RETHINKING BILATERAL INVESTMENT TREATIES

CRITICAL ISSUES AND POLICY CHOICES



EDITED BY KAVALJIT SINGH AND BURGHARD ILGE

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The cross-border investment flows are currently governed by bilateral and regional investment treaties. Today, more than 3,000 BITs are in existence globally. However, there are signs of growing unease with the BIT regime across countries and regions. The growing number of investor claims against sovereign states challenging a wide array of public policy decisions and regulatory measures has evoked deep concerns about the potential costs associated with such treaties.

A number of countries have been revisiting their BITs program since the early 2000s. In recent years, a backlash against BITs has gained momentum in the global South, particularly in the Latin America. Bolivia, Ecuador, Venezuela, and Nicaragua have all rolled back their BIT commitments. South Africa has replaced its BITs regime with a new domestic legislation that aims to protect investor rights while safeguarding policy space to regulate in the public interest. In Asia, several countries are taking steps to protect themselves from costly investor-state arbitration. All these important developments call for collective thinking and constructive engagement by all stakeholders – governments, inter-governmental organizations, the private sector, civil society, think-tanks and academia.

This free-to-download book takes stock of current developments and explores alternative approaches to reform investment treaties. It provides an up-to-date account of the model BIT reviews undertaken by South Africa, India and Indonesia. Some of the authors have suggested a broad gamut of useful policy solutions. The book presents a debate that is very relevant to the ongoing initiatives to reform the BITs regime. It raises some critical policy issues which are missing in the current debates. The book attempts to launch a dialogue among government officials, legal experts drawn from academia, international organizations and civil society groups to address the systemic shortcomings of the current BIT regime.

This book will be of prime interest to anyone concerned with issues surrounding bilateral investment treaties and international law. In particular, the book will be useful to policymakers, parliamentarians, private sector companies, NGOs, academics, lawyers, scholars and journalists.

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Praise for the Book

"The authors deserve special congratulations for bringing out this much needed well debated treatise, knitting together various strands of the subject. The bilateral investment treaties are unknown to the people, although they affect their lives substantially and for a long time to come. This book will help place the subject on public anvil for debate."

– P. B. Sawant, Former Judge, Supreme Court of India

"The book fills an important void in our understanding of bilateral investment treaty regime that has evolved over the decades. I hope that this free-to-download publication will trigger a constructive public debate on the nature and the quality of cross-border investments. I am sure that such a debate will facilitate cross-border investment flows which are benign and consistent with the interests of the people at large in the recipient countries."

– E. A. S. Sarma, Former Secretary, Department of Economic Affairs, Ministry of Finance, Government of India

"A comprehensive, critical and competent treatment of important aspects of bilateral investment treaties, particularly their provision of investor-state dispute settlement mechanism, at a time when the current regime has come in for severe contestation on social, economic and environmental grounds, by governments and civil society organisations in both developed and developing countries, and alternative approaches are being seriously explored."

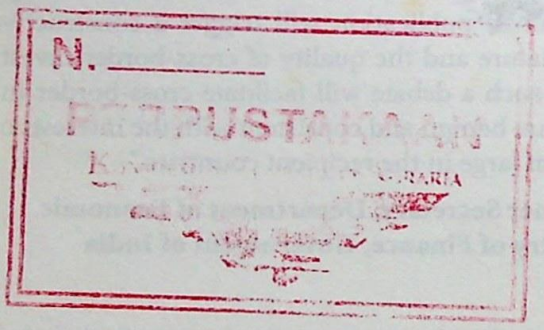
– Muchkund Dubey, Former Foreign Secretary, Government of India

"Rethinking, reforming, and where necessary terminating bilateral investment treaties is an imperative because of superior treaty obligations under the UN Charter and human rights conventions. This book tackles such complex issues in a lucid and readable style. Highly recommended."

– Alfred de Zayas, Independent Expert on the Promotion of a Democratic and Equitable International Order, Human Rights Council, UN

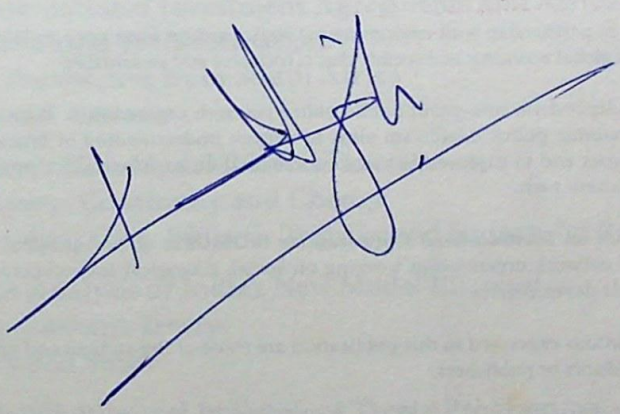
"Pertinent and urgent! This collection of contributions on the complex dangers of investor-state arbitration and a wide range of new attacks on the state's legal order by transnational corporations should trigger academic, policy-makers and citizens' mobilization for systemic reform."

– Pedro Páez, Superintendent for Market Power Control (Ecuador) and Former Minister for Economic Policy Coordination



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Edited by Kavaljit Singh and Burghard Ilge



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Both ENDS works in partnership with environmental justice groups from poor and developing countries towards a global economy and society that is inclusive and sustainable.

Madhyam is an independent, non-profit public policy research organization. With a special focus on macroeconomic policy, Madhyam aims to deepen understanding of finance, trade and investments issues and to explore the macroeconomic policies required for promoting a sustainable development path.

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  Lorenzo Cotula

Acronyms

AALCO	Asian-African Legal Consultative Organization
ALCC	Asian Legal Consultative Committee
APEC	Asia–Pacific Economic Cooperation
ASEAN	Association of South-East Asian Nations
BKPM	Indonesian Investment Coordinating Board
BoP	balance of payments
BIPA	bilateral investment promotion agreement
BIT	bilateral investment treaty
CAC	collective action clause
CAFTA	Central American Free Trade Agreement
CEP	closer economic partnership agreement
CETA	comprehensive economic and trade agreement
CFIA	cooperation and facilitation investment agreement
DR-CAFTA	Dominican Republic-Central America Free Trade Agreement
DTT	double taxation treaty
ECB	European Central Bank
EC	European Commission
ECJ	European Court of Justice
ECT	Energy Charter Treaty
EIA	economic integration agreement
EFTA	European Free Trade Association
EMA	European Medicines Agency

EP	European Parliament
EPA	economic partnership agreement
FCN	friendship, commerce and navigation treaty
FDI	foreign direct investment
FERA	Foreign Exchange Regulation Act of India
FET	fair and equitable treatment
FII	foreign institutional investment
FIPA	foreign investment protection agreement
FITR	'Fork-in-the-Road'
FTA	free trade agreement
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	gross domestic product
ICC	International Chamber of Commerce
ICCPR	United Nations International Covenant on Civil and Political Rights
ICJ	International Court of Justice
ICS	Investment Court System
ICSID	International Centre for the Settlement of Investment Disputes
IIA	international investment agreement
ILO	International Labour Organization
IMF	International Monetary Fund
INTA	International Trade Committee of the EU Parliament
IP	intellectual property
IPFSD	Investment Policy Framework for Sustainable Development of UNCTAD

IPRs	intellectual property rights
IPPA	investment promotion and protection agreement
ISDS	investor-state dispute settlement
LDCs	least developed countries
LIBOR	London Interbank Offered Rate
MAI	Multilateral Agreement on Investment
MFN	most favoured nation
NAFTA	North American Free Trade Agreement
NGO	non-governmental organization
NBIP	non-binding investment principles
NT	national treatment
OECD	Organisation for Economic Co-operation and Development
PTIA	preferential trade and investment agreement
REIO	regional economic integration organization
RTA	regional trade agreement
SADC	Southern African Development Community
SDR	sovereign debt restructuring
SDRM	Sovereign Debt Restructuring Mechanism
SSDS	state-state dispute settlement
TFEU	Treaty on the Functioning of the European Union
TNC	transnational corporation
TRIMs	WTO Agreement on Trade-Related Investment Measures
TRIPS	WTO Agreement on Trade-Related Aspects of Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership

TPP	Trans-Pacific Partnership
UAE	United Arab Emirates
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNHRC	UN Human Rights Council
UDHR	Universal Declaration of Human Rights
UNCAC	United Nations Convention Against Corruption
VAT	value-added tax
WTO	World Trade Organization

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Introduction

Kavaljit Singh and Burghard Ilge

One of the most remarkable recent developments in international law is the exponential growth of International Investment Agreements (IIAs). An IIA is a treaty between countries to deal with issues concerning the protection, promotion and liberalization of cross-border investments. The most common types of IIAs are standalone Bilateral Investment Treaties (BITs) and Free Trade Agreements (FTAs) that contain investment chapters. Double Taxation Treaties (DTTs) between countries are also considered as IIAs due to strong linkages between taxation and foreign investment.

Although not precisely defined, a BIT is a legally binding agreement between two countries that establishes reciprocal protection and promotion of investments in both countries. The treaty primarily deals with the substantive and procedural rules related to admission, treatment and protection of foreign investment. The United Nations Conference on Trade and Development (UNCTAD) defines BITs as "agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other's territories by companies based in either country." The countries signing BITs commit themselves to following specific standards on the treatment of foreign investments within their jurisdiction. If there is a breach of such commitments, BITs provide expansive procedures for the resolution of disputes. By and large, the substantive provisions of BITs are similar

across countries, but there can be important differences between treaties in different jurisdictions.

In the absence of a comprehensive multilateral agreement on investment, cross-border investment flows are currently governed by bilateral and regional investment treaties along with investment chapters in FTAs. It is fair to say that BITs have emerged as the primary source of international investment law to protect and promote cross-border investment flows. The first BIT was signed between Germany and Pakistan in 1959. Today, there are more than 3,000 BITs in existence globally, with the great majority having been concluded since 1990. Almost every country in the world has signed at least one BIT.

These treaties originated from the desire of capital-exporting developed countries to seek protection for investors and their investments in capital-importing developing countries. However, the underlying interests and power relations have changed considerably in recent years due to the rise of South-South Foreign Direct Investment (FDI) flows. A number of developing countries, especially the BRICS – Brazil, Russia, India, China and South Africa – are increasingly emerging as important outward investors. The number of BITs between developing countries has grown remarkably since 2004. With the changing pattern of global investment flows, the landscape of BITs is quickly evolving.

Paradoxically, it seems that the current BIT regime is at a crossroads, in spite of the rapid proliferation of treaties in recent years. There are signs of growing unease with the current regime across countries and regions. To a large extent, this unease has arisen due to frequent use of investor-state dispute settlement (ISDS) mechanisms under BITs, which allow investors to directly sue host state governments before international arbitral tribunals for alleged violations of treaty provisions. The increasing number of known treaty-based ISDS cases seeking billions of dollars in compensation have evoked a sharp public outcry against the BITs. As evident from the ongoing negotiations on the Transatlantic Trade and Investment Partnership (TTIP), the relatively obscure ISDS provision has turned into highly-publicized public debates in Europe and the US. There is now a greater awareness and understanding about the procedural shortcomings of dispute settlement mechanisms than at any time in the past.

The growing number of investor claims against sovereign states challenging a wide array of public policy decisions and regulatory measures has evoked deep concerns about the potential costs associated with such treaties. As discussed by several contributors in this book, the vague terms (such as 'fair and equitable treatment,' 'indirect expropriation' and 'umbrella clause') and other ambiguities can result in expansive interpretations by arbitral tribunals, leading to substantial monetary claims by foreign investors while unduly restricting regulatory space in the form of 'regulatory chill.' The risk of regulatory chill is very real, as a wide range of policy and regulatory measures (from taxation to the plain packaging of tobacco products to the disposal of hazardous waste) have all been challenged by foreign investors in the recent past.

The increasing use of ISDS mechanisms also highlights the lack of balance between public rights and private interests under the framework of a BIT. The current BITs regime has failed to address the balance of rights and responsibilities of foreign investors as it offers numerous legal rights for investors without requiring corresponding responsibilities for them. In both policy and academic circles, legitimate questions are being raised on the cost and procedure of arbitration, expansive interpretations by arbitral tribunals and the inconsistency of awards.

The proponents of BITs claim that the ISDS serves as a de-politicized forum for the resolution of investment claims against host governments. The proponents further argue that ISDS provisions reduce the risk of investment and thereby facilitate greater foreign investment in countries with weak legal and judicial systems. However, there is hardly any empirical evidence to prove that BITs alone result in increased investment flows. At best, BITs could be considered as one factor among many in creating a favorable investment climate for foreign investors in a host country.

Apart from ISDS provisions, there are numerous problematic provisions contained in existing BITs that require serious rethinking. Of late, a number of host governments are grappling with the issue of coherence between BITs and other policy areas such as taxation, public health and safety, and environmental protection.

There is a growing realization in policy circles that the existing treaty regime is becoming increasingly irrelevant in terms of addressing emerging social, economic, environmental and developmental challenges, both at national and global levels.

Revisiting BITs

Both developed and developing countries are paying far greater attention today to the scope of their treaty obligations and, now more than ever before, are seeking a better balance between investor rights and the right to regulate in the public interest.

A number of countries have been revisiting their BITs program since the early 2000s. Some countries are clarifying the language used in BITs in order to bring uniformity and coherence in treaty interpretations while others are terminating their existing treaties. Some of the North American Free Trade Agreement (NAFTA) awards (such as Metalclad v. Mexico) prompted the parties to issue an interpretative statement in 2001 confirming that the obligation for a "minimum standard of treatment" is equivalent to that granted under customary international law. Later on, the US updated its Model BIT text twice (in 2004 and 2012) to limit the expansive interpretations of NAFTA tribunals. In the same vein, the Canadian Model BIT was revised in 2004 and 2012. Due to strong opposition from civil society and political groups, Norway had to abandon its draft model BIT in 2009, which paved the way to a new draft model BIT published in 2015.

Australia rejected the ISDS provisions under the Australia-US Free Trade Agreement, which came into force in 2005. In 2011, the Gillard Government announced that it would not seek to include ISDS provisions in future investment and trade agreements. However, the Abbott Government (which came to power in 2013) reversed this policy in 2014 and reverted to including ISDS on a case-by-case basis. To illustrate, the ISDS provisions are included in Australia's FTAs with Korea and China but are excluded from FTAs with Japan. In 2011, Tobacco giant Philip Morris initiated an ISDS claim against Australia on tobacco plain packaging laws banning all branding from cigarette packets. On December 17, 2015, a three-member arbitral tribunal at

Permanent Court of Arbitration (PCA) unanimously supported Australia's position that Philip Morris had no jurisdiction to bring the case against Australia. In other words, Australia's plain packaging laws banning all branding from cigarette packets will remain in force.

The inclusion of ISDS provisions in the TTIP has become a major stumbling block for the conclusion of this agreement between the European Union (EU) and the US. The level of opposition to ISDS in Germany and France has taken EU negotiators by surprise. Few had anticipated that the inclusion of investment arbitration under the TTIP would be met with resistance in countries like Germany and the Netherlands – long-time supporters of BITs.

Growing backlash in the South

In the Global South, the backlash against BITs is gaining momentum. It surfaced when dozens of claims were launched against Argentina when the country imposed new regulatory measures during the financial crisis that erupted in 2001. In 2007, Bolivia became the first country to denounce the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention), which has been ratified by more than 150 member states.

Following Bolivia's lead, Ecuador and Venezuela also submitted written notices of their denunciation of the ICSID Convention. In 2008, Ecuador terminated nine BITs – with Cuba, the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay, Romania and Uruguay. In 2010, Ecuador's Constitutional Court declared the arbitration provisions of six more BITs unconstitutional. Ecuador has claimed that the investment arbitration system is biased towards investors and therefore has called for the establishment of an alternative forum for investment arbitration in the region. In 2008, Venezuela issued notice to terminate its BIT with the Netherlands.

However, it is important to note that that, despite termination of BITs, the BIT regime in these countries is not fully dismantled, as most of their BITs contain a so-called survival clause. This allows investors to bring a claim in relation to an investment that was made whilst the BIT was in

force. Even after the termination of a BIT, the provisions often remain in force for an additional period of 10-15 years, depending on the treaty.

Nevertheless, the decisions taken by these countries to roll back their BIT commitments represent a significant development and should be viewed in the much broader context of attempts made by other countries to revisit their BIT regime. At the time of writing, a number of other developing countries are questioning the rationale of investment agreements as these are neither necessary nor sufficient to attract foreign investment. South Africa terminated its treaties with Belgium and Luxembourg, Switzerland, the Netherlands, Spain, Austria and Germany based on a three-year review (concluded in 2010) and replaced its BITs regime with new domestic legislation that aims to protect investor rights while safeguarding domestic policy space.

