tobacco bills for restricting the sale of cigarettes. The bills allowed cigarettes to be sold only in packets with large health warnings and no brand logos; company names were permitted in small size. Philip Morris, a firm with a considerable presence in Australia, argued that the government's

the standards set out in an environmental permit required for the operation of a coal-fired power plant situated on the Elbe River aimed at limiting increase in water temperatures.

The disputes referred to above signal the emerging struggle between foreign investors and sovereign states in economic spaces that are looking constricted in the face of uncertain growth prospects. In the post-2008 world, governments have increasingly been called upon to "manage" economies, but their ability to formulate policies has run up against the rights granted to foreign investors. This has forced several governments in the developed world, most notably the European Union, to have a re-look at their bilateral investment treaties and other agreements guaranteeing investor rights.

The following section highlights some of the provisions in India's BIPPAs that either have been invoked by foreign investors to initiate disputes or could potentially be used in such disputes.

IV. Problems with India's BITs

The adverse ruling by the UNCITRAL arbitration panel against India in the White Industries case brought out several weaknesses of the BITs that India endorsed. These weaknesses, in our view, need to be rectified in order to ensure a better balance between the rights and obligations of foreign investors and India as a host country. As referred to earlier, the process of revisiting the existing model BIT text has already been initiated by India.

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move would "substantially diminish the value of [Philip Morris Asia's] investments in Australia". The firm initiated an arbitration process under UNCITRAL invoking the Australia-Hong Kong BIT, alleging breach of investor rights, including unlawful expropriation, failure to provide fair and equitable treatment, impairment of investment and failure to provide full protection and security. Australia has already announced that it will not have the investor-state dispute settlement provision in its future investment agreements.

The following discussion deals with some of the more critical areas in which some rethink is required, in our view, to bring about a better balance in the BITs.[15]

(i) Definition of Investment

What constitutes an investment is a key aspect of an investment treaty for it lays down the areas in which foreign investors can operate in their host countries. Most BITs that are currently in operation include a broad definition of investment. These treaties usually cover "every kind of asset", which is usually followed by a non-exhaustive list of covered assets.

The genesis of this definition lies in the series of BITs that the then Federal Republic of Germany (FRG) formalized in the early 1960s.[16] The BIT with Malaysia (the then Malaya) signed in 1961 provides the template[17] for the definition of "investment" that has been adopted by all countries. It may be mentioned here that the BITs are essentially agreements that the capital-exporting countries have entered into with their partners in the developing world and the former Socialist Republics. In other words, the traditional exporters of capital have not signed any BIT amongst themselves.

15 This chapter was prepared before the draft revised model investment treaty was made available by the Government of India for public consultation purposes.

16 FRG signed the first of these BITs with Pakistan in November 1959 and it became effective in 1962.

17 According to this agreement, the term "investment" shall comprise every kind of asset and more particularly, though not exclusively: (a) movable and immovable property as well as any other rights *in rem*, such as mortgage, lien, pledge, usufruct and similar rights; (b) shares or other kinds of interest in companies; (c) title to money or to any performance having an economic value; (d) copyright, industrial property rights, technical processes, trade-names and goodwill; and (e) such business concessions under public law, including concessions regarding the prospecting for, or the extraction or winning of, natural resources, as give to their holder a legal position of some duration.

India, too, has followed this approach. The definition of "investment" under the Model Text of the Bilateral Investment Promotion and Protection Agreement reads as follows:

> "investment" means every kind of asset established or acquired including changes in the form of such investment, in accordance with the national laws of the Contracting Party in whose territory the investment is made and in particular, though not exclusively, includes:
> (i) movable and immovable property as well as other rights such as mortgages, liens or pledges;
> (ii) shares in and stock and debentures of a company and any other similar forms of participation in a company;
> (iii) rights to money or to any performance under contract having a financial value;
> (iv) intellectual property rights, in accordance with the relevant laws of the respective Contracting Party;
> (v) business concessions conferred by law or under contract, including concessions to search for and extract oil and other minerals;

Many countries foresaw the danger of leaving the window open for expansionist interpretation and hence incorporated parameters into the investment treaties that would define whether an act is an investment or not. The United States in its Model BIT 2004 and 2012 (Article 1) and Australia in its free trade agreement (FTA) with the US (Article 11.17.4) define investment as "every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or assumption of risk". This implies that the US and Australia will provide protection only to those investors that have undertaken a degree of risk by committing resources in their territory (Dhar, 2012).

The other aspect of the definition of investment provided in India's BITs is the lack of consistency in what constitutes investment. In one of India's BITs (India-France BIT) the definition of investment explicitly recognizes minority and indirect forms of investments. The implication of such a broad definition is that even a single individual with a 0.01% share in a company which has invested in the territory of a Contracting Party can bring a state to international arbitration. The term "indirect forms" of investment is not defined and the only interpretation available for this term is under the scope of the treaty which states "indirect investment made through another company, wherever located, which is owned to an extent of at least 51 per cent". This clause would extend the benefit of the treaty to investors (subsidiaries) located even in the territory of a non-Party. Since investments from subsidiaries located anywhere are recognized as investments originating from within France, the subsidiaries located in those countries with which India has a BIT with more favourable terms can initiate disputes on behalf of the parent company in France. Since this provision is in one of India's BITs, investors from other Contracting Parties can import this provision using the MFN provision and initiate disputes through their subsidiaries located in other territories. It should be noted in this context that many other countries in their BITs have confined the scope of the treaty to "covered investments" only, which is defined as investment into the territory of one Contracting Party from an investor in the other Contracting Party.[18]

(ii) National Treatment and Most Favoured Nation

National treatment (NT) and MFN guarantee the investment and the investor from a Contracting Party treatment that is not less favourable than what is given to the host country's own investment and to investors from any third country. Many countries

18 For example, the US Model BIT 2012 (Article 2), US-Australia FTA (Article 11.1) and the North American Free Trade Agreement (Article 1101).

have restricted the scope of application of NT and MFN to similar situations. Investment treaties of the United States (Model BIT and the North American Free Trade Agreement (NAFTA)) and the Association of Southeast Asian Nations (ASEAN)-Australia-New Zealand FTA refer to “treatment no less favourable than it accords, *in like circumstances*” (emphasis added). These treaties also limit the application of NT and MFN to certain aspects of the investment. The US Model BIT 2004 and 2012 limit the scope of these two provisions to “the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition” of investment and do not extend to other aspects of investment such as dispute settlement. The US Model BIT further states that NT and MFN do not apply to “(a) government procurement or (b) subsidies or grants provided by a Party including government supported loans, guarantees and insurance” (Article 14).

It is very important to clearly define the scope of these terms because often MFN is used to import more favourable provisions. India in its existing BITs has not limited the scope of these clauses. The BIT with France not only states that NT and MFN clauses are applicable to “investments of investors of the other Contracting Party, including their operation, management, maintenance, use, enjoyment or disposal”, but also provides that investors are free to resort to any provision in any BIT “whichever is more favourable”. Since this was a clearly stated position of India, there was no point in arguing during the White Industries arbitration that import of the “effective means” clause from the BIT with Kuwait would subvert the carefully negotiated balance of the BIT. In this regard, the tribunal held that it “achieves exactly the result which the parties intended by the incorporation in the BIT of an MFN clause” (para 11.2.4 in UNCITRAL, 2011).

The BITs of India have not qualified NT and MFN with the term “like circumstances”, whereby the obligation would be

not to discriminate between domestic and foreign investors in similar circumstances (Ranjan, 2010). A number of countries have insisted on the incorporation of this qualification in their investment agreements. The importance of this qualification was emphasized by the US during the negotiations on the Multilateral Agreement on Investment (MAI) in that it "ensures that comparisons are made between investors and investments on the basis of characteristics that are relevant for the purposes of comparison" (Dhar and Chaturvedi, 1998, p. 839). It was further argued that the "objective (of the proposed instrument) is to permit the comparison of all relevant circumstances, including those relating to a foreign investor and its investment, in deciding to which domestic or third country investors and investment they should appropriately be compared, while excluding from consideration those characteristics that are not germane to such a comparison" (Dhar and Chaturvedi, 1998, pp. 839-840). The NT and MFN provisions in NAFTA, US Model BIT 2012, and investment chapter of the Australia-US FTA are qualified by the term "like circumstances".

(iii) Expropriation

Expropriation of investment, which is often equated with nationalization, is a major issue in the investment context. The recent nationalization in Argentina of the hydrocarbon corporation YPF majority-owned by Repsol of Spain has brought this issue to the limelight. The Government of Argentina argues that Repsol has failed to comply with its obligations in Argentina and has given priority to the international market, thus reducing the domestic production of crude and gas considerably.

All investment treaties provide for expropriation under certain circumstances. NAFTA, the US-Australia FTA, the ASEAN-Australia-New Zealand FTA, and India's BITs provide that expropriation of investment is not allowed except for public

purpose, in a non-discriminatory manner and on payment of fair and equitable compensation. All these treaties except the BITs of India clarify that compulsory licences (CL) granted in relation to intellectual property rights in accordance with the World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) do not come under the purview of expropriation.

A compulsory licence is an instrument resorted to by developed as well as developing countries to serve various public interests. Recently India issued a CL to Natco over Bayer's patented anti-cancer drug Nexavar. The drug is used in the treatment of kidney and liver cancer and patients need to take it on a lifelong basis. The grounds on which the CL was issued are unaffordable prices and less-than-adequate availability of the drug. The cost of the drug was Rs. 280,428 per month and Bayer's supply was meeting only 1% of the total requirement in the country. Under the CL Natco agreed to supply the drug at Rs. 8,800 per month and to provide the drug at no cost to at least 600 patients every year. The CL was issued under the Indian Patents Act, which provides that at any time after the expiration of three years from the date of the grant of patent, any person interested may make an application to the Controller-General of Patents, Designs and Trade Marks for the grant of a CL if the reasonable requirements of the public with respect to the patented invention have not been met (Article 84). Now the drug would cost just 3% of Bayer's price and many more patients will be able to access it.

Nothing prevents Bayer from taking the Government of India to international arbitration by invoking India's BITs. Although the CL has not transferred the intellectual property of the investor, this may not be sufficient to disregard it as an act of expropriation. According to Correa (2004), "the concept of expropriation is generally broadly construed and investment agreements do not only include direct and full takings of property but also de facto

or indirect expropriation" (p. 15). Whether the act amounts to indirect expropriation will be determined by the tribunal. In such situations, the criteria used for deciding whether an act amounts to indirect expropriation are the economic impact of the government action, the extent to which the act interferes with the reasonable expectations of the investor and the character of the government action. That the price offered by Bayer is not reasonable (reasonable to whom – the patients, the company, or a reasonable price that balances the interests of the patients as well as the company?) and Natco's price is reasonable, and whether all patients will be able to afford the CL price are some of the issues the Government of India would have to prove in the arbitration process.

The other aspect of the provisions on expropriation in India's BITs is that they would enable Bayer to claim compensation that is based on the market value of the investment immediately before the issue of the CL. India's BITs provide that expropriation even for a public purpose will have to be compensated.

Whether Bayer will invoke the investor-state dispute provisions of India's investment treaties is a different matter, but the fact is that the company is entitled to do that. All these uncertainties can be avoided if it is clarified that a CL issued pursuant to the TRIPS Agreement does not fall under the purview of expropriation. Some countries have been extremely careful in this regard; they have clarified that certain acts aimed at protecting public interests cannot be brought under the purview of not only direct expropriation but also indirect expropriation. The annexes on expropriation in both the US-Australia FTA and the investment chapter of the ASEAN-Australia-New Zealand FTA state that "non-discriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives such as the protection of public health, safety, and the environment do not constitute indirect expropriation".

(iv) Investor-State Dispute Settlement

The investor-state dispute settlement mechanism in the investment treaties provides investors the facility to drag sovereign states to an international arbitration process. Even worse are the scenarios where sovereign states are held liable for disputes on commercial agreements between firms. The verdict of the UNCITRAL tribunal on the dispute brought by White Industries has been an embarrassment for the Government of India. Not only was the Government of India brought into the dispute over a commercial engagement between White Industries and Coal India Ltd., but India was also held liable to White Industries. This case also brings out yet another aspect of investment treaties, namely that foreign investors are well equipped to bypass even the highest courts of a country.

Realizing the potential constraints that this clause will create, Australia has already moved in the direction of excluding ISDS provisions from its investment treaties. The investment chapter of the US-Australia FTA has restricted the rights of the investor to initiate a dispute. The investor can initiate arbitration against a Contracting Party only if the law of that Contracting Party permits such arbitration. Article 11.16.2 of the US-Australia FTA states that nothing "in this Article prevent[s] an investor of a Party from submitting to arbitration a claim against the other Party to the extent permitted under that Party's law". If this is not the case, disputes need to be initiated through a Contracting Party in accordance with the dispute settlement provision of the FTA which provides for a dispute settlement panel constituted jointly by both the Contracting Parties. It was reported that the negotiations on the investment chapter of the proposed Trans-Pacific Partnership Agreement involving Pacific region economies are

caught up in a debate as Australia has officially stated that it will no longer agree to any ISDS provisions in its FTAs.[19]

It should be noted that the US Model BIT 2012 came in the wake of the Obama administration's decision to "review … the implementation of our FTAs and BITs to ensure that they advance the public interest".[20] The decision came in the context of mounting concerns on whether the FTAs and BITs give foreign investors in the US greater rights than what US investors have under US law and whether these agreements give governments the "regulatory and policy space" needed to protect the environment and the public welfare.

V. Conclusions

In this chapter our attempt was to present a case for a review/revision of the BITs involving India which are currently in force in the country. The review should cover, inter alia, issues of more favourable treatment to foreigners than locals, and limitations on the policy space of government to address public interest concerns, in particular, those in the areas of public health and the environment.

More specifically, the review should look into the need for clear and transparent provisions that set the parameters for identifying the investments that qualify for protection under the BITs. The review should also clarify the obligations that India has for protecting foreign investment. The national treatment and most favoured nation treatment provisions should be applicable only to "like circumstances" and the use of terms such as "whichever

19 International Institute for Sustainable Development, "Investment Developments in the Trans-Pacific Partnership Agreement", Investment Treaty News, 12 January 2012.

20 Report of Hearing before the Committee on Ways and Means of the US House of Representatives on "Investment Protections in US Trade and Investment Agreements", Serial 111-20 (Washington D.C., 2009).

is more favourable", "enjoyment" and "effective means of asserting claims" that can be subjected to expansionist interpretation should be avoided. The review should specify that compulsory licences granted pursuant to the TRIPS Agreement and acts aimed at protecting public interest objectives such as public health, safety and the environment ought to be kept completely out of the purview of the clause on expropriation of investments. It may also be necessary to qualify the term "expropriation" to exclude from its purview results consequent to any legislation passed by a state or national legislature as well as the orders resulting from a judicial process. The review should also ensure consistency in provisions across all BIPPAs.

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Chapter 10

Crisis, Emergency Measures and the Failure of the ISDS System: The Case of Argentina

Federico Lavopa[1]

I. Introduction

The investor-state dispute settlement (ISDS) system has become the object of increasing criticism in recent years. Inconsistent decisions, poorly reasoned awards, lack of transparency, parallel proceedings, serious doubts about arbitrators' impartiality and the sheer size of the compensation sought by investors and awarded by arbitration tribunals are just some examples of the flaws that have been pointed out by the detractors of the system.[2] The dozens of cases that were initiated against Argentina as a result of the outburst of one of its worst economic and financial crises in late 2001 became an oft-cited, sad illustration of many of these shortcomings of the ISDS system.

Apart from the tragic consequences entailed by the economic and political crisis which was faced by Argentina, in particular in 2001-2002, which included a fall in GDP per capita of 50%, an unemployment rate of over 20%, a poverty rate of 50%,

1 The author owes thanks to Gabriel Bottini and Facundo Pérez Aznar for their helpful comments on earlier drafts.

2 See, e.g., Van Harten (2005, 2010); Franck (2005); Waibel, Kaushal, Chung and Balchin (2010); Bernasconi-Osterwalder, Johnson and Marshall (2010); Corporate Europe Observatory (2012); and Rosert (2014).

strikes, demonstrations, violent clashes with the police, dozens of civilian casualties and a succession of five presidents in 10 days, Argentina received a flood of claims from foreign investors that were filed under different ISDS mechanisms and, in particular, before the International Centre for Settlement of Investment Disputes (ICSID). Indeed, in the period 2003-2007, claims against Argentina represented a quarter of all the cases initiated within the framework of the ICSID Convention.

These claims before international arbitral tribunals challenged the changes to the economic rules that Argentina had implemented to contain the effects of perhaps the worst economic cycle in its history. The estimates carried out at that time – widely quoted by academics and the local and international media – calculated that, if all the claims filed by foreign investors were fully addressed, Argentina would have to face compensation of around $80 billion, a figure which is equal to 13% of Argentina's GDP for 2013 (at current prices).

Though Argentina's experience captured for some time the attention of a number of authors who brought up the poor response of the ISDS system to the exceptional circumstances surrounding the cases brought against the country (Waibel, 2007; Burke-White, 2008; Kasenetz, 2009; El-Hage, 2012), to my knowledge no study has so far made a systematic and comprehensive assessment of the final outcome of this story. How successful were the investors that filed cases against Argentina? How large was the bill that Argentina had to pay at the end of the day? How did the ISDS system work when faced with dozens of cases based on quite similar facts, arguments and counter-arguments? These are some of the questions that this chapter seeks to address.

To that end, this chapter will present a brief but comprehensive account of the most important aspects of the Argentine experience before investment arbitral tribunals in the period 2001-2014.

Given the restrictions of space in this publication, this chapter will focus on three main characteristics that, in the author's opinion, make the Argentinian case particularly interesting both for the implications they may have on the ISDS system and for the experience of other developing countries which may undergo a similar situation. First, we will have a look at the extraordinary situation that triggered the flood of claims against Argentina – one of the worst political and economic crises in its history – and the sheer size of the compensation that, at least potentially speaking, this country would have had to face if all those claims had been successful. Second, we will present a general overview of the current status of all the cases initiated against Argentina, as well as some figures and other elements that will help to assess Argentina's performance in dealing with these cases. Third, we will analyze the difficulties encountered by the ISDS system in tackling the particular circumstances of the Argentinian cases. Lastly, we make some final comments.

II. Crisis, Emergency Measures and Multi-Million-Dollar Claims

Beginning in 1991, Argentina embarked on an economic deregulation and liberalization programme. Among other features, this programme included the convertibility of the Argentine peso and the creation of a currency board to maintain parity between the peso and the United States dollar, by limiting the local money supply to the amount of Argentina's foreign exchange reserves.