Several Asian countries are also rethinking the costs and benefits of BITs and are taking various policy measures to protect themselves from costly investor-state arbitration. India, Pakistan and Indonesia are currently reviewing their old Model BIT texts and are preparing a new template for future treaties. India launched a review of its investment treaties in mid-2012 in the wake of public outcry over arbitration notices served by more than a dozen foreign companies. These notices challenged various policies (and judicial decisions) and demanded billions of dollars in compensation for the alleged violation of India's BITs. The purpose of review is to revise India's 1993 model treaty text and to provide a roadmap for the re-negotiation of existing BITs.

Similarly, Indonesia is currently reviewing its BITs as well as investment chapters of FTAs that it has previously signed. Indonesia believes that the current IIA regime does not grant sufficient space for sustainable development and that revisions are needed to update the existing IIAs in order to preserve the right for states to exercise their regulatory and policy space. One of Indonesia's greatest concerns regarding IIAs is the ISDS provision, which has increased Indonesia's exposure to investor claims in international arbitration.

In addition, academics, legal experts and civil society groups have also been voicing concerns about the scope of treaty obligations and obstacles imposed by BITs while pursuing legitimate policy objectives.

For a long time, civil society groups have also been calling for a fundamental rethink of the costs and benefits of BITs, in the wider context of preserving policy space and sovereignty. In the past few years, a wide range of alternative policy proposals and solutions have been put forward by different stakeholders to reform the present investment agreement regime.

All these important developments call for further collective thinking and constructive engagement by all stakeholders – policy-makers, legal experts, legislators, international institutions, think-tanks, civil society groups and development practitioners. As pointed out by Howard Mann[1] and many other scholars, the ongoing backlash against BITs offers not just an opportunity to address the shortcomings of the BIT regime, but it could also usher in a new era of economic engagement to promote sustainable development on a global scale. Needless to say, it has the potential for transforming into a true global partnership by involving all countries and all stakeholders. This confluence of circumstances makes it a very opportune time to explore innovative policy solutions to tackle the problems posed by the current BIT regime, as well as to improve the governance of cross-border investment flows.

Why this book?

Against this backdrop, we decided to bring out a free-to-download book, which provides a comprehensive overview of recent developments in this field and explores a wide range of policy solutions to reform the current IIA regime. At present, there is hardly a single book or compilation of articles in one place that captures these developments and discussions from the perspective of international investment law and its troublesome relationship with development policy.

The idea behind this book originated at an international workshop on India-EU FTA held at Pondicherry (India) in 2014. The overall objective of the book is to provide a comprehensive overview of the rapidly changing landscape of global investment treaties in one single volume,

1. Mann, Howard. (2003). International Investment Agreements: Building the New Colonialism? *American Society of International Law Proceedings*, 97, 247-50.

and to explore myriad policy options that can inform and enrich the ongoing discussions at various levels. The book presents a rich debate that is very relevant to the ongoing initiatives to reform the governance of investment treaties. The authors also raise some critical policy issues that are missing in the current debates.

Through this publication, we have attempted to initiate a dialogue between government officials, legal experts drawn from academia, international organizations and civil society groups about exploring innovative policy solutions. We hope that the book will stimulate broader thinking and new ideas to address the systemic shortcomings of the current BIT regime that are spelled out all too clearly in many of the articles.

The book covers a wide range of topics – from current trends in investor-state arbitration to the wider ramifications of investment treaties on sovereign debt restructuring, the extractive industry, intellectual property rights and human rights. It provides an up-to-date account of the model BIT reviews undertaken by South Africa, India and Indonesia. Some of the authors have suggested a broad gamut of useful policy solutions. Some policy solutions are narrow in scope while others are extremely broad. While all contributors agree on the complexity of the problem and the need to reform the current BIT regime, they may disagree on the merits of specific reforms.

The book includes 19 distinct analyses by leading experts in the field, covering both national and international perspectives. We have deliberately tapped a wide range of international expertise by inviting contributions from diverse professional backgrounds. Some of the papers are contributed by current or former government officials working at various levels. Others are written by legal experts, researchers and economists based in academia, think tanks and non-governmental organizations (NGOs).

We asked contributors to avoid jargon where possible and to present their views as clearly and as accessibly as possible in order to enhance the paper's readership and impact. We have not followed a particular style sheet (related to spelling, footnotes, references, figures, and similar matters) as authors have followed different formats that are consistent within their own papers.

Organization of the book

In the first chapter, James Zhan from UNCTAD provides an overview of current trends in international investment agreements and major policy challenges, with special reference to ISDS cases. In recent years, UNCTAD has emerged as an international lead agency on the reform of IIAs. Based on his work at UNCTAD, Zhan outlines five sets of reform options to address key concerns related to ISDS. While seeking systemic reforms, Zhan calls for a new generation of IIAs that addresses the challenges of investment policies in the 21st century. He argues that ISDS issues should and can only be addressed in the context of overall reforms of the investment regime, not in isolation.

Zoe Phillips Williams shares the initial results of her empirical study of 583 known investor-state arbitration cases. She has examined the data on the subject of investor-state arbitration's relationship with domestic institutions and actors in order to understand the underlying causes of investor-state disputes. Her detailed assessment highlights the fact that explanations for investor-state disputes that focus on weak institutions and law enforcement are most likely incomplete. Rather, exposure to the IIA regime in terms of the amount of FDI hosted and IIAs significantly increases the likelihood of arbitration. She emphasizes that an understanding of the political goals and preferences that may conflict with those of foreign investors is important if we are to devise a system that is better able to balance investor and domestic actor concerns.

Gus Van Harten provides a comprehensive critique of international investment treaties by questioning the much-touted justifications put forward by proponents of international investment treaties. Drawing on empirical evidence, the author shows why prominent justifications for the treaty-based investment law regime are groundless or, at least, open to serious doubt. The paper debunks three of the most common arguments given in defence of the BITs – investment treaties are a means to encourage foreign investment; that they respond to the bias and unreliability of domestic courts; and investment arbitration ensures fairness and the rule of law in the resolution of investment disputes. After questioning the justifications for the investment treaty system, the paper examines the prospects and limitations of reform options. Van Harten concludes his paper with blunt words: "The most pressing priority is

for states and the public to become more familiar both with the uncertain but potentially crippling public liabilities created by the system and with the perverse shift in bargaining power to the most powerful private economic actors on the planet at the expense of the institutions and processes that represent most everyone else."

The next seven chapters of the book examine the recent developments taking place in South Africa, India, Indonesia and Brazil.

The paper by Xavier Carim provides a broad perspective on the implications of international investment agreements for sustainable development with particular attention to the experience and policy approaches to IIAs in South Africa. Carim provides a detailed account of South Africa's review process and recent developments that led to the termination of BITs and the introduction of a new domestic legislation that seeks to protect foreign investment while preserving the sovereign right to pursue legitimate public policy objectives in line with the country's constitutional requirements. Based on South African BIT review experience, the author calls upon other African countries to undertake a comprehensive review of their investment treaties in order to assess the risks posed by such treaties to policy-making for structural transformation in Africa.

The next three papers reflect a broad spectrum of viewpoints on India's new model BIT. The first paper by Saurabh Garg, Ishita G. Tripathy and Sudhanshu Roy analyses the evolution of India's BIT policy in terms of continuity and change over time, in tune with the changing domestic and international investment regimes. On the drafting of India's new model BIT, the paper explains why the Indian authorities pursued a realistic approach to find a "middle path" between investment protection standards and the legitimate right of governments to regulate economic activity in the public interest. The authors explain the underlying rationale behind the substantive and procedural changes made in the new model BIT. According to the authors, the review of the model treaty is merely one more contribution to changing the system of investment treaties worldwide. The next challenge is perhaps to overhaul the large number of India's existing BITs to bring them in line with the renewed approach and to integrate the trade and investment regimes towards a common agenda.

The next paper by Kavalijt Singh discusses several key features of India's new model text for BIT approved in 2015. The paper clarifies the meaning and intention of safeguard measures and other important provisions under the new model text. Singh sees merit in the new approach adopted by the Indian authorities. He asserts that India's new model BIT is a major departure from the earlier model BIT. According to Singh, the new model BIT provides an innovative approach to dealing with imperfections of the current investment treaty regime in India as it does not include several controversial investment protection obligations (such as most favored nation treatment) while new obligations on investors have been introduced to ensure a balance between investor rights and obligations. The paper highlights some of the legal and practical implications involved in the process of re-negotiations or termination of India's standalone investment treaties and investment chapters of FTAs. Despite positive features of the proposed new model BIT, Singh warns that the Indian government should not solely rely on a treaty-based approach to protect foreign investments as defending against investment treaty claim could cost a considerable amount of money.

After analysing India's initial approach to foreign investment, Prabhash Ranjan examines the emergence of India's BIT programme in a historical context. The paper critically examines some of the safeguards and provisions contained in the proposed new model BIT text. In contrast to Singh, Ranjan remains sceptical about the approach adopted under the new model BIT. According to Ranjan, India's future BIT practice should be developed keeping in mind that BITs act as a 'signaling device' to foreign investors about congenial investment environment besides many Indian companies that are investing abroad would need a treaty framework to safeguard their overseas investments.

The next two papers deal with the developments related to Indonesia, which has experienced a steady increase in investor-state arbitration cases in recent years. In light of the ongoing BIT review in Indonesia, the paper by Abdulkadir Jailani explains the rationale behind the official review and discusses some of the key policy challenges faced during the review process. The paper presents a critical outlook to some of the outstanding issues (particularly ISDS) that appeared during the review process. According to Jailani, dropping ISDS provision altogether may not be a wise approach in the context of Indonesia but the scope

of its application should be restricted. He has invited suggestions and inputs to further fine-tune Indonesia's new approach under the new treaty model.

While welcoming a review of Indonesian BITs in terms of bringing greater clarity, Junianto James Losari and Michael Ewing-Chow call for the preservation of the ISDS mechanism under new agreements to be signed by Indonesia. The authors believe that the inclusion of ISDS mechanisms may contribute to better governance in Indonesia as it has proved to be effective in disciplining local authorities in Mexico. The authors have also recommended several domestic reforms, ranging from greater coordination between government officials to improving the management of investment disputes.

Brazil is an interesting case study as the country is not a party to any BITs but still receives substantial amounts of foreign investment. The country had signed 14 BITs in the 1990s but the National Congress of Brazil refused to ratify them because of potential risks associated with the traditional ISDS system. Of late, Brazil is reassessing its long-standing policy stance. In 2015, Brazil signed Cooperation and Facilitation Investment Agreements (CFIAs) with Mozambique, Angola, Colombia, Malawi and Mexico. These CFIAs focus primarily on cooperation and investment facilitation. By excluding investor-state arbitration, the CFIAs promote amicable ways to settle investment disputes. The paper by Martin Dietrich Brauch provides an in-depth analysis of the Brazilian CFIAs with Mozambique, Angola and Mexico. In light of growing criticism of the investor protection paradigm and the flaws in investor-state arbitration, Brauch elucidates how Brazil's CFIAs are markedly different from the traditional BIT-ISDS regime.

The Treaty of Lisbon (which entered into force on 1 December 2009) has given the EU exclusive competence to conduct its investment policy. More than 1,200 BITs concluded by EU member states have considerable influence over the current international investment regime. In this context, the paper by Burghard Ilge gives an overview on the important developments taking place at the European level. The paper provides a critical assessment of the proposed ISDS reforms under the TTIP and raises many questions about the current approach adopted by the EU. As Ilge concludes: "Europe is currently standing at a

critical crossroads. It has to decide which path to pursue. Does it want to maintain a focus on the reform of an old model of international investment agreements that solely focus on the self-interest of foreign investors? Or to instead choose a more holistic approach?"

The Netherlands was the first country in Europe to sign a BIT (with ISDS provision) with one of its former colonies (Indonesia) in 1968. In recent years, Dutch BITs have become one of the main sources of ISDS cases. Roos Van Os examines the Dutch BITs in a wider political economy context. Her paper analyses key features of the Dutch model BIT as well as some well-known arbitration cases. According to Van Os, recent proposals made by the European Commission to reform the ISDS system are timid and do not address the fundamental structure of the system. The paper enlists a number of recommendations for building a new framework for Dutch BITs to ensure genuine sustainable development and protection of human rights. In the words of Van Os: "The Netherlands has a particular responsibility to reassess its investment policy in terms of policy coherence and to ensure that businesses incorporated in the Netherlands respect human rights in their operations abroad."

Most international investment agreements define investment in very broad terms. They define investment as "every kind of asset" including the intellectual property rights. Authors Brook K. Baker and Katrina Geddes look into the implications of the inclusion of IPRs under BITs on public health policies across the world. The authors fear that the ongoing case (Eli Lilly v. Canada) will encourage other pharmaceutical companies to resort to investor-state arbitration to remedy lost expectations of profit arising out of government measures to improve public health. Baker and Geddes assert that foreign investors should not enjoy greater legal rights than citizens of a state by virtue of their ability to bring treaty claims against government measures, which domestic citizens cannot challenge. They conclude that there must be recognition that not all areas of social life should be open to the market, and these must be defined with a clear rationale.

It is well recognized that investment agreements could have serious implications for sovereign debt restructuring (SDR). Kevin P. Gallagher examines this important issue by looking at the experience of Argentina and ongoing ISDS cases against Greece and Cyprus. His paper

outlines how investment agreements can tangle with sovereign debt restructuring since safeguards and exceptions in many agreements are not adequate enough to provide cover for nations to restructure their debts. The paper also offers several policy solutions (such as excluding sovereign debt from the definition of investment) to ensure that investment agreements grant the policy space to conduct effective SDRs in the future.

At present, very few BITs make reference to the protection of human rights. This is at odds with a growing consensus amongst civil society activists and scholars that BITs should also take human rights obligations into account. In his paper, Patrick Dumberry discusses how investment treaties should be suitably modified to incorporate human rights obligations. His paper emphasizes that nothing in international law prevents countries from signing BITs imposing human rights obligations upon private corporations. Dumberry suggests a number of alternative approaches to including such obligations in the investment treaty text and the precise language that should be used. He points out that the policy solutions offered in his paper are practical and could be easily adopted by states.

At the global level, extractive industries (oil, gas and mining) are witnessing the greatest number of investment disputes. A large number of all known investor-state claims relate to such industries. This trend is more evident in Latin America. Authors Sarah Anderson and Manuel Pérez-Rocha discuss how foreign oil and mining companies use investment agreements as a strong weapon in disputes with the host governments in Latin America. Drawing on some of the recent investor lawsuits (especially the Pacific Rim v. El Salvador case), the paper critically examines some of the most controversial elements of the investment treaties and illustrates how these undermine the ability of governments to regulate extractive sectors in the public interest.

The paper by Pia Eberhardt and Cecilia Olivet provide a glimpse into the inner workings of an investment arbitration industry that consists of law firms, arbitrators and financiers. Their paper illustrates how law firms, arbitrators and financiers are fuelling an investment arbitration boom. This paper sheds light on the conflicting interests of the investment arbitrators and the effects of third-party funding. Eberhardt and

Olivet contend that meaningful change to address even the most egregious injustices of the international investment regime will not come from the arbitration industry. On the contrary, the authors argue that those fighting for such changes will have to continue to confront the anti-reform counter-offensive by law firms, arbitrators and funders, including by ousting their vested interests in the system.

Before the advent of investor-state arbitration, state to state dispute settlement (SSDS) was the most common dispute resolution mechanism in early investment agreements. Because of the numerous problems associated with investor-state arbitration, SSDS options are getting renewed attention recently from policy-makers and academia as an alternative mechanism to resolve investment disputes. The paper by Nathalie Bernasconi-Osterwalder closely examines the growing relevance and potential of SSDS mechanisms at the present time. The paper offers recommendations on how state-state arbitration could potentially be used as an alternative to investor-state arbitration. Bernasconi-Osterwalder observers that well-drafted and thought-through SSDS provisions could help countries overcome several of the interpretive and procedural concerns arising from the current investment arbitration regime.

In the past, BITs were typically drafted by a handful of technocrats in capital exporting developed countries and were then offered to developing countries for signature. The final agreement reflected only minor changes from the original draft, if any, and were signed and ratified without any substantial engagement of parliaments or public debate. Given the far reaching implications of investment treaties on a wider range of public policies, however, this low level of public oversight creates real challenges in terms of democratic governance and accountability. Against this background, the paper by Lorenzo Cotula supports active citizen engagement with international investment law making and shows how such spaces for engagement are evolving rapidly. The author calls for new collaborations that harness research and advocacy for greater citizen participation in the making of international investment law.