This pro-market programme was accompanied by a strong emphasis on attracting foreign investment that, among other aspects, resulted in the conclusion of 58 bilateral investment treaties (hereinafter, BITs) – 55 of which came into effect. It also included a mass privatization process of public companies that, at that time, represented an important part of the domestic

economy. The legal framework within which the privatizations were carried out, as well as the concession contracts of the different public services, included a series of guarantees and benefits for the licensee foreign companies, namely, tariffs calculated in US dollars and converted into pesos at the time of billing, adjustment of tariffs in accordance with the US wholesale inflation, and stabilization mechanisms.

Due to various reasons which go beyond the scope of this study, but which have been thoroughly analyzed by a great number of authors[3] and – to a greater or lesser extent – by all arbitral tribunals summoned to decide on the cases against Argentina,[4] this market-oriented model reached its limits in the late 1990s. Despite the financial juggling of the government in office at that time to deal with its debt maturity payments – which included a series of increases in its Stand-By Agreement line of credit with the International Monetary Fund (IMF) and an extensive renegotiation of its debt, known as "mega-swap" – and its desperate efforts to project "credibility" and fiscal discipline, for example, through the adoption of the so-called "Zero-Deficit Law", tax increases, labour market flexibility and the so-called "Intangibility Law",[5] by the end of 2001 the situation had become unsustainable.

As a result, the government took a series of emergency measures aimed at avoiding foreign currency drain, which included the imposition of limits on foreign currency transfers abroad and on money withdrawals from local banks ("*corralito*"). The unpopularity of these measures reinforced the discontent accumulated

3 See, e.g., Arriazu (2003); Costa, Kicillof and Nahón (2004); Damill and Frenkel (2003); O'Connell (2002); Roubini and Setser (2004); and Teunissen and Akkerman (2003).

4 A quite complete and detailed account of the facts preceding and following the crisis can be found, for instance, in *Continental Casualty Company v. The Argentine Republic*, Award, 5 September 2008, ICSID, Case No. ARB/03/9, paras. 100-128.

5 This law set forth that "the government would not alter terms of deposits in the banking system".

over years of recession and increasing unemployment, poverty and inequality, thus causing strikes, protests and mass demonstrations, which resulted in the death of dozens of people and the resignation of the then president, Fernando de la Rúa.

After a period of unusual political instability, which involved a succession of resignations and appointments of five presidents in a period of 10 days and which lasted until May 2003 (when a new elected president took office), the regulatory framework for the economy and, in particular, that for the public services privatized over the 1990s were reformed. Among the measures adopted by the different successive governments to try to offset, or at least mitigate, the most serious consequences of the dramatic economic downturn, the following are particularly relevant for this study: (i) the imposition of a "*corralito*" and "*corralón*", i.e., a temporary bank freeze and rescheduling of term deposits; (ii) the termination of peso convertibility and its pegging to the US dollar at the fixed exchange rate of 1:1 (the new exchange rate stabilized at around US$1 = AR$4); (iii) a default on and the unilateral rescheduling of governmental debt; (iv) termination of the right of licensees of public utilities to adjust tariffs according to US PPI; (v) the "pesification" of tariffs at a rate of AR$1 for each US$, as well as the "pesification" of all contracts denominated in dollars and subject to Argentine law; and (vi) restrictions on fund transfers abroad.

This package of emergency laws implied a considerable change in the conditions under which foreign investors and, in particular, public services providers had to run their business in Argentina. As a consequence, many of them decided to resort to the investor-state dispute settlement mechanisms embodied in the dozens of bilateral investment treaties that Argentina had signed in the 1990s.

The results were not long in coming. As can be seen in Figure 10.1, the number of cases filed against Argentina soared from

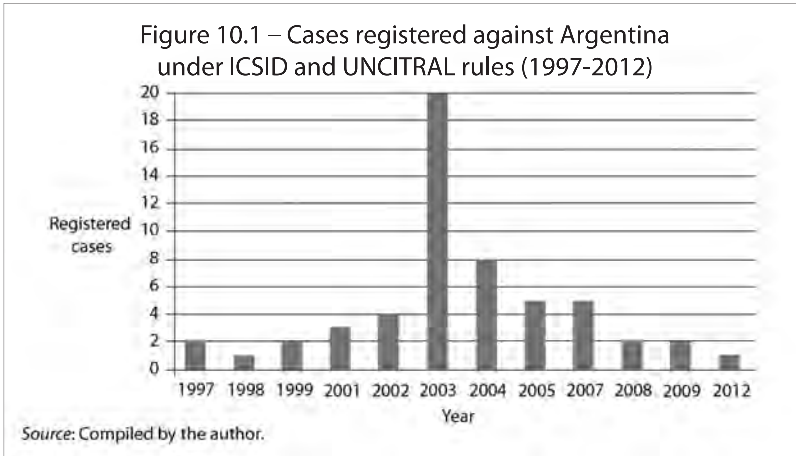

Figure 10.1 – Cases registered against Argentina under ICSID and UNCITRAL rules (1997-2012)

Source: Compiled by the author.

2001 onwards. In total, in the period 2001-2012, exactly 50 cases were filed against Argentina, 36 of which have complete public information available. Twenty-seven (75%) of the latter[6] were

6 These 27 cases are: AES Corporation, ICSID, Case ARB/02/17; Aguas Cordobesas S.A., Suez, and Sociedad General de Aguas de Barcelona S.A., ICSID, Case ARB/03/18; Anglian Water Group (AWG) PLC v. Argentina, UNCITRAL; BG Group Plc v. Argentina, UNCITRAL; BP America Production Company and others, ICSID, Case ARB/04/8; Camuzzi International S.A., ICSID, Case ARB/03/2; Camuzzi International S.A., ICSID, Case ARB/03/7; CMS Gas Transmission Company, ICSID, Case ARB/01/8; Continental Casualty Company, ICSID, Case ARB/03/9; Daimler Financial Services AG, ICSID, Case ARB/05/1; EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A., ICSID, Case ARB/03/23; El Paso Energy International Company, ICSID, Case ARB/03/15; Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P., ICSID, Case ARB/01/3; Gas Natural SDG, S.A., ICSID, Case ARB/03/10; ICS Inspection and Control Services Limited (United Kingdom) v. The Argentine Republic, UNCITRAL; Impregilo S.p.A., ICSID, Case ARB/07/17; LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc., ICSID, Case ARB/02/01; Metalpar S.A. and Buen Aire S.A., ICSID, Case ARB/03/5; National Grid v. Argentina, UNCITRAL; Pan American Energy LLC and BP Argentina Exploration Company, ICSID, Case ARB/03/13; Sempra Energy International, ICSID, Case ARB/02/16; Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A., ICSID, Case ARB/03/17; Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A, ICSID, Case ARB/03/19; Telefónica S.A., ICSID, Case ARB/03/20; Total S.A., ICSID, Case ARB/04/1; Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa, ICSID, Case ARB/07/26; and Wintershall Aktiengesellschaft, ICSID, Case ARB/04/14.

exclusively or mainly related to the package of measures adopted by Argentina to mitigate the economic effects of the crisis of 2001-2002.[7]

III. Is the Bark Worse Than the Bite?: Argentina's Performance Before Investment Arbitration Tribunals

As pointed out above, a striking characteristic of the Argentinian experience is the amount of compensation claimed by the companies that sued Argentina to redress the damage purportedly caused to their investments as a result of the alleged failure of Argentina to fulfil its international obligations under the BITs. According to estimates made when the peak of cases following the crisis was reached, if all the investors who sued Argentina had obtained 100% of their claims, the total amount that the country would have had to bear would have been at around $80 billion (Burke-White, 2008; Wong, 2005).[8]

This sum would have been practically impossible to pay, even if Argentina had not been undergoing a period of acute economic crisis. To give a clearer idea of the relative significance of such a sum, this figure represented approximately 13% of Argentina's GDP for 2013 (calculated at current prices), a little less than 10 times the federal education budget for the same year, double the funds allocated by the country to the payment of retirement and pension benefits during 2013, and an amount similar to the entirety of the public-sector foreign debt that Argentina defaulted on during the late 2001 economic collapse.

7 Twenty-three of these cases were filed under ICSID, and the other four under UNCITRAL (UN Commission on International Trade Law) rules. Among the remaining 25% of the cases, three dealt with claims filed by bond holders who challenged the debt restructurings carried out by Argentina in 2005 and 2010. Thus, these cases might also be considered as intimately related to the post-crisis tools implemented by Argentina after the 2001-2002 crisis.

8 More conservative estimates, also quoted by Burke-White (2008), calculated that Argentina's liabilities amounted to $8 billion.

What is so notable about the "invoice" that Argentina would have to pay in the event of losing all these cases lies not so much in the amount of compensation claimed in each of these cases but in their sum total. Although none of the individual claims against Argentina involved extraordinary sums of money – at least not if compared to other ISDS cases such as the Occidental case against Ecuador or, most recently, Exxon against Venezuela – Argentina amassed a considerable number of cases in a very short period of time as most cases pertained to the same package of measures taken as from 2001.

Although Argentina's response to this flood of cases was varied and it is still too early to arrive at definite figures, it is already possible to conclude that, in general, arbitration tribunals were prone to render awards in favour of investors. Figure 10.2 shows the status, at the time of concluding this chapter, of the 27 cases initiated by foreign investors as a result of the package of emergency economic measures adopted by Argentina following the crisis of 2001-2002.

Figure 10.2 – Current status of cases filed against Argentina (challenges of post-crisis measures only)

Source: Compiled by the author.