In conclusion, we humbly accept that this book alone cannot do full justice to such a complex issue as bilateral investment treaties. This

book is a first step towards a series of research, publications and popular educational interventions with the goal of undertaking a systemic rethink of today's BIT regime, as well as democratizing the ongoing discussions on these vital public policy issues.

We are grateful to all those who expressed an interest in and support for this publication. We particularly thank our contributing authors for their contributions to this book. Both ENDS, Madhyam and SOMO are delighted to provide a platform for an exchange of views on this critical topic.

International Investment Rule-making: Trends, Challenges and Way Forward

James X. Zhan*

In the absence of a multilateral investment system, the current international investment regime is multi-layered and multi-faceted, consisting of close to 3,270 investment treaties at the bilateral, regional and plurilateral level (by the end of 2014). The overwhelming majority of countries are party to at least one international investment agreement (IIA). Some have even signed more than 100 such agreements.

I. IIA regime: Reform is imperative

1. The IIA regime shows diverging trends

- On the one hand, we see an up-scaling of treaty making in two respects: First, in terms of participation, up-scaling means that more and more countries are actively engaged in negotiating IIAs. For example, 44 IIAs were concluded in 2013; and 88 countries are currently involved in negotiating seven mega-regional agreements with investment chapters. The EU alone is engaged in negotiating

* This paper is prepared largely on UNCTAD policy analysis led by the author, but it does not necessarily represent the views of the UNCTAD secretariat or its member states.

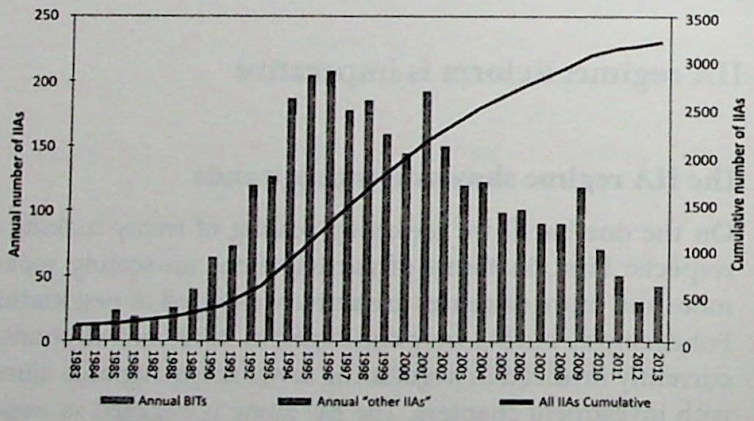
more than 20 agreements that are expected to include investment-related provisions (which may vary in their scope and depth).

Second, up-scaling occurs with regard to the substance of agreements. They become broader in the coverage of issues (i.e. they expand existing treaty elements and include new ones) and they introduce more sophisticated treaty standards.

- On the other hand, some countries are disengaging from the IIA regime. Over the past two years, some countries have unilaterally terminated existing treaties (e.g. Ecuador, South Africa and Indonesia), and some also denounced multilateral investment arbitration conventions (e.g. Bolivia, Ecuador and Venezuela).

- In addition, there is a continued trend of re-adjusting treaty negotiating positions. At least 40 countries and four regional integration organisations have been recently reviewing and revising their model investment agreements and negotiation strategies, partially through a multi-stakeholder approach.

Figure 1: Trends in IIAs signed, 1983-2013



Source: UNCTAD, IIA database.

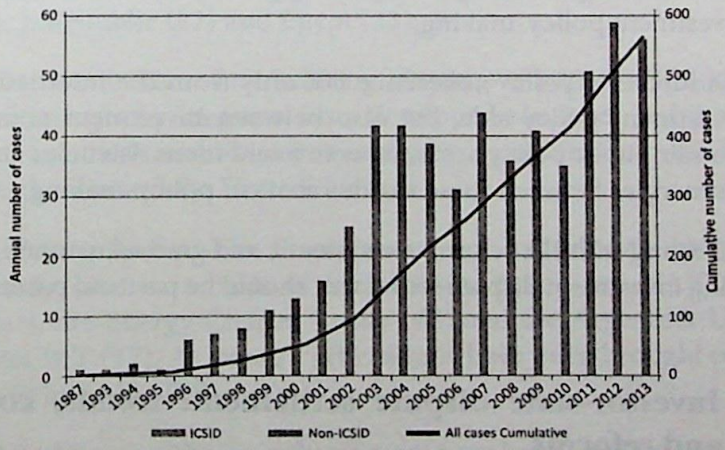
2. The IIA regime has to overcome three major challenges

The investment-development paradigm has been shifting towards sustainable development, in terms of both national and international investment policy-making. At the national level, this manifests itself in investment policy measures, such as those taking the form of regulations for the pursuit of environmental or social objectives or industrial policies.

At the international level, while almost all countries are party to one or several IIAs, many are dissatisfied with the current international investment regime. The international investment-development community is facing three main challenges:

- First, how to integrate sustainable development objectives into the IIAs? Most existing IIAs follow the 'traditional' approach of focussing more or less exclusively on investment promotion and protection, and largely neglect the sustainable development impact of investment. New IIAs, in turn, illustrate the growing tendency to craft treaties that are in line with sustainable development objectives.

Figure 2: Trends in known ISDS cases, 1987–2013



Source: UNCTAD, ISDS database.

- Second, how to rebalance the rights and obligations between investors and states? There is growing concern that IIAs in their common content could unduly restrict policy space for host countries. Broad and vaguely formulated IIA provisions create a risk that investors challenge core domestic policy decisions, for instance in the area of environmental, energy or health policies.

- Third, how to address the systemic complexity of the IIA regime, including investor-state dispute settlement (ISDS), and ensure coherence between investment policies and other public policies. Investment policies do not exist in isolation, but interact with other policy areas, such as environmental policies, trade policies, social policies, labour policies, industrial policies and others. However, the current IIA regime does not make a link to these other policy areas and risks creating inconsistencies.

3. Reforms should be the way forward

A broad consensus is emerging regarding the need to address the above challenges and improve the system. The question is how. In my view, we should adopt a holistic approach to addressing the multiple challenges by:

- Establishing a set of global guiding principles for international investment policy-making;

- Addressing policy coherence not only from the international investment policy side, but also between investment policies and other public policy areas, so as to avoid inconsistencies and create synergies between these various areas of policy-making;

- Dealing with IIA reform in a systemic and gradual manner. Improving investment dispute settlement should be part and parcel of it.

II. Investor-state dispute settlement: trends, concerns and reforms

Allow me to present the current trends, summarise the key problems and highlight some reform options.

1. Current trends and the broader perspective

Investor-state dispute settlement (ISDS) is a regular feature of international investment agreements. However, the first bilateral investment treaty that was concluded in 1959 between Germany and Pakistan did not contain an ISDS mechanism; it contained a clause for the settlement of disputes between the two states. Towards the end of the 1960s, states gradually started to include ISDS clauses in their treaties.

Today, the vast majority of bilateral investment treaties (BITs), as well as 'other IIAs' - which we define as free trade agreements, economic cooperation agreements and other agreements with an investment chapter - contain provisions for the settlement of disputes between investors and the host state through international arbitration.

The total number of known treaty-based ISDS cases reached 568 by the end of 2013. Since some arbitration forums do not maintain a public registry of claims, the total number of cases is likely to be higher. The main features of these cases include:

- *Respondent states*: In total, over the years at least 98 governments have been respondents to one or more investment treaty arbitrations. Over 70% of all known cases were brought against developing and transition economies. Argentina (53 cases) and Venezuela (36) continue to be the most frequent respondents, followed by the Czech Republic (27) and Egypt (23).

- *Home states*: The overwhelming majority (85%) of ISDS claims were brought by investors from developed countries. Arbitrations have been initiated most frequently by claimants from the European Union and the United States.

- *Legal instruments*: The three investment instruments most frequently used as a basis of ISDS claims have been NAFTA (51 cases), the Energy Charter Treaty (42) and the Argentina-United States BIT (17). At least 72 arbitrations have been brought pursuant to intra-EU BITs.

- *Arbitral forums*: The majority of cases have been brought under the ICSID Convention and the ICSID Additional Facility Rules (353

cases) and the UNCITRAL Rules (158). Other venues have been used only rarely, with 28 cases at the Stockholm Chamber of Commerce and six at the International Chamber of Commerce.

- *Outcomes*: 2013 arbitral developments brought the overall number of concluded cases to 274. Out of these, approximately 43% were decided in favour of the State and 31% were decided in favour of the investor. Approximately 26% of cases were settled. In settled cases, the specific terms of settlement typically remain confidential.

- *ISDS cases involving EU and US as respondents*: Looking more closely at the 568 known ISDS cases, we found that about 20% of those were brought against EU Member States (117 cases). The US has faced 16 arbitrations - about 3%. In the majority of cases brought against EU Member States, the respondents are the 'new' Member States (those that acceded to the EU in 2004 or later) – not the 'old' Member States like Germany or the United Kingdom. The Czech Republic and Poland as well as the US appear in the global list of most frequent respondents.

- *The claimants and their home states*: Claimants from the US and EU Member States account for 75% of the investment treaty arbitrations. Claimants from EU Member States have initiated 300 cases, while claimants from the US have filed 127 disputes. Within the EU, we are mostly seeing investors from the Netherlands (with 62 initiated cases), the United Kingdom (43) and Germany (39). Investors from these three countries are the most active in terms of bringing ISDS cases.

- *Putting ISDS cases into a broader perspective*: In the context of $26 trillion of global foreign direct investment (FDI) stock undertaken by 104,000 multinational companies with over 892,000 foreign affiliates worldwide, the 568 cases that mainly occurred over the past two decades may indicate that ISDS has not been extensively used by the foreign direct investors. There are also questions about the effectiveness with which investors have used ISDS so far. In addition, a large number of IIAs have not been used as the legal basis for ISDS cases. Having said that, a number of ISDS cases do have far-reaching implications for international investment policies and

sustainable development. It is therefore important to carefully assess the benefits and costs of ISDS and design a system for investment dispute settlement that best serves the needs of investors, governments and other affected stakeholders alike.

2. Key problems and concerns

In light of the increasing number of ISDS cases, the debate about the usefulness and legitimacy of the ISDS mechanism has gained momentum, especially in those countries and regions where ISDS is on the agenda of high-profile IIA negotiations.

Originally, the ISDS mechanism was designed to ensure a neutral forum that would offer investors a fair hearing before an independent and qualified tribunal, granting a swift, cheap and flexible process for settling investment disputes. Moreover, ISDS gives disputing parties considerable control over the process (for example, by allowing them to select arbitrators). Given that investor complaints relate to the conduct of sovereign states, taking these disputes out of the domestic sphere of the state concerned provides aggrieved investors with an important guarantee that their claims will be adjudicated in an independent and impartial manner.

However, the actual functioning of ISDS under investment treaties may disprove many of the advantages that arbitration purports to offer. Indeed, systemic deficiencies of the ISDS mechanism have emerged. Deficiencies have been well documented in literature and have been summarised in the UN Conference on Trade and Development (UNCTAD)'s *World Investment Report 2013*.

- *Legitimacy*: It has been criticised that three individuals, appointed on an ad hoc basis, are entrusted with assessing the validity of states' acts, particularly when they involve public policy issues. The pressures on public finances and potential disincentives for public-interest regulation may pose obstacles to countries' sustainable development paths.

- *Transparency*: Even though the transparency of the system has improved since the early 2000s, ISDS proceedings can still be kept

confidential, if both disputing parties so wish, even in cases where the dispute involves matters of public interest.

- *"Nationality planning"*: Investors may gain access to ISDS procedures using corporate structuring, i.e. by channelling an investment through a company established in an intermediary country with the sole purpose of benefitting from an IIA concluded by that country with the host state.

- *Consistency of arbitral decisions*: Recurring episodes of inconsistent findings by arbitral tribunals have resulted in divergent legal interpretations of identical or similar treaty provisions, as well as differences in the assessment of the merits of cases involving the same facts. Inconsistent interpretations have led to uncertainty about the meaning of key treaty obligations and lack of predictability as to how they will be read in future cases.

- *Absence of an appeals mechanism*: Substantive mistakes of arbitral tribunals, should they arise, cannot be effectively corrected through existing review mechanisms.

- *Arbitrators' independence and impartiality*: An increasing number of challenges to arbitrators may indicate that disputing parties perceive them as biased or pre-disposed. Particular concerns have arisen from the perceived tendency of each disputing party to appoint individuals sympathetic to their case. Arbitrators' interest in being re-appointed in future cases, and their frequent 'changing of hats' (serving as arbitrators in some cases and counsel in others) amplify these concerns.

- *Financial stakes*: The high cost of arbitrations can be a concern for both states and investors (especially small- and medium-sized enterprises). From the state perspective, even if a government ends up winning the case, the tribunal may refrain from ordering claimant investors to pay the respondent's costs, leaving the average US$8 million spent on lawyers and arbitrators as a significant burden on public finances and preventing the use of those funds for other goals.

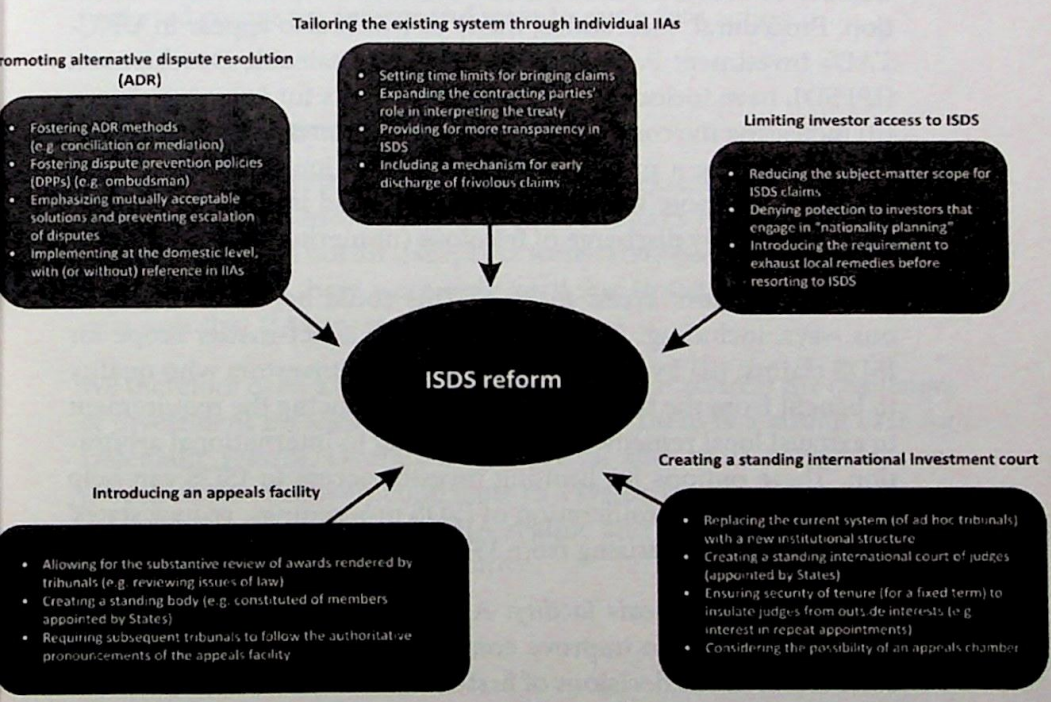
These issues have prompted a debate about the challenges and opportunities of ISDS in multiple fora.

3. Options for ISDS reform

ISDS is one problem of the IIA regime, but it is by no means the only problem, nor is it at the root of the problem. An important point to bear in mind is that ISDS is a mechanism of application of the law. Therefore, improvements to the dispute settlement mechanism should go hand-in-hand with reform of the IIA regime. ISDS issues should and can only be addressed in the context of overall reforms of the investment regime, not in isolation.

In my view, the debate on the ISDS issue should now go beyond the question of 'to have or not to have.' There have been many multi-stakeholders debates on the good and bad of ISDS over the past few years.

Figure 3: Five ways of reforming ISDS



Source: UNCTAD.

UNCTAD has taken stock of the different arguments brought forward in these debates. The question now should be: "What is the way forward in case we decide to drop ISDS?" And "What improvements need to be made to the ISDS mechanism in case we decide to retain it?"

UNCTAD outlined five sets of reform options for international investment arbitration, which are as follows:

- *Promoting alternative dispute resolution*: Non-binding ADR methods, such as conciliation and mediation, can help to save time and money, find a mutually acceptable solution, prevent escalation of the dispute and preserve a workable relationship between the disputing parties. ADR could go hand in hand with the strengthening of dispute prevention and management policies at the national level.

- *Modifying the existing ISDS mechanism through individual IIAs*: A number of countries have already embarked on this course of action. Procedural innovations, many of which also appear in UNCTAD's Investment Policy Framework for Sustainable Development (IPFSD), have included: (i) setting time limits for bringing claims; (ii) increasing the contracting parties' role in interpreting the treaty; (iii) establishing a mechanism for consolidation of related claims; providing for more transparency in ISDS; and including a mechanism for an early discharge of frivolous (unmeritorious) claims.

- *Limiting investors' access to ISDS*: This could be done in numerous ways, including: (i) by reducing the subject-matter scope for ISDS claims; (ii) by restricting the range of investors who qualify to benefit from the treaty, and (iii) by introducing the requirement to exhaust local remedies before resorting to international arbitration. These options for limiting investor access to ISDS can help to slow down the proliferation of ISDS proceedings, reduce states' financial liabilities arising from ISDS awards and save resources.

- *Introducing an appeals facility*: An appeal facility has been proposed as a means to improve consistency among arbitral awards, correct erroneous decisions of first-level tribunals and enhance the predictability of the law. In a word, an appeals facility would add direction and order to the existing decentralised, non-hierarchical and ad hoc regime.

- *Creating a standing international investment court*: This option implies the replacement of the current system of ad hoc arbitral tribunals with a new institutional structure. The standing international court would consist of judges appointed or elected by states on a permanent basis, for example, for a fixed term. It could also have an appeals chamber. A standing investment court would be an institutional public good serving the interests of investors, states and other stakeholders.

Among the five options, some imply individual actions by governments and others require joint action by a significant number of countries. While the collective action options would go further in terms of addressing the problems, they would face more difficulties in implementation and require agreement between a larger number of states on a series of important details. A multilateral policy dialogue on investment dispute settlement could help develop a consensus on the preferred course for reform and ways to put it into action.

Concluding remarks

The content of most IIAs as they currently exist has been developed decades ago and does not correspond to today's realities. In the past, sustainability was not an issue, IIAs were rarely used as a liberalisation instrument, and there were only very few investment disputes. It is only now that IIAs are starting to 'bite.'

We therefore need a new generation of IIAs that address the challenges of investment policies in the 21st century. There is a strong case for systematic reform. Overall, a multilateral and multi-stakeholder approach could effectively contribute to a systemic reform that could address the complexities of the IIA regime and bring it in line with the sustainable development imperative.

What, When, Where and Why? Patterns in Investor-State Arbitration

Zoe Phillips Williams

Who are the key actors in investor-state disputes? Which states are sued most frequently? On a sub-state level, which domestic institutions are passing the measures that are subsequently being challenged by investors? Despite the ongoing debate over the impact of the investment protection regime on policy space, there remains a lack of data on the subject of investor-state arbitration's relationship with domestic institutions and actors. This paper attempts to fill this gap by presenting the results of an empirical study of investor-state arbitration cases,[1] based on an original dataset of known disputes.[2] The latter looks at a range of variables that may increase the likelihood of an investor-state dispute, including those related to domestic institutions and actors, and those related to the exposure of the state to opportunities to be sued by investors.

1. These include 583 International Centre for Settlement of Investment Dispute (ICSID) and UN Commission on International Trade Law (UNCITRAL) cases, as well as those held at other arbitral forums where information was available. Cases where insufficient information has been made public were excluded.
2. For more information about the statistical analysis performed here, please contact the author (zoephillipsw@gmail.com).

Ultimately, the objective of this paper is to uncover the role that domestic actors and institutions play in investor-state disputes, in order to better understand the underlying causes of investor-state disputes.

Which states are being sued?

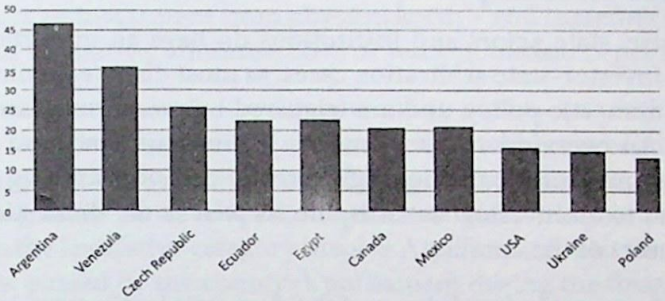
While most states in the world have signed and ratified at least one investment treaty, the pattern of global foreign direct investment (FDI) flows has ensured that, until quite recently, developing countries have almost exclusively acted as respondents in arbitration. In fact, with some notable exceptions, few very wealthy or very poor nations have been taken to arbitration; the former do not, on the whole, receive inward FDI flows that are covered by an international investment agreement (IIA), while very low-income countries do not host very much investment at all (UNCTAD, 2014). Large multilateral or regional trade agreements with investment chapters, such as the Energy Charter Treaty (ECT) and the North American Free Trade Agreement (NAFTA), depart from this pattern somewhat, although at least with regard to the ECT, the respondents have generally been Eastern European and Commonwealth of Independent States (CIS), with claimants coming from Western Europe.

Indeed, the distribution of income levels across the population of states that have ratified at least one IIA (and can therefore at least in theory act as the respondent in arbitration) is fairly even – low-income countries make up 31%, middle-income 46%, and high-income states 23%. However, middle-income countries make up over 67% of countries that have been the respondent in at least one investor-state arbitration case, while high- and low-income countries make up 17% and 14% respectively.

On the other hand, when we look at the countries that have most frequently acted as respondents, we see a much more heterogeneous group of states.[3]

3. These are the top ten respondent states as of January 2015.

Figure 1: Top Ten Respondent States



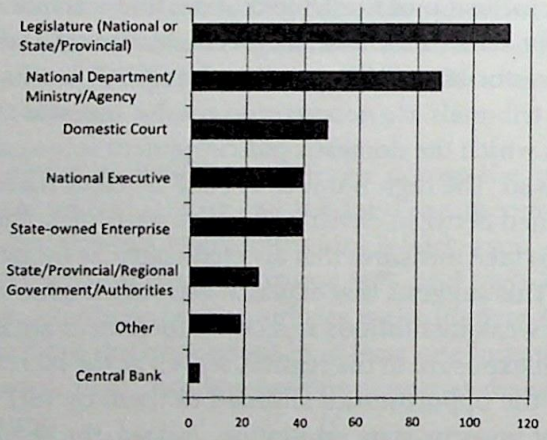
Argentina and Venezuela are of course rather exceptional cases – almost all of the cases faced by Argentina are a result of the country's severe financial crisis of 2002, while former Venezuelan President Hugo Chavez's propensity toward expropriation has triggered a large number of disputes. On the other hand, the cases faced by the other states in Figure 1 cannot be explained by any one measure or cause. However, the inclusion of the United States and Canada amongst the top respondent states is of note, as this challenges the traditional rationale for investor-state dispute settlement (ISDS) mechanisms – that international tribunals are necessary to resolve investor-state disputes in contexts in which the domestic judicial system is too corrupt or politicized to do so. The high number of NAFTA cases makes clear that, if IIAs are signed between developed country partners, these states are just as likely to take measures that are challenged by investors as developing states. This suggests that explanations for investor-state disputes that focus on weak institutions and law enforcement are likely incomplete, and that exposure to the regime, as well as the increased investor awareness of the opportunities afforded to them by ISDS, are important drivers of investor-state arbitration. Indeed, the results of my statistical analysis indicate that exposure to the IIA regime in the form of amount of FDI hosted and IIAs, as well as time (a proxy for investors' awareness) significantly increases the likelihood of arbitration, even when controlling for other factors such as democracy level and control of corruption, which are generally associated with lower levels of political risk (Busse & Hefeker, 2005; Freeman, 2013; Knutsen, 2011).

Which domestic institutions are implicated in investor-state disputes?

Of course, state actors and institutions do have an important role to play in investor-state arbitration cases, as most disputes center on matters of domestic policy, and are triggered by measures taken by these actors. An overview of the domestic institutions that have taken the disputed measures can shed light on the decision-making processes that lead to an investor-state dispute, as well as the domestic interests at the heart of the conflict.

Figure 2 presents a breakdown of the domestic institutions involved in the cases included in the dataset. Many involve more than one institution, if the investor challenges a number of state measures related to the investment. Therefore, I have included all relevant domestic institutions in my coding of cases.

Figure 2: Domestic Institutions and Investor-State Arbitration



While the legislature is the single institution most often involved in investor-state disputes, the majority are administrative or bureaucratic bodies. Therefore it is not surprising that most of the measures taken that are subsequently challenged by investors are administrative. Indeed 61% of cases (281) were triggered primarily by administrative measures; 26% (117) were triggered by legislative measures alone; and

11% (50) were related to judicial decisions. The remainder relate to cases in which the state failed to act – for example, they may have failed to protect an investment from physical harm – and therefore cannot be coded as legislative, administrative or judicial measures per se.

Interesting patterns emerge when we look at the countries in which certain domestic institutions are more often taking measures that are challenged by investors. For example, legislative measures are most often being taken in developed countries. Slightly less than half of the cases in the legislative category involve Argentina, due to the 'pesofication' law passed by the country's parliament during the financial crisis in 2002. The other respondent countries in this category include Albania, Canada, Czech Republic, Germany, Hungary, Mexico, Panama, Slovak Republic, Spain, the US and Venezuela – the majority of which are high-income countries. On the other hand, the majority of countries in which judicial measures have been challenged by investors are low-income countries, including India, Laos, Jordan and Pakistan, although the US and Canada are also included in this category. Unsurprisingly, given their ubiquity in investor-state disputes, administrative measures are common across income levels.

I have also included variables related to domestic institutions in my statistical analysis. As mentioned above, the literature on political risk and the determinants of expropriation have on the whole concluded that democracies are more likely to exhibit respect for investors' rights and maintain legal protection of property, which suggests that we would see higher levels of democracy associated with a lower likelihood of investor-state arbitration. However, even when controlling for the amount of FDI hosted and the number of ratified IIAs (democracies tend to attract more investment), a state's democracy level[4] is positively associated with the likelihood of an investor-state arbitration case. This indicates that, overall, democratic institutions are more likely to take measures that are challenged by investors.

Less surprisingly, states with higher numbers of effective veto players – decision-makers, either individuals or organisations, whose consent is required to pass new policy (Tsebelis, 2000) – are less likely to be

4. Measured here by the Polity score.

involved in investor-state arbitration, although the relationship is not statistically significant. The inverse relationship between veto players and arbitration is not surprising, given the importance to investors of policy stability – higher numbers of veto players make it more difficult for any domestic institution to unilaterally pass a measure that investors might find objectionable. However, as Kastner and Rector (2003) note, while lower numbers of veto players are associated with a higher likelihood of expropriation, veto players are positively associated with the imposition of capital controls – a less dramatic means of extracting rent from investors. Given the range of measures challenged by investors that represent our dependent variable, it follows that the relationship between this and the number of veto players is less than clear.

Finally, the World Bank's measures of control of corruption and government effectiveness are both negatively correlated with the likelihood of a dispute, meaning that states that experience lower levels of corruption and more effective bureaucracies are less likely to be implicated in an investor-state dispute. However, the government effectiveness variable did not have a statistically significant correlation with the dependent variable, indicating that the relationship is slightly ambiguous.

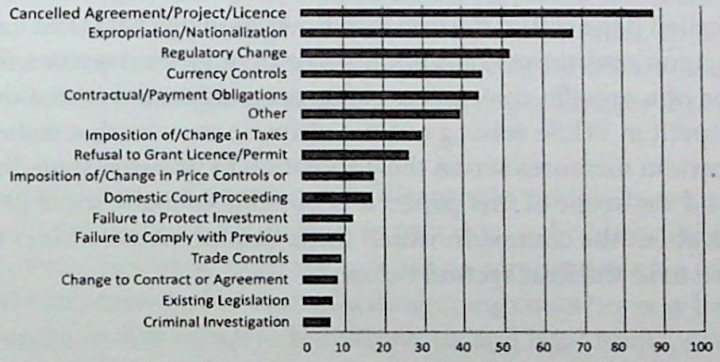
What are the implications of these findings for understanding the role that domestic institutions play in contributing to, or decreasing the likelihood of, investor-state arbitration? The findings regarding veto players and corruption are unsurprising, and correspond with the bulk of literature on what makes states risky locations for FDI. On the other hand, the relationship between democracy levels and investor-state arbitration cases is less intuitive, and suggests a possible relationship between democratic governance and the policy measures challenged by investors. One explanation for these ambiguous findings is the heterogeneous nature of the object of study. As will be discussed at greater length below, and as anyone familiar with the regime is aware, investors are challenging quite a wide array of state measures, from expropriation to contractual changes to the final rulings of environmental impact assessments. Therefore, it is more difficult in this case to formulate causal relationships between specific domestic institutions and the many policy measures that trigger investor-state disputes, than in the case of studies that look only at the domestic determinants of expropriation (Jensen, Johnston and Lee, 2013; Li, 2005)

What measures are being challenged by investors?

Investor-state disputes that culminate in arbitration are triggered by a wide range of state measures taken, as discussed above, by different domestic institutions. As part of this research study, I have coded these measures based on their target, and content. With regard to the former, the measures were categorized in two groups – specific or general. Specific measures, in which the aim was to regulate or impact an individual or small group of investors, made up 66% of the measures taken. General measures, which regulate an entire industry or the population at large, accounted for 32% (the bulk of these, unsurprisingly, being the legislative measures mentioned above). The remaining 2% were, as above, instances in which the state failed to act.

The content of the measures are presented in Figure 3.

Figure 3: Content of Measures



The majority of cases involve the cancellation of a project, agreement or licence. Investor-state disputes triggered by this measure span different industries and levels of development, but are generally administrative (although a number also involve judicial decisions). Expropriation of a foreign investment makes up the next largest category of measures taken, although it is worth noting that Hugo Chavez's series of expropriations make up over 25% of these cases. The third most frequent measure is the rather broad category of regulatory change. Included within this category are measures that ban specific industrial activities; ban certain substances (for example, pesticides); or other changes

to the regulatory framework of an entire industry. Unsurprisingly, the bulk of these are legislative measures, and most were taken by a developed country respondent. Additionally, half of these cases involve electricity or other energy companies, which underscores the public-policy dimension of these disputes. Like expropriation, the currency controls category is dominated by one state – in this case Argentina, again as a result of measures the state took during its financial crisis.

An overview of the content of the measures taken gives us an indication of the types of policies and decisions that investors are challenging. The majority of these are aimed at individuals or smaller groups of investors – the large numbers of cases relating to cancellations of licences or agreements, changes to contracts, and the refusal to grant permits or licences underscore this finding. However, the problem of significant heterogeneity in our object of study persists, and causes difficulty in any attempt to generalize even about specific categories in the chart above. For example, a foreign investor's contract or licence may be cancelled if the state determines that a certain project is not meeting agreed upon environmental standards, or in order to deprive a foreign investor of a specific concession or licence, and award it to a domestic competitor. While teasing out the ultimate reasons that states have taken certain measures across the population of investor-state disputes is beyond the scope of this paper, it is possible to make some generalizations about the context in which these disputes arise. This is what I will turn to in the final section below.

Why are states taking these measures?

There are two (in theory, competing) hypotheses regarding why states comply or do not comply with treaties and agreements they have signed found in international relations literature on domestic cooperation. While determining ultimate compliance with an IIA is not the focus of this paper, both these approaches to the issue can provide a useful framework for analysing investor-state disputes.

The managerial approach to compliance suggests that states fail to act in accordance with their international commitments due to lack of capacity to do so; vague treaty provisions; lack of sufficient time to

bring domestic laws and actors into compliance; and lack of bureaucratic effectiveness (Chayes & Chayes, 1993; Simmons, 1998). Applied to investor-state disputes, this would suggest that states fail to provide policy stability and friendly environments for investors because they are unable to do so, or due to an insufficient understanding within the domestic bureaucracy of the duties imposed on them by the IIA. Additionally, this approach suggests that changing economic circumstances, for example, Argentina's severe financial crisis, may also lead to inadvertent non-compliance.

On the other hand, the enforcement approach suggests that compliance is the result of agreements that do not place too great a burden on states in terms of behavioural change – in other words, states only negotiate and comply with agreements with which they want to comply (Downs, Rocke, & Barsoom, 1996). Therefore, non-compliance is the result of cost-benefit calculations regarding the costs imposed by international agreements on the one hand, and domestic constituents that are in favour of, or oppose compliance, on the other. In the context of investor-state disputes, this implies a role for domestic interest groups that have the power to alter the state's preferences toward foreign investment.

The concentration of investor-state disputes in middle-income countries is, as discussed above, at least in part due to the historical pattern of FDI flows. However, both approaches to compliance may offer additional explanations. For example, developing countries may have less experienced or less effective bureaucracies and legal teams, and thus, as the managerial approach to compliance suggests, may have more trouble interpreting IIAs and maintaining policy stability for investors. There is some evidence to suggest that this is the case – as mentioned above, government effectiveness and control of corruption are negatively associated with the likelihood of an investor-state dispute.