As can be observed, almost 45% of the cases have received a condemnatory award,[9] although some of these cases could still be reversed by annulment proceedings, whereas only 15% of the arbitration proceedings ended up with a decision completely in favour of Argentina.[10] Another 30% are mostly cases which resulted in an agreement between the parties or which were altogether suspended.[11] Only three of the proceedings (11%) are still awaiting an award on the merits.[12] In this respect, it is worth mentioning that two of these three cases[13] correspond to proceedings that already had an award favourable to the claimant but which were annulled in their entirety and, therefore, reinitiated.

9 These cases are: Anglian Water Group (AWG) PLC v. Argentina, UNCITRAL; BG Group Plc v. Argentina, UNCITRAL; CMS Gas Transmission Company, ICSID, Case ARB/01/8; Continental Casualty Company, ICSID, Case ARB/03/9; EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A., ICSID, Case ARB/03/23; El Paso Energy International Company, ICSID, Case ARB/03/15; Impregilo S.p.A., ICSID, Case ARB/07/17; LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc., ICSID, Case ARB/02/01; National Grid v. Argentina, UNCITRAL; Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A., ICSID, Case ARB/03/17; and Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A, ICSID, Case ARB/03/19.

10 These cases are: ICS Inspection and Control Services Limited (United Kingdom) v. The Argentine Republic, UNCITRAL; Daimler Financial Services AG, ICSID, Case ARB/05/1; Metalpar S.A. and Buen Aire S.A., ICSID, Case ARB/03/5; and Wintershall Aktiengesellschaft, ICSID, Case ARB/04/14.

11 These cases are: AES Corporation, ICSID, Case ARB/02/17; Aguas Cordobesas S.A., Suez, and Sociedad General de Aguas de Barcelona S.A., ICSID, Case ARB/03/18; BP America Production Company and others, ICSID, Case ARB/04/8; Camuzzi International S.A., ICSID, Case ARB/03/2; Camuzzi International S.A., ICSID, Case ARB/03/7; Gas Natural SDG, S.A., ICSID, Case ARB/03/10; Pan American Energy LLC and BP Argentina Exploration Company, ICSID, Case ARB/03/13; and Telefónica S.A., ICSID, Case ARB/03/20.

12 These cases are: Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P., ICSID, Case ARB/01/3; Sempra Energy International, ICSID, Case ARB/02/16; and Urbaser S.A. and Consorcio de Aguas Bilbao Bizkaia, Bilbao Biskaia Ur Partzuergoa, ICSID, Case ARB/07/26.

13 Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P., ICSID, Case ARB/01/3 and Sempra Energy International, ICSID, Case ARB/02/16.

While the outcome of these cases has been eminently negative from Argentina's perspective, this has not been fully reflected in the total amount of compensation Argentina was ultimately requested to pay. So far, in 15 of the total 55 cases that have been initiated over time against Argentina, compensation for a total amount of $1.4 billion (interest and cost free) was fixed.[14] Two of these decisions – in the Sempra and Enron cases – which involved compensation of $235 million, were fully annulled and the proceedings were reinitiated. Furthermore, another three cases – EDF International, LG&E and SAUR, whose combined awarded compensation amounted to $233 million – are still under review by ICSID Annulment Committees, which means that they could eventually be rendered null and void. All in all, therefore, of the $80 billion in possible compensation calculated when the peak of cases against Argentina was reached following the crisis, Argentina has so far received final rulings involving the payment of $900 million.[15]

14 These cases are: Azurix Corp., ICSID, Case ARB/01/12; BG Group Plc v. Argentina, UNCITRAL; CMS Gas Transmission Company, ICSID, Case ARB/01/8; Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A., ICSID, Case ARB/97/3; Continental Casualty Company, ICSID, Case ARB/03/9; EDF International S.A., SAUR International S.A. and León Participaciones Argentinas S.A., ICSID, Case ARB/03/23; El Paso Energy International Company, ICSID, Case ARB/03/15; Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P., ICSID, Case ARB/01/3; Impregilo S.p.A., ICSID, Case ARB/07/17; LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc., ICSID, Case ARB/02/01; National Grid v. Argentina, UNCITRAL; SAUR International, ICSID, Case ARB/04/4; Sempra Energy International, ICSID, Case ARB/02/16; and Siemens A.G., ICSID, Case ARB/02/8. It is worth highlighting that of the $1.4 billion in total compensation awarded in these cases, $507 million corresponds to three cases – Azurix, Aguas del Aconquija and Siemens – which were not related to the package of measures adopted by Argentina as a result of the crisis. Compensation was also fixed in the case Total S.A., ICSID, Case ARB/04/1, but the award on the damages was not made public.

15 In October 2013, Argentina decided to pay the compensation fixed by five of these awards, namely, CMS, Continental, Vivendi, Azurix and National Grid (see Ministry of Economy Resolution No. 598/2013, available at http://www.infoleg.gob.ar/infolegInternet/anexos/220000-224999/221161/norma.htm (last visited 29 November 2014)).

Another interesting fact revealed by the Argentinian experience is that the condemnatory awards in the ISDS cases filed in response to the package of post-crisis measures were all issued on the grounds of violation of the "fair and equitable treatment" (FET) standard set in the BITs.[16] This should come as no surprise: as a consequence of the overly broad interpretations given to the FET clause by arbitration tribunals,[17] the FET standard became a natural avenue to channel the claims filed by investors which, in general, revolved around the "investment climate" and the "legitimate expectations" created by the investment-friendly regime during the 1990s, and around the change in the rules of the game which took place after the crisis of 2001-2002.

Yet, without doubt, the aspect of the Argentinian experience which stood out the most was the inability of the ISDS system to properly address a circumstance that Argentina put forward by way of defence in all the cases: the background of economic and political crash that affected Argentina at the time, which largely accounts for its post-crisis package of economic measures. The following section will focus on this final aspect of the Argentine experience before ISDS mechanisms.

IV. The (Erratic) Reluctance of the ISDS System to Sustain Argentina's Plea of Necessity

As mentioned above, almost half of the arbitral proceedings initiated against Argentina as a result of the post-crisis measures resulted in awards that, for one reason or another, rejected the possibility that the extreme circumstances in which the meas-

16 In a minority of these cases, the tribunals also found violations of other standards, in particular, of the so-called "umbrella clause" and other standards that usually accompany the FET standard.

17 See, e.g., *Metalclad Corporation v. The United Mexican States*, Award, 30 August 2000, ICSID, Case No. ARB(AF)/97/1; *Técnicas Medioambientales TECMED S.A. v. The United Mexican States*, Award, 29 May 2003, ICSID, Case No. ARB(AF)/00/2; *El Paso Energy International Company v. The Argentine Republic*, Award, 31 October 2011, ICSID, Case No. ARB/03/15.

ures in question were adopted constituted a sufficient cause for excluding Argentina's liability. The lack of coherence among the decisions on this point was probably one of the aspects of the Argentine experience which most attracted the attention of the specialized literature (Waibel, 2007; Reinisch, 2007; Burke-White, 2008; Kasenetz, 2009; El-Hage, 2012) and which most contributed to making the case of Argentina gain visibility in the international debates on the flaws of the ISDS system.

As a matter of fact, the peculiar characteristics of the Argentinian case make it particularly interesting to test the "institutional quality" of the ISDS system and, especially, its ability to deliver coherent decisions. As pointed out in the previous sections, a great number of the cases submitted against Argentina sought to question the same regulations passed by the Argentine government – the package of post-crisis measures – on the basis of identical or very similar legal arguments and grounds, mainly the fair and equitable treatment standard. What is even more important for the purposes of this study is that Argentina presented a series of defences that were virtually identical in all of these cases, including the plea of the state of necessity and/or of non-prohibited measures. In this context, the decisions that were taken then and those that are being taken at present by the arbitration tribunals summoned to address these cases constitute a kind of quasi-laboratory experiment that allows for a study of the level of consistency in the "outputs" delivered by the ISDS system for very similar – and, in many instances, practically identical – "inputs". It will be shown in the following paragraphs that the results of this experiment are far from promising.

In general, Argentina adopted a two-pronged legal strategy. First, it denied that any of its actions amounted to a violation of the substantive standards of BITs (indirect expropriation, FET, umbrella clause, etc.), inter alia, because those standards do not impede states from taking regulatory measures in order to

face a serious economic crisis. Second, it argued that, even if it was found to have infringed any of these obligations, its actions should be justified due to the extreme context in which they had been carried out. This latter line of argument was typically based on three provisions: (i) the standard clause found in BITs obliging host states to treat investors in a non-discriminatory way in case they are compensated for the losses they suffer owing to war, armed conflicts or other situations of "national emergency"; (ii) the "non-precluded measures" clause found in the BITs concluded with the United States; and (iii) the customary rule of "state of necessity".

Argentina's line of argument based on non-discriminatory compensation in cases of emergency was rejected by all the arbitral tribunals called upon to decide on it.[18] In contrast, the arbitral decisions on the defence arguments based on the other two grounds mentioned above were much less consistent. Table 10.1 schematically presents the differences existing in the 14 arbitral awards issued so far that referred to the aforementioned two lines of argument put forward by Argentina.

The column headed "non-precluded measures" refers to a clause existing in only some BITs, among them that signed by Argentina with the United States, whose Article XI sets forth that the application of the treaty "shall not preclude the application … of measures necessary for the maintenance of public order … or the protection of its own essential security interests". The varied interpretations adopted by the arbitration tribunals on different

18 Following the decision in the CMS case, all the awards issued so far against Argentina as a result of the implementation of the package of post-crisis measures have ruled out the possibility that this type of clause could be invoked to render lawful a measure that would otherwise result in the violation of some of the relevant standards provided for under the BITs. In taking such a decision, the arbitrators have stressed that this clause does not refer to the legality or illegality of the measures, but rather to the characteristics of the eventual compensation a host state decides to offer to the investors affected by measures adopted in times of war, armed conflict, revolution, or other types of "national emergency".