On the other hand, middle income or developing countries (as well as transition economies, which are also disproportionately among the most frequent respondent states) may be less willing to provide policy stability for investors in the face of other interests, as suggested by the enforcement approach.

As Tienhaara (2009) argues,

> "Given the low base level of regulation in developing countries, and the pressures from both domestic and international sources for governments to 'catch up' to international best practices, would it not be fair to assume that investors should expect regulation to change even more dramatically in developing countries than in developed ones?" (p. 211)

Indeed, liberalization processes advocated by international financial institutions for developing and transition countries can include the withdrawal of subsidies and other state aid, changing the policy framework on which investors have previously relied.[5] Similarly, leaders of democratizing states may be more susceptible to public pressure to take action against investors, especially if previous regimes were seen as providing deals to foreign investors that did not serve the public interest (Bonnitcha, 2014). Wherever the pressure is coming from, developing states may be more likely to experience changes of regulatory requirements than in developed countries where standards are already fairly high. This shift in policy may in turn alter the terms of existing agreements with investors and trigger arbitration.

Finally, it is worth noting that investor-state disputes are concentrated in industries that have an important public policy dimension; investors in oil mining and gas projects, and electricity and other energy generation and distribution, are more frequently suing states than investors from other industries. Both extractive industries and energy production affect a wide array of stakeholders, from mass interests such as energy consumers and communities living near extractive projects, to narrower interests such as state-owned enterprises. Whether through elections or other less public processes, these groups may pressure governments to take measures at their behest, against the interests of investors. Indeed, it is not surprising that investor-state arbitration is concentrated in these politically contentious 'strategic' industries, and this lends further support to the cost-benefit approach to the respect of investment agreements suggested by the enforcement approach to compliance.

5. For example, market liberalization and pressures from the EU contributed to investor-state disputes between Hungary and a number of electricity distributors.

Ultimately, neither of the aforementioned approaches to compliance can provide a complete causal explanation for investor-state arbitration based on domestic-level variables. As this paper has demonstrated, an array of domestic institutions and interests are involved, and many different kinds of measures are challenged by investors. Moreover, the high numbers of NAFTA cases suggest that no explanation for this phenomenon can ignore the role that exposure to the investment regime, and investors' interests to pursue arbitration increase the number of arbitration cases. However, as more focus is placed on reforming the ISDS system, an understanding of the political goals and preferences that may conflict with those of foreign investors is important if we are to devise a system that is better able to balance investor and domestic actor concerns in future.

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A Critique of Investment Treaties

Gus Van Harten

The treaty-based investment law regime is based on the most powerful system of international adjudication in modern history. In essence, the regime re-allocates power from states to transnational companies and from domestic courts to a private arbitration industry based in Washington, New York, London, Paris, The Hague, and Stockholm.

It remains a recent development in international adjudication, having been put into widespread use only from the mid-1990s. Further, the arbitrators have wielded their power assertively through both expansive legal interpretations and the economic size of their awards. Not coincidentally, there is growing apprehension about the regime and pressure for reform.

The aim of this paper is to canvass debate about the regime and identify elements of investment treaties and investment treaty arbitration that give cause for concern. The discussion is presented as a series of responses to justifications often advanced for the system in academic or trade literature or in public commentary. The purpose is not to provide comprehensive answers to the questions raised but rather to explain why prominent justifications for the regime are groundless or, at least, open to serious doubt.

1. Justification: investment treaties are a means to encourage foreign investment

A common argument in support of investment treaties is that they are a way for states to encourage foreign investment flows into their territory (especially from the other state party to the treaty). Thus, we might say that Ecuador, wishing to encourage investment from the US, could conclude an investment treaty with the US in order to signal its commitment to protect US investors, thus encouraging them to invest in Ecuador rather than another country. The logic here appears almost self-evident. However, there are a number of difficulties with this justification, arising from the text of investment treaties and from the empirical evidence.

First, many of the treaties take a liberal approach to forum-shopping. That is, they allow owners of foreign assets to pick and choose among nationalities at their convenience for the purpose of bringing investment treaty claims against countries in which they own assets. An investor may acquire the nationality of a state party to an investment treaty, thus gaining access to the treaty's arbitration mechanism, merely by setting up a holding company in that state. A domestic business may make itself foreign so as to bring a claim against its own country simply by creating a holding company in a state that is party to a bilateral investment treaty (BIT) with the home country.

If the aim of investment treaties is to encourage *foreign* investment between the states that are party to the treaty – and not to extend special legal rights and privileges to an international class of corporate owners of assets – then the expansive approach to forum-shopping enabled by the broad language in many of the treaties – and, in turn, by the permissive judgments of the arbitrators – make little sense. It undermines the framework for characterizing in legal terms the capital movements on which the inter-state bargains leading to an investment treaty would be based if the purpose indeed was to encourage bilateral investment flows.

Second, few if any investment treaties impose enforceable obligations on home states of investors, which are primarily the major capital-exporters in North America and Western Europe, in order to encourage

or facilitate outward investment by, for instance, liberalizing their own regulatory regimes or enhancing their programs for investment insurance. This is anomalous if the purpose of an investment treaty is indeed to encourage capital flows between the state parties.

Home states might, for instance, commit to subsidizing regulatory risk insurance for investments covered by the treaty and use that insurance to supplement the compensatory regime of the treaty in situations where an investor suffered losses due to general regulatory activity by the host state. On this basis, the regulatory risks inherent in all business decision-making in the face of changing social, economic, and environmental conditions would be shared between host and home states.

Instead, the treaties typically establish the subrogation rights of political risk insurance or guarantee programs in order to allow the home country to step into the shoes of the investor in advancing a claim against the host country. Thus, the purpose appears to be more about protecting the economic position of the major capital-exporting states than it is about encouraging investment flows.

Third, the empirical research is mixed on whether the treaties actually do encourage investment or affect investment flows in a significant way, beyond isolated cases. Different studies have found and failed to find connections between the treaties and investment flows. This mixed evidentiary record demonstrates in part the limitations of quantitative legal research but also that there is at best conflicting evidence that investment treaties actually encourage foreign investment and, in turn, that any signalling effect of the treaties has an actual effect on investor decision-making about where to commit capital.

As such, and in light of the major fiscal risks assumed by states under the treaties, it is dubious to assert today that the treaties are a vehicle to encourage actual investments. Also, it is clear that in the 1990s – when so many of the treaties were concluded – there was no empirical evidence that the treaties served this stated purpose. Most states committed themselves to what are arguably the most financially risk-laden international obligations in the world today without any credible empirical basis for the belief that the treaties would achieve their stated purpose.

2. Justification: investment treaties respond to the bias and unreliability of domestic courts

It is often pointed out by advocates for investment treaty arbitration – which is the centerpiece of the investment treaty regime – that domestic remedies in developing and transition states (and even in developed states) are inadequate because they take much too long, are biased, are corrupt, or are otherwise unreliable. In its more aggressive form, this argument mutates into a rejection of courts in general because the judicial process entails too careful and time-consuming a consideration of disputes, and too many opportunities for appeal, to permit the necessary speed and clarity in business decision-making. More commonly, the justification is framed not as a condemnation of all courts as biased against foreign investors but rather reflecting the view that the courts of some countries are unreliable and, on this point at least, there can be little doubt.

Presumably, as a matter of principle, states should work to address this problem for all investors, domestic or foreign, and indeed for all citizens. Accepting this, those promoting investment treaties as a response to the weaknesses of domestic legal systems might also be expected to champion provisions in investment treaties that sought to address the unreliability of courts for investors and non-investors alike. The treaties could, for example, allow citizens with a grievance against a foreign investor – due to pollution or human rights abuses it has allegedly caused – to bring an international claim against the investor where the domestic legal system did not offer an expeditious and fair process.

Likewise, in the absence of broader access by non-investors to the process of international adjudication of investment disputes, it might be acknowledged that investment arbitration itself appears unfair. This is because fairness calls for all parties that are affected by the resolution of a dispute to be given standing in the adjudicative process and because, in investment treaty arbitration, only one class of private interests – the investor – has that right to be heard. Others affected by the conduct of the state or investor are barred from party status and thus from the right to introduce evidence, make submissions, and otherwise participate fully in the process. If domestic remedies are unreliable, then why allow only investors to take part in the international adjudicative process?

Thus, the response of the treaties to this rationale for the system is under-inclusive. It extends the benefits of international arbitration to a narrow class of private actors, giving foreign investors the unique opportunity to resort to domestic or international options (or both) as they prefer. Of course, not all foreign investors are well positioned by the system to bring a claim against a state that has abused them in some way. The cost of access precludes many foreign investors ever from bringing a claim.

On the other hand, there is a class of large companies with substantial wealth wrapped up abroad that can use the system in a range of ways. Most problematically, when one considers the lack of access by other private actors to the process, large companies are uniquely positioned to use the system to attack general government measures aimed at advancing a development strategy, stabilizing the financial system, promoting human rights, protecting public health and the environment, and so on.

This raises a second difficulty with the present justification in light of the system's design. The treaties are over-inclusive because they do not account for situations in which domestic courts do offer justice to a foreign investor. By removing the duty to exhaust local remedies unconditionally, many investment treaties allow investors to turn their back entirely on domestic law or, indeed, to play the system by bringing multiple claims under the treaty (or multiple treaties) and in domestic courts. The investor has the sole discretion, unlike in other treaty regimes that allow individual claims, to decide on the reliability and suitability of the alternative remedies. Combined with the permissive approach to forum-shopping endorsed by most arbitration tribunals, this facilitates remarkable maneuvering by lawyers to maximize the pressure on host governments and enhance the prospect of public compensation for their clients. It likewise gives immense power to a class of large foreign investors that is unavailable to other investors and, of course, to citizens and communities in general.

Based on this justification for the system, one would expect to see a rational connection between the treaty provisions and the purported rationale. If the concern was that domestic courts systems in some countries are unreliable, then the duty to exhaust local remedies should be

removed only in such circumstances. At least the treaties should allow a state to demonstrate that its legal system does offer justice to a foreign investor as a basis for limiting a tribunal's jurisdiction over the claim. Likewise, the question of the reliability of the host country's courts should be decided by an independent adjudicator and not by the foreign investor or the state.

Yet we do not see such provisions in the treaties. Instead, the duty to exhaust local remedies is removed unconditionally, even for countries that have mature and advanced systems of justice; systems that far surpass investment arbitration for their institutionalized fairness, openness, and independence. The treaties also remove the duty to exhaust local remedies in the case of developing and transition states that offer high standards of access to justice or that have made major strides in this direction. Thus, the treaties do not leave space for recognition and acknowledgement of variations in the quality of domestic legal systems.

3. Justification: Investment arbitration ensures fairness and the rule of law in the resolution of investment disputes

A further common justification for investment treaty arbitration is connected to the criticism of domestic legal systems that is implicit in the unconditional removal of the duty to exhaust local remedies. It is claimed that investment treaties replace domestic law and courts with a fair, independent, and neutral process of adjudication to resolve investor-state disputes and that the system therefore advances the rule of law.

This is a dubious claim if we assume that the rule of law rests, at minimum, on high standards of procedural fairness – and, as such, institutional safeguards of independence – especially at the final level of adjudicative decision-making. The problem is that, on close scrutiny, the system of investment treaty arbitration falls well short of this requirement of the rule of law.

The problem is specific to investment treaty arbitration because it is a

form of (formally non-reciprocal) public law adjudication and because investment treaty arbitrators lack institutional safeguards of their independence, especially security of tenure. This would not be a major issue if the matters decided by the arbitrators were minor concerns or subject to thorough re-examination by an independent court. On the contrary, investment treaty arbitrators often resolve finally fundamental matters of public law without the prospect of close scrutiny by independent judges, whether domestic or international. As a result, longstanding safeguards of judicial independence in domestic legal systems have been jettisoned in the unique context where foreign investors can bring international claims against states and, by extension, the populations represented by states.

To elaborate, security of tenure is one of the core safeguards of adjudicative independence in public law. By removing it, as investment treaties do, states have returned to a model of adjudicative decision-making that is directly dependent on the discretion of executive officials in powerful governments and, remarkably, in international business organizations and the arbitration industry. This is an odd way to promote the rule of law if that is an aim of the investment treaty system.

Combined with other institutional safeguards of judicial independence – including the state's provision of a set salary for the judge, bars on outside remuneration, and an objective means to allocate judges to cases – security of tenure insulates the judge from the appearance of inappropriate pressure on her decision-making and, by extension, allows the courts to provide a foundation for the rule of law. Without secure tenure for the judge who decides public law, one must ask, where does the judge's career interest lie?

In the case of investment treaty arbitration, the first problem is that the system is a one-way process of public law claims in which only one class of parties (investors) triggers use of the system by bringing claims, and only the other class (states) is liable to pay awards for violating the treaty. Unlike in other situations where arbitration is used, the ability to bring claims is non-reciprocal. Thus, arbitrators – especially those whose careers are intertwined with the interests of the arbitration industry – are reasonably seen to have an interest in encouraging claims and arbitrator appointments by interpreting the law in favour

of prospective claimants. However, presented as judicial concerns, investment treaty arbitration is also a private business and usually a career path for those employed to adjudicate the disputes.

Thus, the industry is made up of cross-connected players who affiliate around prominent centres of arbitration such as the International Chamber of Commerce in Paris. Arbitrators often name each other for appointments and may exclude those who are not accepted within the industry's networks. As Dezaley and Garth pointed out in their classic study, *Dealing in Virtue*[1], the arbitrators are typically technocrats, intent on promoting the arbitration industry in competition with its alternatives (in the present context, domestic courts and international diplomacy). Unlike judges, the arbitrators can earn income from activities beyond their adjudicative role. Prominent figures in the industry often sit as arbitrators while advising and representing claimants or respondents and while promoting arbitration clauses in investment contracts, treaties, or arbitration rules.

This provides a basis for reasonable suspicion of bias in the investment treaty system. It raises precisely the sorts of concerns that institutional safeguards of independence dispel by removing judges from the adjudicative marketplace and positioning them instead in a public institution. Arbitrators will no doubt vary in their level of commitment to values of fairness in adjudication and in their sensitivity to the outside economic or political powers at play. Yet it must be obvious to anyone working in the industry, as it is to the informed outsider, that investment arbitration does not thrive unless international businesses consider it worthwhile to bring claims and unless powerful states also see benefits in the system. Because this creates a credible prospect of bias in the system, and because the issues at stake involve matters of public law, the institution of investment treaty arbitration is inconsistent with the rule of law.

A second issue arising from the lack of institutional safeguards of independence in investment treaty arbitration is the role of the organizations designated as appointing authorities under investment treaties.

1. Yves Dezalay and Bryant Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order*, University of Chicago Press, 1996.

These organizations – of which the International Centre for Settlement of Investment Disputes (ICSID) is the most prominent – exercise major powers within the system. They appoint the presiding arbitrator in the absence of agreement by the disputing parties or where a party (usually the state) has declined to appoint its own arbitrator. They often play an active role in directing negotiations between the disputing parties about who to appoint by proposing a list of prospective arbitrators that the appointing authority would be inclined to select. If a party claims a conflict of interest on the part of an arbitrator, the claim is usually resolved by the appointing authority. Finally, an appointing authority may exercise key supervisory powers over the arbitration rules and awards issued in particular cases. At ICSID, awards are subject to annulment proceedings before three arbitrators, all appointed by default by the President of the World Bank.

The key problem here is that executive officials have discretionary power over major aspects of the adjudicative process. The institutional safeguards of judicial independence that would otherwise address concerns arising from this executive control of the process (i.e. safeguards such as an objective method of assignment of judges to cases and the resolution of conflict of interest claims against a judge by an independent judicial process – are absent. In turn, one may ask for example whether the appointing authority is sufficiently impartial and independent and whether its power structure reflects a balance between the interests of capital-exporting and capital-importing countries.

As it stands, virtually all organizations acting as appointing authorities under the treaties have a marked slant in favour of the major Western capital-exporting states and international business. This supports a perception that the interests of a powerful state or a multinational firm, where implicated by the relevant dispute, can influence the appointing authority in the exercising of its powers. Put differently, it creates a perception of bias within the system that favours the position of prospective claimants, powerful states, and private interests in the arbitration industry.

With this design, investment treaty arbitration appears to contradict basic norms of procedural fairness and judicial independence. If the aim was to advance these values, a more obvious choice would be the

use of an international body that incorporated safeguards of judicial independence for the resolution of investor-state disputes. In the absence of any serious consideration of this option by the major states, and considering the defensive reaction of many in the arbitration industry to the idea, one must question this justification for the system.