Table 10.1 – Decisions on Argentina's defences under Article XI of the US-Argentina BIT and the "state of necessity" of general customary law

Claimant	Award Date	BIT	Non-Precluded Measures			Customary State of Necessity		
			NPM ≠ custom	Necessity	Compen-sation	Essential interest threatened?	"only means"?	State contrib.
CMS	12/05/2005	US	NO	Restrictive	YES	NO	NO	YES
LG&E	03/10/2006	US	YES	"good faith"	NO	YES	YES	NO
Enron	22/05/2007	US	NO	Judicial economy	YES	NO	NO	YES
Sempra	28/09/2007	US	NO	Judicial economy	YES	NO	NO	YES
Continental	05/09/2008	US	YES	GATT XX	NO	Judicial economy	Judicial economy	Judicial economy
El Paso	31/10/2011	US	YES?	"not restrictive"	YES?	Judicial economy	Judicial economy	YES
BG*	24/12/2007	UK	N/A	N/A	N/A	N/A	N/A	N/A
National Grid	03/11/2008	UK	N/A	N/A	N/A	Judicial economy	Judicial economy	YES
Suez, SGAB & InterAgua	30/07/2010	France/ Spain	N/A	N/A	N/A	YES	NO	YES
Suez, SGAB & Vivendi	30/07/2010	France/ Spain	N/A	N/A	N/A	YES	NO	YES
Anglian Water Group	30/07/2010	UK	N/A	N/A	N/A	YES	NO	YES
Total	27/12/2010	France	N/A	N/A	N/A	NO	NO	Judicial economy
Impregilo	21/06/2011	Italy	N/A	N/A	N/A	YES	Judicial economy	YES
EDF, SAUR & León	11/06/2012	France	N/A	N/A	N/A	NO	NO	YES

* Although the customary defence of state of necessity was also invoked by Argentina in this case, the tribunal rejected it without entering any analysis of the different elements set forth in Article 25 of the International Law Commission (ILC) Articles on State Responsibility (see *BG Group Plc v. Argentina*, Award, UNCITRAL, para 407).

aspects of this article are of paramount importance, since they were crucial for the total or partial exemption of Argentina from paying the compensation ordered in the only two instances in which this type of defence was accepted: in the LG&E and Continental cases.

As Table 10.1 reveals, six of the tribunals summoned to interpret the "non-precluded measures" clause in the cases against Argentina have so far diverged in three major aspects of interpretation:[19, 20] i) the interaction of this clause with the international customary state of necessity; ii) the standard of interpretation used for the "necessity test"; and iii) the persistence or not of the duty to compensate even in those cases in which the clause is applicable.

The first of these aspects refers to different stances with respect to the relationship existing between Article XI and the customary state of necessity. Whereas some tribunals (in the CMS, Enron, Sempra and, to a lesser extent, El Paso cases) considered that international customary law should inform the interpretation of Article XI, others (LG&E, Continental) considered that they are two totally different legal concepts, and that one should not be confused with the other. This difference in criteria seemed to have been settled with the decisions adopted by the Annulment Committees of the CMS and Sempra cases. Among other aspects, both Committees vehemently pointed out that Article

19 The treaties concluded by Argentina with Germany and the Belgian-Luxembourg Economic Union (BLEU) also contain clauses similar to Article XI of the Argentina-US BIT, but no case filed under those treaties relating to Argentine post-crisis measures has reached the merits phase yet. This explains why of the 14 arbitral awards reviewed, only six refer to the analysis of this clause.

20 It is worth highlighting that there are at least two aspects that concentrated much of the discussion on the cases analyzed and in which the decisions of the tribunals were totally consistent. First, all the awards rejected the idea that Article XI should be "self-judging" (that is, not subject to judicial review). Second, all tribunals considered that nothing can prevent the said article from being applied to a context of acute economic crisis.

XI and the customary state of necessity are totally distinct and independent defences, and thus should be treated separately.[21] However, most recently, the arbitration tribunal called upon to decide on the El Paso case seems to have included once again aspects of the customary state of necessity in its interpretation of Article XI of the Argentina-US BIT.[22] To add to the confusion, this controversial approach was subsequently confirmed by an Annulment Committee.[23]

A final aspect in which the arbitral tribunals summoned to interpret Article XI have followed clearly different criteria is the standard used to determine the "necessity" of the measures adopted. In fact, the test used in the CMS, Sempra and Enron cases was much more restrictive than that used in the decisions taken in the LG&E, Continental and – at least on paper – El Paso cases.[24] Additionally, as a result of the different interpretations on the relationship between the aforementioned article and the customary state of necessity, the tribunals adopted different views on whether the duty to compensate the investor persisted even in those cases in which all the conditions for the application of Article XI were fulfilled.

The third and last defence argument used by Argentina to exclude

21 *CMS Gas Transmission Company v. Argentine Republic*, Annulment Proceeding, Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007, ICSID, Case No. ARB/01/8, paras. 124-125, 130-132.

22 *El Paso Energy International Company v. The Argentine Republic*, Award, ICSID, Case No. ARB/03/15, paras. 613-615, 624 and 665.

23 *El Paso Energy International Company v. The Argentine Republic*, Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, ICSID, Case No. ARB/03/15, paras. 203, 247-248.

24 In Enron and Sempra the determination of the test was rather "implicit", since both awards equated the necessity test under Article XI to that set forward by Article 25 of the ILC Articles on State Responsibility, which requires that the act sought to be justified be the "only way" for the state to safeguard an essential interest against a grave and imminent peril.

its liability for the implementation of the package of post-crisis measures was based on the grounds that those measures had been taken in the context of state of necessity, one of the circumstances that exclude the wrongfulness of the acts of a state within the framework of general international law, as reflected in Article 25 of the International Law Commission (ILC) Articles on State Responsibility.

All the tribunals which examined this defence rejected it, but, as can be observed in Table 10.1, they arrived at this conclusion through different ways of reasoning. In spite of these differences, in all the cases the arbitrators put themselves in a situation in which – with a greater or lesser declared deference towards Argentina's sovereign powers to decide its own policies – they had to analyze, ponder and even criticize the economic measures implemented by the country to tackle the crisis and, in some cases, the economic policy followed by the country over long periods prior to the crisis.

Thus, for example, most decisions on this aspect of Argentina's defence were taken exclusively or concurrently based on the fact that, to some extent, Argentina had contributed to the outburst of the crisis. In order to come to this conclusion, the arbitrators interpreted that the applicable standard would not require Argentina to have "caused" or "created" the crisis. Rather, it would be enough if Argentina's contribution to it had been "sufficiently substantial and not merely incidental or peripheral".[25] In this context, they determined that the Argentinian crisis resulted from a combination of both exogenous and endogenous causes, the latter of which included government actions and omissions which would have allegedly had a "substantial" impact on the origins and development of the crisis, such as "excessive public spending", "inefficient tax collection", "delays in responding to

25 See, e.g., CMS Gas Transmission Company, Award, ICSID, Case ARB/01/8, para. 328.

the early signs of the crisis", "insufficient efforts at developing an export market, and internal political dissension" and "problems inhibiting effective policy making".[26] Given that the conditions specified in Article 25 for the application of the state of necessity are cumulative, the sole determination that Argentina had contributed to the outbreak of the crisis was sufficient for these tribunals to reject this defence altogether. Moreover, the findings of the arbitrators on these complex macroeconomic matters were usually based on no more than one or two paragraphs of analysis.

Another common argument used by the arbitration tribunals to support their rejection of the state-of-necessity defence was the determination that the measures adopted by Argentina were not the "only available means" to avoid the crisis. In this case, the arbitrators found themselves again in the uncomfortable situation of assessing the pertinence of hypothetical economic measures that could have achieved the same result as those measures adopted by Argentina, without affecting the interests of foreign investors. Thus, the tribunals referred, for example, to the possibility of "dollarization of the economy", "granting of subsidies to affected population", "restructuring of its debt", and "devaluation without pesification".[27]

Without doubt, the fact that tribunals comprised of three arbitrators – typically, international legal experts specializing in investment protection law – should base a key part of their awards on an ex-post or counterfactual assessment of the economic policy implemented by a sovereign state over decades shows the dif-

26 See, e.g., Suez, Sociedad General de Aguas de Barcelona S.A. and InterAgua Servicios Integrales del Agua S.A., Decision on Liability, ICSID, Case No. ARB/03/17, para. 242; Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A., Decision on Liability, ICSID, Case No. ARB/03/19, para. 264.

27 See, e.g., CMS Gas Transmission Company, Award, ICSID, Case ARB/01/8, para. 323; Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P., Award, ICSID, Case ARB/01/3, para. 300.

ficulties faced by the ISDS system in dealing with an absolutely exceptional case like that of Argentina. Moreover, it may result, as rightly pointed out by the Enron Annulment Committee decision, in the complete substitution of the arbitral tribunal's judgment by the opinion of "expert witnesses" called upon to counsel the arbitrators.[28]

V. Some Final Considerations

Due to a series of particular – and, perhaps, unique – circumstances, since 2001 Argentina has become one of the main users of the ISDS system. In fact, in spite of having a very small share in global foreign investment, in the period 2002-2007 Argentina was the object of a quarter of all the cases initiated within the framework of the ICSID Convention.