Conclusion

In the history of investment treaties, developing and transition states were presented with take-it-or-leave-it offers from major capital exporters to conclude investment treaties that, it was said, would attract foreign investment in exchange for commitments by the capital-importing countries not to expropriate or discriminate against foreign investors. There is now much evidence that the promised benefits did not materialize whereas the obligations of host states have amounted to wide-ranging constraints on general regulations adopted in good faith and on a non-discriminatory basis. Many states have faced the difficult challenge of unexpected waves of claims against them on matters of economic policy, financial stability, and environmental and health regulation.

One avenue for reform of the regime lies in the renegotiation or abrogation of investment treaties. This is the best option for extrication from the regime but also has limitations due to the 10 to 20-year survival clauses in the treaties. Another option for reform is to focus on the institutional mechanisms and, specifically, the establishment of alternative forums and processes for the resolution of investment disputes. It would be beneficial to their perceived neutrality if such alternatives were based outside the conventional arbitration centres of Western Europe and North America and if they surpassed the current system in terms of their fairness, openness, and independence. Yet the most pressing priority is for states and the public to become more familiar both with the uncertain but potentially crippling public liabilities created by the system and with the perverse shift in bargaining power to the most powerful private economic actors on the planet at the expense of the institutions and processes that represent everyone else.

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

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Introduction

At a time of great change in the global economy, there is an intensifying and widening debate about the implications of international investment agreements (IIAs) (including bilateral investment treaties) 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.[1] 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.

This paper aims to draw lessons of that debate for Africa's economic development strategy and objectives. To this end, it outlines the broad

* 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.

1. Mann, H. (2013), "Reconceptualizing International Investment Law: Its Role in Sustainable Development." *Lewis & Clark Law Review*. Volume 17(2). pp 521-544.

features of alternate policy approaches to foreign direct investment (FDI) and the policy perspectives embedded in IIAs. The paper 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 the experience and policy approach to IIAs from South Africa. 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 policy-makers.

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, liberalise investment regimes, reduce or limit regulations and conditions on investors and, in so doing, realise 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 recognises 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 spill-over 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. Taking 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. 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 to 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 a 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.

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,' indirect expropriation, have all been the subject of extensive legal wrangling, varying interpretations and conflicting arbitration awards.[2]

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

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, investors and investment 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.

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 among members of panels.[3]

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 state, 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.

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

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 US$8 million per investor-state dispute, exceeding US$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 and respondents, as well as sitting on arbitration panels, which raises concerns of conflict of interest.[4]

These risks are amplified by the rapid growth in investor claims around the world that are challenging a widening ambit of government measures.[5] 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 of which 61 (more than 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 US$100 million from states and the largest award in favour of investors was delivered in 2012 against Ecuador to the tune of $2.4 billion. Importantly for Africa, fully 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 licenses (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

4. Eberhardt, P. and Olivet, C. (2012), *Profiting From Injustice*. Corporate Europe Observatory and Transnational Institute. Amsterdam. November.
5. UNCTAD (2013a), op.cit.

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.

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 combine with an arbitration process that lacks an institutional framework to safeguard legal certainty, correctness and predictability, suggesting a crisis of legitimacy.

IIAs and FDI flows: a grand bargain?

If the concerns with inherent imbalance in IIAs are legitimate, it would be logical to ask what are the benefits of signing IIAs? 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 UNCTAD analysis found a weak correlation between the signing of BITs and increased FDI inflows.[6] After conducting a cross-sectional data analysis for 133 countries between 1993 and 1995, UNCTAD found that the impact of BITs on FDI is non-existent or small and secondary to the effects of other determinants, especially market size.

After analysing investment flows from 20 OECD countries to 31 developing countries during 1980-2000, Hallward-Dreimeier found that treaties act more as complements than as substitutes for good institutional quality and local property rights.[7] He pointed out that the rights

6. UNCTAD (1998), *Bilateral Investment Treaties in the Mid-1990s*. Geneva, UNCTAD. (Available at http://books.google.com/books/about/Bilateral_Investment_Treaties_in_the_Mid.html?id=X3-RAAAAMAAJ).
7. Hallward-Dreimeier, M. (2003), "Do Bilateral Investment Treaties Attract FDI? Only a bit… and it might bite." Washington DC, World Bank. (Available at http://ideas.repec.org/p/wbk/wbrwps/3121.html).

given to foreign investors may exceed those enjoyed by domestic investors and expose policy-makers to potentially large-scale liabilities that curtail the feasibility of different reform options. Over a 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 bilateral investment agreements. Japan, the second largest source of FDI in the world, has signed 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 BIT agreements. Similarly, numerous countries that have ratified BIT agreements are having difficulties attracting FDI, particularly in sub-Saharan Africa. Recognising the significance of these trends, the report concludes, "a BIT is not a necessary condition to receive FDI."

A study by Tobin and Rose-Ackerman found a very weak relationship between BITs and FDI based on FDI flows to 63 countries during 1975-2000. The study also found 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 of the investment environment in low- and middle-income countries.[8]

One study found a positive association between the adoption of BITs and FDI flows. Neumayer and Spess looked at 119 developing countries

8. Tobin, J. and S. Rose-Ackerman, S. (2004), "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties." Yale Center for Law, Economics, and Policy. (Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=557121).

(29 of which are in Latin America) between 1970 and 2001.[9] They used an independent variable of 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: "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."[10]

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 FDI. Thus developing-country policymakers should not assume that signing up to BITs will boost FDI..."[11]

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.

How are countries responding?

Most governments that were active in negotiating BITs in the 1990s, have reviewed their early investment treaties, and have effected signifi-

9. Neumayer, E. and Spess, L. (2005), "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?" *World Development*, 33(10), pp. 1567-85.
10. Yackee, J.W. (2010), "Do Investment Treaties Promote Foreign Direct Investment? Some Hints at Alternative Evidence." *Legal Studies Research Paper Series* No. 1114. Wisconsin Law University, March.
11. UNCTAD (2014), *Trade and Development Report 2014*. Geneva. September. pp. 155-160.

cant changes to their policy on investment treaties as they have come to recognise the shortcomings, flaws and risks inherent in those first generation BITs. The re-think on investment treaties is largely related to considerations of the link between investment treaties and flows on FDI and the legal and policy implications of commitments made by entering into IIAs.

UNCTAD has outlined the actions that 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).[12] Interestingly, the UNCTAD report points out that, by the end of 2013, more than 1,300 bilateral treaties will be 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 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 US, Sweden, South Africa and more recently in the EU and India.

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.

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

However, South Africa soon became aware of challenges posed by international investment treaties. It observed the fractious debate in the Organisation for Economic Co-operation and Development (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 World Trade Organization (WTO) that sought to include, as one of the Singapore Issues – trade and investment – in 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 that bilateral investment agreements can pose profound and serious risks to government policy.

The experience demonstrated that 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 it signed BITs, and at the same time, the country continues to receive investment from jurisdictions with whom the country has not signed any investment treaty. 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 potential challenges, brought under various BITs. Most of the potential challenges may be described as spurious but they all underscored the fact that BITs do not adequately take into account the specific conditions found in South Africa, the complexities of our 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 about 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 and all investors need to undertake their activities in this context of the transformation agenda set out in the Constitution. However, an assessment of bilateral investment treaties brought out several 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 paper: notably the risks associated with imprecise legal commitments, the shortcomings in international arbitration. In particular, South Africa was particularly concerned with 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 policy-making.

Against this background, in April 2010 the South African Cabinet concluded that South Africa should: First, refrain from entering into BITs in future, except in cases of compelling economic and political circumstances. Second, Cabinet instructed that all 'first generation' BITs that South Africa signed shortly after the democratic transition in 1994, many of which have now 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 regarding the protection offered to foreign investors. In this respect, key considerations would be to codify BIT-type protection into South African law and clarify their meaning in line with the South African Constitution. The legitimate exceptions to investor protection where warranted by public policy considerations – such as, for example, national security, health, environmental reasons or for measures to address historical injustice and/or promote development – were incorporated. Fourth, 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.

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 coun-

tries with which it had BITs that it would terminate the treaties.[13] South Africa had made its intention clear by publishing the Cabinet decision in July 2010, and in several formal engagements at multilateral meetings in the UN Conference on Trade and Development (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 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 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.[14] The new Southern African 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 replacement of investor-state disputes settlement procedures.[15]

At the domestic level, a new Promotion and Protection of Investment Bill 2013 was published for public comment in South Africa in November 2013. The Bill was the outcome of extensive intra-governmental legal and policy consultations.[16] It does not introduce any new restrictions on investment. However, it clarifies the non-discriminatory protections offered to all investors from all countries. It also 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.

It 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 existing legal framework. The

13. Termination notices were served to Belgium, Luxembourg, the UK, Germany, France, the Netherlands, Spain, Sweden, Denmark, Greece, Italy, and Switzerland.
14. See Southern African Development Community (SADC), Investment Portal, (http://www.sadc.int/themes/economic-development/investment/) (http://investment.sadc.int.).
15. See Southern African Development Community (SADC). SADC Investment Portal. (http://www.sadc.int/investment/).
16. 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.

preamble confirms South Africa's commitment to an open, transparent environment for 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' – known as '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 in the Constitution, and certain government measures will not be considered as expropriation where they 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.

Under the right to regulate, it specifies that the government may take measures to, among other things: redress inequalities; preserve cultural heritage; foster economic development and industrialisation; achieve socio-economic rights; and protect health and the environment. The provision on 'transfer of funds' confirms existing practice in South Africa that allows investors to freely invest and repatriate returns, subject to taxation and other applicable legislation. Dispute settlement provides that, if a foreign investor should seek to challenge a government measure, the jurisdiction for the settlement of disputes would be any 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 were received by the end of the comment period. Comments from all sectors: government, non-governmental organisations (NGOs), policy think tanks, academics, domestic and international. Some submissions were critical that the Bill was too narrow in its scope, while others believed it was too broad. Some argued that it gave too much protection to 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 has carefully considered all submissions and, at the time of writing, it is expected that a second iteration of the Bill will be submitted to the Cabinet in October 2014. Should the Cabinet endorse the Bill, it will be presented to Parliament for ratification and could enter into force in 2015.

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.

Responses by other governments

The US and Canada have responded by effecting amendments to their Model BIT, adopting interpretative statements and redrafting key provisions in subsequent IIAs, clarifying certain provisions and seeking to give greater authority to governments to interpret the meaning of the obligations undertaken. These reforms aim to address some of the challenges raised by IIAs to some degree.

As the competence for negotiating IIAs has moved from its Member States to the supranational level under the 2010 Lisbon Treaty, the EU is re-thinking the traditional approach to these treaties. On 21 January 2014, the European Commission announced its intention to pause investment treaty negotiations with the US under the Transatlantic Trade and Investment (TTIP) Partnership Agreement in order to address what it termed "unprecedented public interest" in the European Union (EU) on the matter of investment treaties.[17] The announcement identified some of the critical issues at stake, notably the need to reaffirm

17. 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.

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 it now appears that this decision may be reversed. Several Latin American countries have withdrawn from the International Centre for the 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 (UNASAR). 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. It is instructive that Brazil still receives large inflows of FDI.

All these developments show that many governments around the world are not at ease with the existing system of IIAs and ISDS. Differences in approaches may to some extent be a function of whether the countries undertaking reform are predominantly capital exporting or capital importing countries and whether there is confidence that a government's right to regulate can indeed be assured through appropriate reform of the system. In all cases, new approaches to making investment treaties aims to mitigate the risks of earlier agreements. There is some evidence of efforts to ensure that 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.

IIAs and Africa's agenda for structural transformation:

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 in any region. Africa's economic growth has been driven by a boom in mineral exports, as well as growth in the agriculture, transport, telecommunications and retail sectors. Africa has enormous reserves of raw materials, 60% of the world's unused arable agricultural land, a young growing population, a growing middle class with considerable purchasing power, as well as urbanisation 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 of 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 industrialisation. Indeed, African governments and leaders have committed 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 paper 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 paper unpacked how the shortcomings and imbalances both in the IIAs and in the ISDS that enforces those treaties constrain policy space. It pointed out that necessary change to policy and regulation such as the tax regimes (levies of mineral exports, for example) that may be important to re-direct resources from primary sectors to support industrialisation may be challenged through international arbitration. Similarly, IIAs place constraints on government efforts to require investors to build linkages to domestic firms, upgrade skills 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 policy-makers 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 policy-making 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 up to. As noted, options for termination, re-negotiation and amendments are all options that countries around the world have undertaken. The challenges with each of these options could also be the 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 policy-makers and experts should participate more actively in the intensifying global debate on IIAs and ISDS.

The Indian Model Bilateral Investment Treaty: Continuity and Change

Saurabh Garg, Ishita G. Tripathy and Sudhanshu Roy*

I. Introduction

The recent release of India's Model Bilateral Investment Treaty (BIT) has generated a rich public debate on India's international investment regime in the media and internet.[1] The debate is welcome, not least because it is an acknowledgement of the fact that there are serious questions being asked about the current structure of the investment treaty system worldwide. India cannot remain isolated from these discussions. In fact, its review of the model BIT is a testament to the constant evolution of the investment regime that has repeatedly confounded both its proponents and detractors with its capacity for evolution and dynamism.

The Indian BIT programme is one of the largest in the world and

* The views and opinions expressed in this paper are those of the authors and do not necessarily reflect the official policy or position of any agency of the Indian government.

1. See Joe C. Mathew, "The Whole BIT," *Business Today*, February 28, 2016, available at http://www.businesstoday.in/magazine/features/revised-model-text-for-bilateral-investment-treaties-litigations-india-renegotiate/story/228897.html; Lise Johnson, Lisa Sachs, Sudhanshu Roy, "Next Generation Treaty," *The Indian Express*, November 12, 2015, available at http://indianexpress.com/article/opinion/columns/best-investment-treaty/.

currently stands at 83 treaties, out of which 73 are in force. Apart from the standalone BITs, India also has negotiated several investment chapters under Free Trade Agreements. The regime has to be viewed in the context of the comprehensive economic reforms package initiated by the Government of India in 1991. The initial motivation behind investment treaties was focused on a liberal economic outlook, where the government in addition to facilitating foreign investment, granted additional protection to investors through such treaties. As a result, since the early 1990s, treaties were signed by India at regular intervals with a range of developed and developing nations across the world.

These agreements, negotiated on the basis of the model treaty of 1993 were simplistic in their content and purpose. Indeed, this was true of the entire Indian BIT system as a whole, which rested on the simple premise that having BITs could lead to an increase in FDI levels. Besides the economic arguments, a number of normative and political justifications could be attributed to the rapid growth of the Indian investment regime in the initial years. However, as a number of subsequent studies have shown, linkages between FDI and having a BIT with a particular nation have been hard to establish.[2]

II. Revised Model BIT: The continuity

The calls for revision of India's approach to its BITs are not new. In fact, within the Government, such calls for reform have been ongoing

2. Among others, a 1998 UNCTAD study concluded that BITs played a "minor and secondary role in influencing FDI flows," see *Bilateral Investment Treaties in the Mid-1990s*, UN Doc. UNCTAD/ITE/IIT/7 (United Nations Publication, Geneva, 1998); In analysing the FDI flows from OECD to developing countries during 1980-2000, Mary Hallward-Dreimeier found a "significant negative finding on the impact of ratifying a BIT," see Mary Hallward-Dreimeier, "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit... and They Could Bite," World Bank Policy Research Working Paper 3121, World Bank Development Research Group (2003); Jennifer Tobin and Susan Rose-Ackerman found that BITs have "little impact" on the attraction of FDI, although they may have an impact in countries with higher political risks, see Jennifer Tobin and Susan Rose-Ackerman, "Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties," Center for Law, Economics and Policy Research Paper No. 293, Yale Law School (New Haven, 2004).

since 2001.[3] The process was significantly accelerated by the decision in *White Industries v. Republic of India*,[4] and a spate of dispute notices that were received in the immediate aftermath of that award. The decision in *White Industries* demonstrated two things:

(i) *first*, BITs could be used to circumvent the domestic justice system and its procedural requirements; and

(ii) *second*, it showed that tribunals could use the most favoured nation protection to expand the scope of the treaties through borrowing, which in turn defeated the entire purpose of having bilateral agreements.[5]

It is also important to remember that the 1993 model was largely based on the OECD's Draft Convention for Protection of Foreign Property of 1967 and was rightly characterized as an older generation treaty. Several countries that had based their initial BIT regimes on the OECD model had already begun abandoning the old regime. This had yet to happen to India, where until the *White Industries* award, there had been little debate about the investment regime. The award and the subsequent developments rightly put India at the heart of the debate on the investment treaty system taking place across the globe.