This flood of cases responded mainly to the changes that took place within the regulatory framework for international investments – particularly in sectors related to the provision of public services – as a result of the implementation of a package of measures aimed at tackling one of the worst economic crises in Argentina's history. Some studies which have attempted to calculate the total amounts involved in those claims estimated that, if Argentina lost all these cases, it would have to pay compensation of up to $80 billion.

Over 12 years after the first case questioning Argentina's package of post-crisis measures was filed, this study intended to provide an assessment of the Argentinian experience.

The first salient conclusion resulting from the data presented in this chapter is that the ISDS system had a very low capacity to adapt to totally exceptional circumstances for which it did not

28 Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P., Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic, ICSID, Case ARB/01/3, para. 377 and 393.

seem to have been designed. Despite the efforts of the Argentinian attorneys to show that the measures implemented in the post-crisis period were adopted in an emergency context, being so exceptional as to justify any breach of the substantial clauses of the BITs, few tribunals were prepared to sustain this defence.

This notwithstanding, and with most of these cases having already been dealt with, the upcoming scenario for Argentina seems much less drastic than that forecasted when the peak of cases was reached. While it does represent a heavy burden for a developing country like Argentina, so far the compensation actually paid amounts to a small portion of the above-mentioned initially estimated sum.

The Argentinian case also represents a worrisome example of the failure of the ISDS system to ensure coherence and soundness in its decisions. As pointed out above, although the dozens of cases submitted against Argentina addressed exactly the same package of measures (the post-crisis emergency laws) and the arbitrators had to assess very similar arguments by the different claimants and a practically identical series of defences put forward by the Argentinian government, the conclusions at which they arrived have shown striking differences. Additionally, some of the decisions have been subject to strong criticism and/or declared null and void by annulment committees.

Finally, the experience of Argentina shows the difficulties that arbitration tribunals might encounter when trying to scrutinize the economic policy choices made by governments. On top of the sensitivities of examining sovereign decisions of states, arbitrators might find themselves in the awkward situation of deciding on highly technical matters they are clearly ill-equipped to assess.

The case of Argentina thus reflects the urgent need to reconsider and reform the ISDS system. Yet, the lessons to be drawn from

this experience do not seem to lead to clear conclusions as to which direction should be followed. On the one hand, the system has proved to be extremely inflexible, which prevented it from addressing the exceptional peculiarities of the Argentinian case. On the other hand, however, the wide margin of discretion available for the arbitral tribunals resulted in the adoption of inherently poor decisions, and with high levels of incoherence among them.

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Chapter 11

Indonesia's Perspective on Review of International Investment Agreements

Abdulkadir Jailani

I. Introduction

Following the contemporary discourse surrounding international investment agreements (IIAs), Indonesia is currently undertaking a thorough review of its 64 bilateral investment treaties (BITs) as well as five investment chapters under various free trade agreements.[1] The review envisages a critical evaluation of the impact of existing IIAs on the Indonesian national economy and formulation of a new approach towards IIAs, which will be finetuned in the interest of pursuing national development goals. Within this context, Mrs. Retno Marsudi, the Minister for Foreign Affairs of the Republic of Indonesia, specifically emphasized in her Annual Press Statement that economic diplomacy carried out by Indonesia will also aim at creating a new regime for investment agreements between Indonesia and other countries.[2]

1 Indonesia-Japan Economic Partnership Agreement, ASEAN-Australia-New Zealand Free Trade Agreement, ASEAN-China Agreement on Investment, ASEAN-Korea Free Trade Agreement and ASEAN Comprehensive Investment Agreement.

2 The Foreign Minister also emphasized Indonesia's commitment to attracting foreign investors and also to introducing a simplified permit procedure for foreign investors. See Annual Press Statement of the Minister for Foreign Affairs of the Republic of Indonesia, 8 January 2015. Available at http://www.kemlu.go.id/Documents/PPTM%202015/PPTM%202015%20ENG%20FINAL%20PDF.pdf (accessed 7 April 2015).

This chapter is an attempt to share the Indonesian experience in seeking to realize this aim.

For this purpose, this chapter will flesh out the rationales of the review. It will also explain how the review process is being undertaken and the challenges faced during the review process. The chapter will also attempt to present a set of critical outlooks on some outstanding issues that appear during the review.

II. Rationales of the Review

The rationales for the review conducted by Indonesia are essentially similar to the rationales for reviews undertaken by other countries.

First, the review has been undertaken to strike a balance between investor protection and national sovereignty, as indicated by Mrs. Retno Marsudi in her opening remarks at the Regional Interactive Meeting on the Development of Investment Treaty Models hosted by the Ministry of Foreign Affairs of the Republic of Indonesia, International Institute for Sustainable Development (IISD) and United Nations Conference on Trade and Development (UNCTAD) in January 2015.[3]

Second, most provisions of the existing IIAs are outdated as they grant extensively broad protections and rights for foreign investors, leaving the host state with little to no policy space to implement its own development goals. Indonesia also believes that the current regime of IIAs does not grant sufficient space for sustainable development. Therefore, a general modernization is needed to update the existing outdated IIAs in order to preserve the right of states to make use of regulatory and policy space.[4]

3 See the Report of the Regional Interactive Meeting on the Development of Investment Treaty Models, available at http://www.iisd.org/pdf/2015/investment-treaty-models-jakarta-report-2015.pdf (accessed 6 April 2015).

4 J. J. Losari and M. Ewing-Chew, "Reflective or Reactionary? Indonesia's

Third, one of Indonesia's greatest concerns regarding IIAs is the provision on investor-state dispute settlement (ISDS), which has increased Indonesia's exposure to investor claims in international arbitration. To Indonesia, ISDS provisions seem to be problematic and their benefits are far from clear. They also create an uneven playing field between national and foreign corporations. It is expected that the inclusion of ISDS provisions will be a highly contentious issue in the ratification process.

To date, Indonesia has been involved in at least six ISDS cases. In comparison to other Association of South-East Asian Nations (ASEAN) countries, Indonesia has the highest number of international arbitration cases.[5] The decision to undertake the review was particularly motivated by a billion-dollar lawsuit by the UK-listed Churchill Mining and a frivolous claim arising from a bailout following the collapse of a private bank (*Rafat Ali Rizvi v. Indonesia)*.[6] Due to this, the then-President of the Republic of Indonesia, Mr. Susilo Bambang Yudhoyono, stressed that the government would not let multinational companies do as they please with their international back-up and put pressure on developing countries such as Indonesia.[7]

Similarly, Jan Knoerich and Axel Berger in their seminal work *Friends or Foes? Interactions Between Indonesia's International*

Approaches to International Investment Agreements and Recommendations for the Future", *Transnational Dispute Management*, Vol. 12, Issue 1 (January 2015), p. 4.

5 Indonesia has the highest number of ISDS cases among ASEAN member states, which amounts to six cases to date. The Philippines comes in second place with three recorded cases. See http://www.italaw.com/search/site/indonesia?f[0]=im_field_case_type%3A1090 and http://www.italaw.com/search/site/philippines?f[0]=im_field_case_type%3A1090.

6 In the *Rafat Ali Rizvi v. Indonesia* case, the issue of frivolous claim came to the fore. The investor's claim, which invoked the Indonesia-UK IIA, was deemed frivolous, or not having legal merit, by the International Centre for Settlement of Investment Disputes (ICSID) panel.

7 Bagus Saragih, "SBY frets over int'l arbitration", *Jakarta Post*, 29 June 2012. Available from http://www.thejakartapost.com/news/2012/06/29/sby-frets-over-int-l-arbitration.html.

Investment Agreements and National Investment Law held that, because the ISDS clause is being invoked by foreign investors with increased frequency, IIAs are beginning to have serious repercussions for developing countries, particularly for Indonesia.[8]

Fourth, the provisions in IIAs may potentially override national legislation. Moreover, the decisions of international arbitration tribunals may possibly supersede the decisions of domestic courts. These two considerations are well-founded considering that the current IIA regime has sometimes appeared to be superior to national law, which will raise questions of the law applicable for either the investors or the host states.[9]

From the aforementioned rationales of the review, it can safely be assumed that Indonesia has not lost faith in IIAs in general. Indonesia merely intends to modernize and to renegotiate its IIAs with a view to providing greater capacity to regulate in the public interest. For that purpose, excessive benefits to foreign investors that may prejudice Indonesia's policy space need to be re-examined. The new investment regime should aim at fostering investments that not only reap benefits for the host state but also contribute to the overall development of that particular host state. Such review process should also take into account the need to place procedural and substantive restraints on foreign investors lodging international claims against Indonesia.

III. Steps Taken

The review process is undertaken through three steps, namely the discontinuation of existing IIAs, reassessing the provisions of the existing IIAs and developing a new treaty model of IIA. In pursuing these steps, the Government of the Republic of Indo-

8 Jan Knoerich and Axel Berger, *Friends or Foes? Interactions Between Indonesia's International Investment Agreements and National Investment Law*, Studies 82 (Bonn, Deutsches Institut fur Entwicklungspolitik, 2014), p. 7.

9 Id., p. 78.

nesia also invites academicians, international/national lawyers, non-governmental organizations, UNCTAD and experts from various countries and agencies to contribute their perspectives. Indonesia also undertakes an intensive engagement with business sectors in the process.

The first step taken by Indonesia is to discontinue its existing IIAs, a process which, as of the date of the writing of this chapter, has extended to 17 out of 64 IIAs.[10] It is important to underline that this discontinuation process is done gradually by means of discontinuing IIAs that are due to expire according to the requirement period set in the termination clause of the IIA, or commonly known as the "ripe period".[11] Another option in this discontinuation process is to do so immediately if the IIA authorizes either party to end the agreement at any time.

The gradual approach is taken in order to avoid any unwanted political implications and bilateral backlash that might potentially undermine Indonesia's position. Indonesia believes that by ending an agreement "by the book" according to the provisions set in the agreement itself, which was of course agreed bilaterally, Indonesia need not be concerned about such backlash.

However, during the review process, there has been an emphatic call to look at this approach again. Given the lengthy ripe periods of many IIAs concluded by Indonesia, such as the Indonesia-Russia IIA that will end only in 2024, it has been suggested that Indonesia consider an earlier discontinuation. If its counterpart

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10 So far Indonesia has discontinued BITs with the Netherlands, Bulgaria, Italy, Malaysia, Slovakia, Spain, Kyrgyzstan, China, Laos, France, Egypt, Hungary, Cambodia, Norway, Romania, Turkey and Vietnam.

11 The ripe period refers to the period in which the IIA is eligible to be discontinued/terminated. One example is Article XIII(2) of the Indonesia-Chile IIA: "This agreement shall remain in force for a period of ten years. Thereafter it shall remain in force indefinitely unless one of the Contracting Parties gives one year's written notice of termination through diplomatic channels." From this provision it is clear that the ripe period is in effect after 10 years.

disapproves of the proposal, Indonesia may just officially notify its intention to terminate the IIA upon the expiration of the period of validity of the IIA. Such notification can be submitted to the other party to the treaty even if expiry is still a long way away.

The second step that Indonesia has taken relates to the issue at the core of the review, namely the reassessment of the existing provisions of IIAs. Every single IIA is dissected to find the most problematic provisions such as the "scope" and "definition of investment", the "most-favoured-nation treatment" principle, "national treatment" principle, "fair and equitable treatment", "expropriation" and ISDS. The reassessment is aimed at identifying problems and finding the most feasible solutions which will serve as the Government's new position on IIAs. The assessment particularly looks into the extent to which those provisions provide protection to the investors and its impact on the policy space of the Government.

The third step is the development of a treaty model. The purpose of developing a model is to set up a guideline for Indonesian officials in negotiating and concluding investment treaties, as has been done by India and South Africa with their respective models.[12] Based on the review itself, new elements were added in the model to strike a balance between investor protection and the state's policy space with a view to promoting sustainable development principles. The model will also ensure consistency in treaty-making practice, although, on the other hand, it may allow for less flexibility in negotiations.

12 Kavaljit Singh, "The very model of a modern Indian investment treaty". Available from http://www.eastasiaforum.org/2015/02/06/the-very-model-of-a-modern-indian-investment-treaty/. Southern African Development Community Model (http://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf, accessed 7 April 2015).

IV. Challenges of IIA Review

Conducting an all-encompassing review of the whole IIA regime is a very challenging endeavour. We have identified a number of challenges, which range from concerns about scaring off investors to the more technical challenge of how to further address the survival-clause issue. What follows is a detailed explanation of each challenge.

Fear of scaring off investors

One of the main challenges is to overcome the unjustified concern that the whole review and discontinuation process is scaring off investors. The Government of the Republic of Indonesia has taken this concern seriously. In the World Investment Forum 2014, Mr. Mahendra Siregar, Chairman of the Investment Coordinating Board of the Republic of Indonesia, assertively assured that the review process shall not compromise the legal certainty and protection of foreign investment. All foreign investment continues to enjoy the same level of protection under the Indonesian National Law on Investment.[13]

It is worth pointing out that the review process does not really affect the foreign investment inflows to Indonesia. In fact, 2014 was the year in which foreign direct investment to Indonesia hit a record high of IDR 78.7 trillion, according to the latest data from the Indonesian Investment Coordinating Board (BKPM).[14] The comparison with previous years can be seen in Table 11.1.

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13 See Statement of Mr. Mahendra Siregar, Chairman of the Investment Coordinating Board, before the World Investment Forum 2014, 16 October 2014. Available at http://unctad-worldinvestmentforum.org/wp-content/uploads/2014/10/Wibowo.pdf (accessed 6 April 2015).

14 Badan Koordinasi Penanaman Modal, "Foreign Direct Investment in Indonesia Hit Record High in 2014". Available from http://www.indonesia-investments.com/news/news-columns/foreign-direct-investment-in-indonesia-hit-record-high-in-2014/item5262 (accessed 6 April 2015).

Table 11.1: Foreign and Domestic Investment in Indonesia (in IDR trillion)

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Domestic Direct Investment	14.1	18.9	19.0	24.0	19.7	20.8	25.2	27.5
Foreign Direct Investment	39.5	43.1	46.5	46.2	51.5	56.1	56.6	65.5
Total Investment	53.6	62.0	65.5	70.2	71.2	76.9	81.8	83.3
	2013				**2014**			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Domestic Direct Investment	27.5	33.1	33.5	34.1	34.6	38.2	41.6	41.7
Foreign Direct Investment	65.5	66.7	67.0	71.2	72.0	78.0	78.3	78.7
Total Investment	93.0	99.8	100.5	105.3	106.6	116.2	119.9	120.4

Source: Indonesian Investment Coordinating Board (BKPM)

Balance between protection of investors and preserving policy space for states

The second challenge that comes to the fore is the question of whether the review and reassessment will be able to achieve the right balance between investment protection and the furtherance of public interest. To this end, we need to recognize what the real balance should look like. In principle, it might be possible to strike a balance between the two interests. Yet, it is indeed a complicated task as the interests of investor protection and policy space preservation seem to be irreconcilable.

The temptation to include broadly drafted clauses on public policy exceptions is very obvious among policymakers. They

maintain that the incorporation of a set of robust clauses that may effectively serve as important tools to safeguard public policy interest would provide additional comfort to the Government.

However, concerns have been expressed about the possible abuse of such public policy clauses as they give too much power to the state. Business sectors may perceive that the existence of such clauses will potentially defeat the purpose of concluding an IIA as an instrument to attract higher amounts of foreign investment.

Nevertheless, this concern has also been questioned on the basis of two strands of argument. First, the assumption that IIAs will increase foreign direct investment inflow in many countries, including in Indonesia, is empirically disputed. Therefore, the existence of such clauses should not correlate with foreign direct investment. Second, the public policy clauses may be formulated in such a way as to prevent their arbitrary invocation. Then, the real challenge would be how to draft such clauses to provide for legitimate regulation of the activities of foreign investors without permitting unreasonable or unjustified treatment.

Investment chapters under free trade agreements (FTAs) or economic partnership agreements (EPAs)

Another challenge is the problem of investment chapters under FTAs or EPAs. Given the legal nature of investment chapters, they are essentially IIAs; they should therefore be subject to the review process. Nonetheless, the review process of the investment chapters cannot be conducted in the same manner as in the case of bilateral IIAs. As the FTAs or EPAs consist of various chapters, which are integrated into a single-undertaking instrument, a specific discontinuation of the investment chapter is not legally possible unless it is done concurrently with all the other chapters of those FTAs or EPAs. Article 44(1) of the Vienna Convention

on the Law of Treaties clearly provides that a right of a state to denounce or withdraw from a treaty may be exercised only with respect to the whole treaty unless the treaty provides otherwise or the parties otherwise agree.

It is true that all chapters of FTAs or EPAs can be technically terminated altogether in accordance with their termination clauses. The problem does not, however, lie in the technical context. Discontinuing whole FTAs or EPAs will certainly require much more extensive consideration of wider bilateral relations between the treaty parties as it may lead to more complicated implications. Consequently, so far, not much can be done with respect to investment chapters of FTAs or EPAs.

The lesson we can learn from this challenge is that the issue of terminating FTAs or EPAs should be wisely dealt with during negotiations. It is recommended that FTAs or EPAs include a clause allowing partial termination of a chapter, particularly the investment chapter.

Survival clause

One of the most interesting aspects in reviewing and discontinuing IIAs is that an IIA will not necessarily cease to have any effect on existing investments even after it has been discontinued, due to a provision commonly known as the “survival clause”. This clause allows foreign investors who made or acquired their investments prior to the date of termination to enjoy prolonged protection for a certain amount of time (usually 10-15 years) after the treaty has been terminated.

The clause has posed a substantial challenge during the review process. It means that all possible legal risks posed by the discontinued IIA will remain intact despite the fact that the treaty is not in force anymore. Thus, the survival clause needs to be

assessed and revised with a view to shortening its time period. Also, different survival clause durations for different sectors of investment could be considered.

Challenge of drafting a treaty model

The review process envisages development of an IIA model which will serve as a basis for future IIA negotiations. The model will provide clearer guidelines in order to maintain coherence between IIAs. According to Jonathan Bonnitcha, the existence of a treaty model will substantially diminish the number of inconsistencies between existing IIAs.[15] Once a treaty model is in place, it will provide Indonesia with a strong and consolidated initial negotiating text that will prove useful in future negotiations.

Apart from the obvious advantages of having such a treaty model at our disposal, there are also a couple of potential disadvantages. Firstly, due to the great number of stakeholders involved in drafting the model, a model will take a long time to develop. Secondly, by having a basic text, we are somehow reducing our flexibility in negotiations. Different negotiating parties will require different elements in their intended IIAs and a treaty model will somehow limit their options, which will arguably hamper or slow down the negotiations to a certain degree. Hence, the ultimate challenge is not that of developing a well-drafted treaty model, but how to actually defend the text in negotiations.

In addressing this challenge, Indonesia is now considering developing a set of basic elements of a position that would be reflected in an illustrative model treaty. Therefore, the illustrative model treaty can in one way or another be modified during negotiations, bearing in mind that some fundamental principles shall be strictly upheld and are off-limits to any kind of compromise.