The review process of the Indian model began in earnest in July 2012, when a Central Government Working Group was constituted to revise the Indian model BIT of 1993. The drafting involved rigorous and thoughtful debates within Central Government Ministries and organizations about the nature and suitability of investment treaties. On the one hand, there were skeptics who argued for a total abandonment of the investment regime by eliminating investor-state dispute settlement

3. The 1993 Model agreement was first revised in 2003 by adding an Annexure to clarify the meaning of indirect expropriation. India's treaty with China signed on August 1, 2007 was the first agreement to incorporate this change.
4. *White Industries Australia Limited v. India*, UNCITRAL, Final Award, November 30, 2011.
5. A number of disputes have resulted directly from the decision of the Supreme Court of India in *Centre for Public Interest Litigation v. Union of India*, (2012) 3 SCC1.

(ISDS) altogether and according only national treatment to investors.[6] Other stakeholders called for a more cautious approach that would leave the regime untouched based on the assessment that existing BITs created a normative[7] framework by providing enforceable rights and protections for investors and changing the entire regime suddenly would expose the entire regime at risk. These debates were vigorous and enriched the democratic nature of the exercise.

In the end, the drafters of the model BIT endorsed neither of the radical alternatives noted above. The drafting process can perhaps best be characterized as a continuous search of finding a middle path between the competing interests of investors to protect their investments and the right of governments to regulate in public interest. Nowhere is this delicate balancing act more evident than in the retaining of the ISDS system and reinforcing its status as a powerful tool for protection of foreign investors.

The ISDS system has been the subject of intense criticism by the global development community over the years.[8] States have responded to

6. The idea of granting foreign investors only national treatment is not new. In the Indian context, the idea first manifested itself in India's leadership in building a New International Economic Order (NIEO) in the 1970s based on equality and sovereignty of nations founded in the idea of economic self-determination. The NIEO found its manifestation in the Charter of Economic Rights and Duties of States (CERD), which affirmed the right of developing nations to regulate foreign investment as per domestic laws. These concepts found expression in several General Assembly resolutions (UNGA), see UNGA Res. 1803 (XVII) of December 14, 1962, 'Permanent Sovereignty over Natural Resources' at 15 / UN Doc. A/5217 (1962); U.N. G.A. Res. 3281(xxix) of December 12, 1974; UN GAOR, 29th session, Supp. No. 31 (1974) 50, UN Doc. A/9631; UNGA Res. 3201 (S-VI) of May 1, 1974 on the NIEO, UN doc. A/res/S-6/3201.
7. For an argument about the normative nature of BITs, see *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries*, UNCTAD/ DIAE/IA/2009/5 (United Nations Publication, New York and Geneva, 2009) at p.xiii noting that "...although most BITs do not change the key economic determinants of FDI, they improve several policy and institutional determinants, and thereby increase the likelihood that developing countries engaged in BIT programmes will receive more FDI."
8. See, for instance, G. Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford, 2007); G. Kahale III, A Problem in Investor/State Arbitration, 6(1) *TDM* 1 (2009); M. Waibel, et al., (eds.), *The Backlash Against Investment Arbitration* (Kluwer Law, 2010); Public Statement on the International Investment Regime, August 31, 2010, available at http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/; Pia Eberhardt and Cecilia Olivet, *Profiting from injustice: How law firms, arbitrators and financiers are fuelling an investment arbitration boom* (Corporate Europe Observatory and the Transnational Institute, 2012).

these criticisms of ISDS in several ways. Some have unilaterally terminated treaties[9] or denounced ISDS,[10] while others have sought to refrain from signing new treaties.[11] The drafters of the model treaty have recognized that such radical reforms may not work as it would risk alienating the strong foundations of investment regime built over a number of years. Without ISDS, investment treaties will have no enforceability. Finally, it would also have exposed outbound Indian investments to regulatory risks aboard.

Retaining the ISDS system demonstrates a continued commitment to settle disputes in accordance with international law. Of course, a number of safeguards such as exhaustion of local remedies, exclusion of purely contractual disputes, prevention of conflict of interest of arbitrators, dismissal of frivolous claims, and transparency have been introduced. However, these safeguards do not change the fundamental attributes of the ISDS system. On the contrary, it can be said that these changes make the ISDS system in the revised model comparable to the most progressive investment treaties across the world.

Within the Indian Government, a second aspect of the consultations was about the nature of BITs. A section of reformers argued in favour of aligning the investment and trade regimes by providing for pre-establishment protection of investments. This would indeed have been a radical step as like most investment treaty regimes around the world, the Indian system was based on the model of post-establishment protection of investments. Almost all 83 Indian BITs that have been negotiated have an admission clause that provides treaty protection only

9. Xavier Carim, "Lessons from South Africa's BIT review," Columbia FDI Perspectives, Perspectives on topical foreign direct investment issues by the Columbia Center on Sustainable International Investment No. 109, November 25, 2013; Ben Bland and Shawn Donnan, "Indonesia to terminate more than 60 bilateral investment treaties," *Financial Times*, March 26, 2014.
10. Australian Government, Department of Foreign Affairs and Trade, *Trading our way to more Jobs and Prosperity* (DFAT Publication, Canberra, April 2011); Stefan Wagstyl, "Germany expresses concerns about US and Canada trade deals," *Financial Times*, September 25, 2014.
11. Pedro Cristofaro and Luiz Fernando Pinto, "Brazil," in *Latin American Investment Protections: Comparative Perspectives on Laws, Treaties, and Disputes for Investors, States, and Counsel* (edited by Jonathan C. Hamilton, Omar E. Garcia-Bolivar, and Hernando Otero Hamilton), Brill, 2012.

after investments have been admitted and established in accordance with the local laws and regulations.

However, the proponents of a pre-establishment system noted the changing nature of the investment treaties worldwide and how increasingly Asian countries had pre-establishment protection in their treaties.[12] Those who argued against pre-establishment highlighted that unlike the multilateral trading system which is based on the principle of market access, control of entry and establishment over investments has always been the prerogative of national governments under international law.[13] This was also because unlike trade in goods/services, interactions relating to foreign investments are far more intrusive through physical presence/establishment and as a result, countries have treated as their sovereign right the right to control the entry of investments as per their national policies.[14] In fact, the lack of consensus among nations to agree on a common framework for market access on investments was cited as the principal reason for failure of all attempts to have a multilateral cooperation on investments in the international plane.[15]

Given the complex nature of capital flows and investments, the drafters perhaps rightly felt that application of market access principles as it

12. For instance, see the Foreign Investment Promotion and Protection Agreement between Canada and China which entered into force on October 1, 2014.
13. UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking," UNCTAD Series on Division on Investment, Technology and Enterprise Development (2007), p. 22 (noting that the "Right of establishment" approach "consists in providing foreign investors with national treatment and MFN treatment not only once the investment has been established, but also with respect to the establishment"). Christopher F. Dugan, Don Wallace, Jr., Noah Rubins and Borzu Sabahi, *Investor-State Arbitration*, (Oxford University Press 2008), p. 285 ("Most investment treaties, including bilateral agreements based on the OECD model, extend protection only to investments (however defined) once established, leaving host states free to promulgate whatever rules they deem appropriate with regard to admission or entry or establishment of foreign capital").
14. M. Sornarajah, "Right to Regulate and Safeguards," in UNCTAD, *The Development Dimension of FDI: Policy and Rule Making Perspectives* (United Nations Publication, Geneva, 2003), p. 205.
15. This is evidenced by the lack of consensus on "Singapore issues" at the World Trade Organization (WTO) and the failed attempts to negotiate a Multilateral Agreement on Investment under the aegis of the Organization for Economic Co-operation and Development (OECD).

exists in goods and services cannot be automatically applied to investments. It is also true that developing countries need to retain the ability to screen and channel foreign direct investment consistent with their domestic interests and priorities. These priorities may also change or evolve over time, which is why pre-establishment was never a part of India's BIT programme and this position has not been changed in the revised model.

An important part of the continuity in the model has also been the reaffirmation of the bilateral nature of the investment treaties. In the initial years, bilateral mechanisms for protection found favour with India because it provided the flexibility and the policy space to determine how to catalyze foreign investment for economic development. This could not have happened in a multilateral forum on investments, which has been repeatedly rejected by India in the past.[16] However, given how the most favoured nation (MFN) clause had developed in the last two decades, the drafters probably felt that it defeated the objective of having BITs by allowing importation of procedural and substantive provisions from other treaties.

Investor-State arbitrations filed and decided to indicate that the MFN may be effectively ratcheting-up investors' treaty protections and governments' treaty obligations by allowing investors to "import" commitments from other agreements thereby altering the balance struck in carefully crafted and negotiated investment treaties.[17] An investor could potentially search the universe of investment treaties to identify more favourable clauses and protections in those other agreements, and use the MFN provision to replace or supplement the protections

16. See Statement by Minister of Commerce and Industry, Ministerial Conference, World Trade Organization, WT/MIN(99)/ST/16 (Seattle, 1999), at para 1 ("we do not, however, subscribe to the view that a multilateral framework on investment is either necessary or desirable"); Statement by Minister of Commerce and Industry, Ministerial Conference, Cancun, World Trade Organization, WT/MIN(03)/ST/7 (Cancun, 2003), at para. 13 ("an [multilateral] agreement [on investment] will certainly curtail the policy space of developing countries").

17. *Maffezini v. Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision on Jurisdiction, January 25, 2000; *Siemens v, Argentina*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, August, 3, 2004; *Gas Natural v. Argentina*, Decision on Jurisdiction, ICSID Case No. ARB/03/10 (June 17, 2005), para. 47; *National Grid v. Argentina*; *MTD v. Chile*.

of the governing treaty. It is probably because of this policy objective that the model BIT no longer has the MFN protection.

The Model BIT also recognizes the fundamental principle of exhaustion of local remedies. While always a part of customary international law,[18] this rule had perhaps been diluted by the expansive and hurried interpretation adopted by the tribunals in the past. It is significant to note that the principle of exhaustion of local remedies exists in other branches of international law such as in human rights treaties.[19] The model merely strengthens the rule by making it mandatory for the investor to litigate the claim before domestic courts for a minimum period of five years. Of course, the model also recognizes that there may be situations where the investor may not have an adequate remedy under domestic law such as when alleging a violation of national treatment. In such situations, the model allows the possibility of circumventing the requirement of exhaustion if the investor can show that there is no reasonable possibility for obtaining remedies under the domestic system.

III. And the "changes"

Before beginning to talk about the substantive changes, a few points about the form and structure of the revised model may not be out of order. Traditionally, Indian investment treaties have been called as "Bilateral Investment Promotion and Protection Agreements (BIPAs)," in spite of the 83 treaties not having any provisions on investment promotion at all. The revised model is called as the "Bilateral Investment Treaty" to reflect its focused goal on investor protection alone.

Another change has been in the length of the agreement. The Model recognizes that there are no substitutes for well drafted treaties. Until now, Indian BITs adopted a minimalistic approach with a typical 10-12 page agreement, highly standardized in its form and structure.

18. *Elettronica Sicula S.p.A (US v. Italy)*, I.C.J. Reports, July 20, 1989, where the International Court of Justice held the local remedies rule is a fundamental principle of international law and it cannot be excluded except by express words of a treaty. The Court also held that the local remedies rule is recognition of judicial sovereignty of the state over issues that fall within its jurisdiction and should not be lightly disregarded.
19. G. Van Harten, M. Loughlin, "Investment Treaty Arbitration as a Species of Global Administrative Law," 17 *EJIL* 121–150 (2006).

This had perhaps left too much interpretative authority in the hands of the tribunal. The Model BIT reflects a new approach with regard to the structure, which is detailed in its approach to scope, substantive protections and the provisions on dispute settlement. In terms of substantive issues, the most fundamental change in the model has been in the change of the definition of investment. The definition of investment goes to the heart of a treaty by covering "*what is*" protected by the treaty. Traditionally, Indian BITs have used an asset-based definition of investment, which focuses on the assets owned and controlled by an investor. This can cover a virtually unlimited range of assets such as portfolio investments, debts and loans, immovable and movable property, IPR and other tangible/intangible rights. An asset-based definition has been the subject of multiple controversies in the past as every kind of asset, irrespective of its size and value, has been provided the protection of a treaty.

Pursuant to interpretations given by tribunals, investments serving as the basis of claims include such diverse assets minority, non-controlling shareholdings;[20] sovereign bonds;[21] rights to payment from hedging contracts;[22] intellectual property rights and goodwill;[23] rights to payment from contracts for services largely performed in the home country;[24] and contingent or revocable government authorizations.[25] Many of these assets may reflect minimal or fleeting connections to the host state.

20. See, for instance, *Urbaser v. Argentina*, ICSID Case No. ARB/07/26, Decision on Jurisdiction, December 19, 2012; *Impregilo v. Argentina*, ICSID/ARB/07/17, Award, June 21, 2011.
21. See, for instance, *Abaclat and others v. Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, August 4, 2011; *Ambiente Ufficio S.P.A. and others v. Argentine Republic*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, February 8, 2013. In each decision, one of the arbitrators filed a dissenting opinion and would have rejected jurisdiction.
22. *Deutsche Bank v. Sri Lanka*, ICSID Case No. ARB/09/2, Award, October 31, 2012. A dissenting opinion was filed in this case.
23. See, for instance, *Philip Morris Asia Ltd. v. Australia*, UNCITRAL, PCA Case No. 2012-12; *Philip Morris Brands Sarl v. Uruguay*, ICSID Case No. ARB/10/7.
24. *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13; *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6.
25. With varying degrees of success, authorizations, licenses and permits are relatively commonly claimed as "investments," even if not yet obtained or guaranteed under domestic law. See, for instance, *Apotex v. United States*, UNCITRAL, Award on Jurisdiction and Admissibility, June 14, 2013; *Técnicas Medioambientales Tecmed, S.A. v. The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award, May 29, 2003.

The transient nature of protection arising from having an asset-based definition can be best demonstrated in the cases against Argentina arising from measures the country took during and in response to its financial crisis of 1999-2001. In these cases, including *CMS v. Argentina*,[26] *Azurix v. Argentina*,[27] *Enron v. Argentina*,[28] and *Siemens v. Argentina*,[29] a common issue was whether minority and/or indirect shareholders could bring an investment treaty claim seeking relief for losses they suffered as a result of damage to the company in which they held shares (as opposed to direct damage to their rights as shareholders such as expropriation or cancelation of the shares themselves). Argentina argued that if the tribunals allowed minority and/or indirect shareholders to bring claims for relief based on damage to the company, host countries could be faced with a multitude of claims from different shareholders as well as claims by the company itself. It further argued that this result would be unreasonable and contrary to the rule of international law, which did not recognize such broad rights as arising from ownership of shares. Tribunals, however, rejected those arguments in favour of a broad definition of "investments" based on a strict textual interpretation.

To overcome limitations such as these, the revised model has an enterprise-based definition of investment that equates investment with an enterprise incorporated in the host state. Of course, the assets of the enterprise are protected as well and the model has an *indicative* list of such assets. In this way, the model also aligns the investment treaty regime with the global regime on FDI and reflecting the objective establishing a lasting interest by a resident enterprise by an investor.

Another key aspect of the scope of the model is about "*who is*" subject to the obligations under the treaty. The position under the rules of state responsibility in international law is that countries are responsible for all

26. *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Decision on Objections to Jurisdiction, & Decision on Annulment, September 25, 2007.
27. *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Decision on Jurisdiction, December 8, 2003, & Decision on Annulment, September 1, 2009.
28. *Enron Corp. and Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, January 14, 2004.
29. ICSID Case No. ARB/02/8, Decision on Jurisdiction, August 3, 2004.

their actions, including those of subordinate organs.[30] However, there is considerable doubt whether under the Indian constitutional scheme the Central Government can bind state and/or local governments over legislative matters allocated to them under the Indian Constitution.[31] Accordingly, measures adopted by local governments have been kept outside the scope of the treaty. It is also important to keep in mind that in the Indian context, where there are more than five hundred municipal governments and thousands of village level governments, there do not exist the necessary capabilities and resources to meet the challenges of complying with complex international obligations.

Next, the model recognizes the need to change the asymmetry in the current BIT system, by which investors are provided protections and procedural avenues irrespective of their conduct. From an Indian perspective, investment treaties are not just instruments of investor protection, but also a valid tool promote development goals, transparency in corporate dealings and prevent unethical business practices. The provisions on investor obligations require foreign investors to comply with domestic laws on corruption, disclosures, transparency. Considering the limitations regarding enforcement of these provisions and the overall objective of BITs, these provisions are not mandatory in nature. However, having these objectives is an affirmation of the principle that BITs can serve as a tool for incentivizing good corporate conduct.