15 Jonathan Bonnitcha, "Cost and Benefit Analysis of Developing Model IIAs", presented at the Regional Interactive Meeting on the Development of Investment Treaty Models, Jakarta, 20-22 January 2015.

V. Most Outstanding Issue

The review process undertaken by Indonesia has addressed almost all common provisions included in IIAs. Yet, the most outstanding issue in the review process is the ISDS mechanism. In spite of this, excluding ISDS provisions altogether might not be a wise approach. Therefore, Indonesia is considering limiting the scope of application of the ISDS provision. The limitation would be substantive and procedural in nature.

Substantive limitations

The definition of investment is key as it will determine the scope of the protection rendered under the IIA. A narrower definition will also narrow down the possible number of cases brought via the ISDS mechanism. Therefore, the review has led Indonesia to seek a more limited definition (a combination between an asset-based and enterprise-based approach which targets particular investments). Portfolio investment is certainly excluded from the definition. The "Salini Test" characteristic of investment has been considered to be part of the definition. Under this approach, not all investments may enjoy benefits under an IIA unless such investments also contribute to national development of the host state.[16]

Furthermore, the current scope of the national treatment (NT) clause also needs to be reduced. The NT clause in Indonesia's existing IIAs extends to the pre-establishment phase. Therefore, the clause will apply not only to investors who are already operating in Indonesia (post-establishment treatment) but also to potential investors seeking to make investments. This kind of NT clause creates the so-called pre-establishment right (right to establishment). It gives potential foreign investors the

16 *Salini Costruttori SpA and Italstrade SpA v. Morocco* (ICSID Case No. ARB/00/4). Available from http://www.italaw.com/cases/958 (accessed 6 April 2015).

right to enter Indonesia and make investments in any sector on the same terms applicable to domestic investors.[17] The clause provides both protection and liberalization undertaking. The review process suggests that the NT clause should only cover the post-establishment phase. It is also suggested that liberalization is better regulated through national law and not through investment treaties. This new approach to the NT clause also considers excluding from its ambit special treatment in favour of domestic small/medium enterprises, and measures affecting certain sectors related to development needs, particularly natural resources, and sectors which possess close ties to national security.

Likewise, restricting the scope of the most-favoured-nation (MFN) clause is also necessary for limiting the possible application of ISDS. The MFN clause in existing IIAs to which Indonesia is party seems to be too broad, as it potentially allows a foreign investor to invoke provisions of any treaty other than the one concluded between the home state of the investor and Indonesia. This classic principle has been substantially modified to fit Indonesia's current stance on IIAs. Some of the important exclusions incorporated in the new MFN clause are:

- pre-establishment measures;
- any existing or future regional FTAs and EPAs;
- existing and future IIAs;
- ISDS provisions; and
- any preferential system for any least-developed countries.

The inclusion in IIAs of the clause on fair and equitable treatment (FET) has brought about a high degree of unpredictability, particularly with respect to ISDS. In this regard, the FET clause has been frequently and successfully used by investors as a basis

17 Organization for Economic Co-operation and Development, "Treatment of Investors and Investments (Pre/Post-Establishment)", Negotiating Group on the Multilateral Agreement on Investment, DAFFE/MAI(95)3. Available from http://www1.oecd.org/daf/mai/pdf/ng/ng953e.pdf.

of their claim against states.[18] The FET clause was initially introduced to provide just and equal treatment to foreign investors as if they were domestic investors. However, due to its overextensive application, there have been a number of uncertainties and legal risks associated with FET. One of the most worrying concerns is the tendency for arbitral tribunals to interpret FET broadly in favour of foreign investors, particularly with respect to the notion of "legitimate expectation".

The review process undertaken by Indonesia found that a vague and broad wording of the FET obligation carries risk of overreach in the application of the principle.[19] This has led Indonesia to craft a new provision to replace FET, namely "standard treatment", which simply shifts the focus from investor rights to protection from denial of justice. In this newly formulated provision, assurances are made that investors shall not be subjected to denial of justice in criminal, civil or administrative proceedings. To augment this treatment, Indonesia also provides police protection from any physical harm to the investor and/or investment.

As far as expropriation is concerned, Indonesia still maintains the clause on expropriation. In this regard, a distinction is made between direct expropriation and indirect expropriation, which is entirely excluded.

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18 FET is the most frequently invoked clause in investment disputes. According to UNCTAD, in 2013, of the seven decisions finding states liable, five decisions found a violation of the FET provision. At least five decisions rendered in 2013 awarded compensation to the investor, including an award of $935 million plus interest, the second highest known award in history. See United Nations Conference on Trade and Development, "Recent Developments in Investor-State Dispute Settlement", IIA Issues Note No. 1, April 2014, p. 10, available at http://unctad.org/en/publicationslibrary/webdiaepcb2014d3_en.pdf.

19 United Nations Conference on Trade and Development, "Fair and Equitable Treatment", p. 3. Available from http://investmentpolicyhub.unctad.org/Upload/Documents/PACER_6%20Fair%20and%20Equitable%20Treatment.pdf.

Direct expropriation shall only be made for the purpose of public interest and carried out with due process of law and followed by prompt and adequate compensation. However, the issue of indirect expropriation[20] seems to be very problematic as investors may have the liberty to assume that any regulatory action taken by the host state that diminishes the economic value of an investment is a form of expropriation.

Such an approach potentially reduces the host state's authority and policy space to implement development-oriented measures and/or policies. Within its new approach to IIAs, Indonesia plans to exclude in whole the provision on indirect expropriation. This also means that any measures that have consequences that amount to expropriation shall be excluded from the clause on direct expropriation. This is done to preserve a greater degree of regulatory space for Indonesia to pursue its development goals without facing legal risk of challenges through the ISDS mechanism.

Procedural limitations

Imposing procedural limitations is a useful way to minimize legal risk of ISDS claims. In most IIAs, the host states have already given their consent for an investor to bring any dispute with the host state to international arbitration without requiring further consent from the host state. This is also the case with Indonesia's IIAs.[21] This approach has become a grave concern for Indonesia

20 Indirect expropriation in principle refers to measures that a state takes to regulate economic activities within its territory, even where such regulation is not directly targeted at an investment. In this case, the legal title to the investment is not affected. See Suzy H. Nikiema, "Best Practices, Indirect Expropriation", IISD Best Practices Series, March 2012, p. 1. Available at http://www.iisd.org/pdf/2012/best_practice_indirect_expropriation.pdf.

21 One example of this automatic consent can be found in Article VIII(2) of the Indonesia-Cambodia BIT: "If such a dispute cannot be settled within a period of six months from the date of a written notification either party requested amicable settlement, *the dispute shall, at the request of the investor concerned*, be submitted

as it will pose great legal risk to the country. As a solution, Indonesia is considering introducing a separate consent requirement before an investor can bring a matter to international arbitration. Therefore, an investor may bring a case to international arbitration if the investor and the host state have expressed their consent to settling the case through such arbitration. A special agreement to settle a dispute through international arbitration would be required on a case-by-case basis. This approach is expected to cut the number of ISDS claims in international arbitration. At the same time, it will also promote settlement of investor-state disputes through the domestic courts or alternative dispute resolution mechanisms.

VI. Conclusion

Indonesia's review of its IIAs was mainly triggered by the increased exposure to investor claims in international arbitration. The review itself has been manifested in several steps such as IIA discontinuation, reassessment of existing IIA provisions and the development of a new IIA model. The effort has met with several challenges, including concerns on whether the review will scare off investors, how to strike a balance between protection to investors and policy space preservation, problems of investment chapters in FTAs or EPAs, survival clauses and the development of a new model of IIA. The review process has also focused on how to limit the scope of application of ISDS provisions. In light of this, substantive and procedural limitations are envisaged. As far as the substantive limitations are concerned, there are at least five pertinent issues related to the definition of investment, national treatment, MFN, FET and indirect expropriation. For procedural limitations, the new IIAs entered into by Indonesia will require a special agreement between the investor and Indonesia for bringing a case to international arbitration.

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either to the judicial procedures provided by the Contracting Party concerned or to international arbitration or conciliation" (emphasis added).

This review is a dynamic process and not a one-off event. Constructive input and suggestions from every stakeholder, including business sectors, and in-depth analysis are still highly needed to further finetune Indonesia's new approach which will be crystallized in the new treaty model.

The debate on the implications of international investment treaties and the investor-state dispute settlement system has been intensifying and widening. There is a growing consensus that the investment protection regime is flawed and needs to be reformed. States, both developed and developing, have been considering various reforms and potential alternatives, including through renegotiation or termination of investment treaties. This situation has been primarily triggered by the states' increasing exposure to claims by investors, who are turning to investor-state arbitration to challenge a wide range of government measures. These investor-state dispute settlement cases have increasingly undermined the states' right to regulate in the public interest and constrained their ability to use foreign direct investment for industrialization and development.

This book discusses the relationship between foreign direct investment, investment agreements and economic development. It examines the experiences of five developing countries reviewing their approach to international investment agreements and seeking alternatives in this area, including South Africa, Indonesia, India, Argentina, and Ecuador. Through reviewing investor-state dispute settlement cases, the book highlights how investment protection rules and the way they have been interpreted by arbitral tribunals have undermined the states' right to adopt measures to protect public health and challenged the use of policy tools essential for industrialization. The book also discusses options for rethinking investment-related dispute settlement, including the option to reform the arbitration rules that apply to the disputes, and poses the question "What should investment-related dispute settlement look like if we were to start anew?".

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ISBN 978-92-9162-046-3