30. Article 4 of the International Law Commission's Articles on State Responsibility, 2001, which codifies customary international law on the subject and provides as follows: "The conduct of any State organ shall be considered an act of that State under international law, whether the organ exercises legislative, executive, judicial or any other functions, whatever position it holds in the organization of the State, and whatever its character as an organ of the central Government or of a territorial unit of the State."

31. The question whether the Union executive in exercise of its powers under Article 73 of the Indian Constitution could enter into international treaties on subjects allocated to sub-national or local governments has been examined by Indian courts on a few occasions. See *P. B. Samant v. Union of India*, AIR 1994 Bom 323, which held that the executive power under Article 73 (1) (a) was co-existent with the power of the Parliament to legislate on matters in the State List under Article 253 and in a similar vein, judgment of the High Court of Delhi in *Shiva Kant Jha v. Union of India*. In spite of these decisions, considerable doubts continue to exist over the treaty-making power of the Union executive over matters allocated to sub-national governments as the Supreme Court of India has not considered the matter in finality. See also Sudhanshu Roy, "Reconsidering Treaty-Making in India: An argument for reform through the Prism of International Investment Agreements," 54 (4) *Indian Journal of International Law*, 283, 2014.

In some quarters, the intent behind having the provisions has been mischaracterized as an attempt to regulate foreign investments.[32] This is perhaps based on a simplistic reading of an enterprise-based definition of investment and the provisions on investor obligation. However, a deeper analysis makes it clear that the attempt is perhaps not to govern, but to ensure a more robust application of the investment treaty regime. The objective is also to avoid conflicts between the investment treaties and regulatory power, which most governments across the world are grappling with.

IV. Conclusions

To sum up, India's revised model BIT is based on a realistic proposition that there are no magic wands for resolving the entire system in an instant. It is an acknowledgement that reform is a gradual and step-by-step process, and that it involves taking each treaty and action into account. The review of the model is merely one more contribution to changing the system of investment treaties worldwide. The next challenge is perhaps to overhaul the large number of India's existing BITs to bring them in line with the renewed approach and to integrate the trade and investment regimes towards a common agenda.

The revision of India's model also has to be viewed in the context of changes in investment regimes worldwide where increasing questions are being asked about the impact of BITs on the policymaking power of governments. We are witnessing fundamental realignments in terms of the position of the governments and the regime as a whole on an everyday basis. These developments can only be welcomed. It is a truism that to sustain in the long run, any democratic system needs both continuity and change. By revising its model BIT and participating in the debate about the global investment regime, India has embraced both these attributes more meaningfully.

32. Prabhash Ranjan, "A BIT of an overreaction," *The Financial Express*, April 4, 2015.

An Analysis of India's New Model Bilateral Investment Treaty

Kavaljit Singh

In the wake of public outcry over arbitration notices served by several foreign investors challenging various policy measures and demanding billions of dollars in compensation for the alleged violation of India's bilateral investment treaties (BITs), India launched a formal review of its 1993 model BIT in 2013. Since India negotiates BITs on the basis of a model, the purpose of the review was to revise the 1993 model treaty text in tune with the recent developments and to provide a roadmap for the re-negotiation of country's existing BITs.

So far, India has signed bilateral investment treaties (BITs) with 83 countries. In addition to standalone BITs, investment chapters of India's free trade agreements (FTAs) with Singapore, Japan and South Korea also contain investment protection measures.

It is important to note that India is not alone in reviewing its BITs regime. Currently, a number of developing countries are questioning the rationale of investment agreements as these are neither necessary nor sufficient to attract foreign investment. In early 2014, Indonesia announced its plan to re-examine more than 60 bilateral investment treaties. Like India, Indonesia is currently engaged in preparing a new template for its future bilateral investment treaties. South Africa terminated its treaties with Germany, Switzerland and Spain based on a

three-year review and decided to replace its BITs regime with a new domestic legislation which aims to protect investor rights while safeguarding domestic policy space.

The review process

In India, a Standing Committee of Secretaries (SCoS) under the chairmanship of Cabinet Secretary was constituted to address all issues pertaining to Indian BITs. In March 2013, the SCoS constituted an inter-ministerial Working Group led by Ministry of Finance to carry out the following tasks, amongst others:

- To prepare a revised model BIT text for the consideration of the SCoS;
- To examine other issues arising out of Indian BITs and to harmonize the provisions of standalone BITs with investment chapters of FTAs signed by the country;
- To address the broader issues arising out of the individual BIT disputes; and
- To provide a detailed roadmap for re-negotiation of existing 83 BITs.

It was also decided that the Working Group will continue to function until all the above-listed tasks have been completed. An action plan for the revision of model BIT text was prepared to finish this task within a period of nine months.

What is perplexing is that no inputs from domain experts, think-tanks, NGOs, and business associations based in India were sought by the Working Group while preparing the model BIT text. Even the state governments whose actions can be challenged and subjected to international arbitration were not consulted.

The drafting of the new model text was carried out by officials in consultation with just four international institutions. There is nothing wrong with consulting foreign experts and institutions *per se*, but no

explanation has been given why no inputs were sought from experts and institutions based in India.

In contrast, the US and South Africa sought active participation of all relevant stakeholders from their society in the review process as well as formulating the new text. It is only after the draft text was prepared, the government sought views from the public by releasing the draft model text[1] in public domain in March 2015 and invited comments from public.

In December 2015, the new model text for BIT was approved by the Cabinet after incorporating the comments received from public. The new text would be used by officials for negotiating investment and trade agreements in the future.

Along with the release of new model text, the government also announced that all future negotiations on standalone BITs and investment chapters of FTAs would be led by Ministry of Finance to ensure policy convergence. Earlier, negotiations on investment chapters of FTAs were handled the Ministry of Commerce while standalone BITs were negotiated by the Ministry of Finance. This indeed is a welcome development as there have been several instances of differences on investment issues between these two ministries resulting in a lack of policy coherence.

Some of the key provisions of the new model text[2] for the Indian bilateral investment treaty (December 2015) are examined below.

Preamble

The Preamble provides an introduction to the long-term objectives of an investment treaty. The Preamble of the new model BIT reaffirms the right of state parties to regulate investments in their territories in

1. The text of draft new model Indian BIT is available at https://mygov.in/sites/default/files/master_image/Model%20Text%20for%20the%20Indian%20Bilateral%20Investment%20Treaty.pdf.
2. The text of India's new model BIT is available at http://finmin.nic.in/the_ministry/dept_eco_affairs/investment_division/ModelBIT_Annex.pdf.

accordance with their laws and national policy objectives.

The Preamble adopts a development-centric approach by aligning the objectives of investment promotion and protection with the promotion of sustainable development.

Defining investment and investor

In a bilateral investment protection treaty, the definition of investment and investor is of paramount importance because it determines what kinds of investments and investors would be protected under its framework.

The 1993 model BIT used an "asset" based definition of investment, which includes "every kind of asset" such as moveable and immovable property, shares, debentures, financial contracts, intellectual property rights and business concessions. The "asset" based definition of investment was formulated way back in the 1960s by the capital-exporting (developed) countries to protect a wide range of assets of their investors in the capital-importing (developing) countries. As pointed out by Nathalie Bernasconi-Osterwalder and Lise Johnson, a major problem with an expansive asset-based definition is that any kind of asset (for example, a company's goodwill or money lying idle in a bank account) could qualify as an investment and therefore is eligible for protections given under the BITs.[3] Whether such assets contribute to the development of host-country economies is highly questionable.

In contrast, India's draft model text (April 2015) adopted an "enterprise" based definition of investment thereby confining it to only one form of external finance, namely, foreign direct investment (FDI) in the host state. In a narrow manner, an enterprise was defined as one having "real and substantial business operations" in the host state with "substantial and long-term commitment of capital" and engagement of a "substantial number of employees in the territory of the host state."

3. Nathalie Bernasconi-Osterwalder and Lise Johnson, (2011), *Commentary to the Austrian Model Investment Treaty*, IISD Report, International Institute for Sustainable Development, September 2011, p.7, available at http://www.iisd.org/pdf/2012/austrian_model_treaty.pdf.

It further required an enterprise to have "assumed entrepreneurial risk" and made "a substantial contribution to the development of the host state through its operations along with transfer of technological knowhow, where applicable." The draft model text only recognised those investors who directly own and control an enterprise, thereby precluding claims being brought by indirect or minority shareholders. Not long ago, multiple cases were brought by minority shareholders of companies against Argentina for implementing measures to mitigate the financial crisis of 2001. There are many other instances where foreign investors (irrespective of shareholdings) have submitted claims under the investor-state arbitration on the grounds that their shares constitute the investment. The draft model also added strict criteria regarding ownership and control of an enterprise. Accordingly, an enterprise would be considered as "owned" by the investor if such an investor directly or beneficially owned more than 50% of the capital in the enterprise. On the other hand, an enterprise will be considered as "controlled" by the investor, if such an investor has the right to appoint directors or senior management officials or to control the policy decision of an enterprise.

The final model text (December 2015) also adopts an enterprise based definition but a wide range of assets possessed by an enterprise have been given protection. Under the new text, an enterprise may possess shares, stocks and other forms of equity instruments of the enterprise; debt instruments; loans; licenses and permits; copyrights, trademarks, know-how and intellectual property rights (such as patents); moveable or immovable property and related rights; and any other interests which involve substantial economic activity and are of significant financial value.

According to the final text, "investment" means an enterprise that "has the characteristics of an investment such as the commitment of capital or other resources, certain duration, the expectation of gain or profit, the assumption of risk and a significance for the development of the Party in whose territory the investment is made." In many ways, the new text follows the so-called 'Salini test' approach (by reference to the arbitration award in *Salini Costruttori SpA & Anor v. Kingdom of Morocco*) to determine whether a transaction qualifies as an investment. The four criteria followed by the arbitral tribunal in this case are:

a contribution made by an investor; certain duration of the enterprise; an assumption of risk; and a contribution to the economic development of the host state.

Despite open-ended language used in the new model text, it is evident that an enterprise that carries out minimal business operations in the host country may not qualify as an investment.

The new model treaty text explicitly states that an enterprise must be "constituted, organised and operated in compliance with the law of a Party." This clause is meant to deny protections to an enterprise that has violated laws in a host country. Of late, there are some recent cases (for instance, *Inceysa Vallisoletana S.L. v. Republic of El Salvador*) where the arbitral tribunals have rejected the claims filed by investors on the grounds that investments were procured by fraud and corruption.

Additionally, the new model treaty excludes the following assets of an enterprise from the definition of investment:

- Portfolio investments of the enterprise or in another enterprise;
- Debt securities issued by a government or loans to a government or government-owned enterprise;
- Any pre-operational expenses incurred for the establishment of the enterprise in the host state;
- Claims to money that arise from commercial contracts;
- Goodwill, brand value, market share or similar tangible rights; and
- An order or judgement in any judicial, regulatory or arbitral proceedings.

Under the new model BIT, "investor" means a natural or juridical person of a Party having "substantial business activities in the territory of that Party." The inclusion of the requirement that investors conduct substantial business activities in the home state is intended to deny protection to so-called "mailbox companies" that have a minimal commercial presence in the home country. A 2006 report by SOMO estimated that the Netherlands hosts nearly 20,000 "mailbox companies"

that do not have a substantial commercial presence.[4] India receives substantial investments from such "mailbox companies" located in Mauritius, Singapore and the Netherlands.

Furthermore, the new model BIT also contains provisions related to the denial of benefits. Article 35 states that the host state can deny the benefits of the Treaty to:

- "An investment or investor owned or controlled (directly or indirectly) by persons of a non-Party or of the denying Party; or
- An investment or investor that has been established or restructured with the primary purpose of gaining access to the dispute resolution mechanisms provided in this Treaty."

The insertion of these provisions in the model treaty text is intended to avoid a recurrence of investor-state disputes such as *Yukos Universal Limited v. The Russian Federation*. On 28 July 2014, an international arbitration tribunal under the auspices of the Permanent Court of Arbitration (The Hague) announced that Russia must pay US$50 billion in damages to former shareholders of the now defunct oil giant, Yukos Oil Company. The arbitration was initiated under the framework of the Energy Charter Treaty in 2005 by five Russian nationals (living abroad) who currently own GML – the Gibraltar-registered holding company through which Mikhail Khodorkovsky (Yukos's former owner) held his controlling stake in the company.[5]

Scope and general provisions

The new model BIT only covers obligations in the post-establishment

4. Michiel van Dijk, Francis Weyzig and Richard Murphy, (2006), *The Netherlands: A Tax Haven?*, SOMO, November 2006, available at http://www.somo.nl/publications-en/Publication_1397.
5. For further details, see Kavaljit Singh, (2014), The Era of Mega-Arbitration: International Court Rules Against Russia in $50 Billion Decision, Commentary, Madhyam, July 30 July, 2014, available at http://www.madhyam.org.in/the-era-of-mega-arbitration-tribunal-awards-50-billion-against-russia-in-yukos-case/.

phase of an investment. Further, the text explicitly states that the Treaty shall not apply to:

- Any measure taken by a local government (such as municipal corporation or village level government);
- Taxation matters;
- The issuance of compulsory licenses in relation to IPRs;
- Debt securities issued by a government or loans to a government or government-owned enterprise;
- Government procurement; and
- State subsidies or grants.

An alternative approach to FET obligation

Most international investment treaties contain an obligation that the host country would accord 'fair and equitable treatment' (FET) to foreign investment. There is a growing trend to include FET standards in investment treaties, even in the case of South-South BITs. In the case of India, the FET obligation can be found in almost all investment agreements except the investment chapter of India-Singapore FTA.

Although the concept of fair and equitable treatment of foreign investments can be traced back to the Havana Charter (1948), there is still a lack of clarity over the exact meaning of the phrase 'fair and equitable treatment.' The FET standard usually covers governmental measures and actions that fall outside the scope of other provisions. Due to its undefined and 'catch-all' nature, the FET standard has become a favourite among the investor community while tribunals have followed varying interpretations of this standard based on their understanding of fairness and equity. A majority of successful claims in investor-state arbitrations have been centred on the alleged violations of the FET standard by the host country.

Since the inclusion of the FET standard can leave considerable scope for its wide application and conflicting interpretations, India's new

model treaty makes no mention of this standard in the text. Rather it has adopted an alternative approach to address some of the core components of the FET standard. Article 3.1 of the new model treaty stipulates:

"No Party shall subject investments made by investors of the other Party to measures which constitute a violation of customary international law through:

- Denial of justice in any judicial or administrative proceedings; or
- fundamental breach of due process; or
- targeted discrimination on manifestly unjustified grounds, such as gender, race or religious belief; or
- manifestly abusive treatment, such as coercion, duress and harassment."

Perhaps the Indian government assumes that by inserting narrowly defined obligations (such as denial of justice and fundamental breach of due process) and binding them to customary international law, the problems of wider interpretations by tribunals could be resolved. In the past, several countries attempted to limit the FET standard by linking it to the customary international law. However, the outcomes were not satisfactory as some tribunals adopted the autonomous approach and interpreted the FET standard more broadly than the customary international law.

Further, the new model treaty states that "full protection and security" only refers to physical security of investors and to investments made by the investors.

National Treatment "in like circumstances"

The 1993 model BIT requires the host state to treat the foreign investors from the home state no less favourably than it treats domestic investors (National Treatment obligation). The new model BIT also provides national treatment to foreign investors but the qualifying

term "in like circumstances" has been explicitly inserted to narrow the scope of the NT principle.

Of late, the concept of "like circumstances" or "like situations" is increasingly being used in bilateral investment treaties. This small textual addition calls for the comparison of the treatment afforded to similarly situated investors. In addition, it acknowledges legitimate reasons behind governmental measures to differentiate among investors and investments on account of the dissimilar circumstances.

The insertion of "like circumstances" in NT obligation may help India to mitigate some of the impacts of its application. However, the determination of "like circumstances" is not going to be an easy task, as these terms can be interpreted too broadly or narrowly by arbitral tribunals. Regrettably, the new model treaty does not describe the criteria that should be used to determine likeness. Thus, it will be at the discretion of the arbitral tribunals to determine likeness.

In the case of sub-national government, the text clarifies that foreign investors will get the same treatment that is given by that sub-national government to investors of the host country.

No MFN provision

The new model BIT has excluded the most favoured nation (MFN) treatment provision, which requires the host state to treat the investor of the home state no less favourably than it would treat investors from any third state. This represents a significant improvement over the 1993 model BIT, even though investment chapters of India-Singapore (2006) and India-South Korea (2009) free trade agreements do not contain this provision.

Of late, many governments are getting increasingly concerned over the frequent use of the MFN obligation by investors to bypass the investment protection provisions listed under those investors' BITs (basic treaty).

By virtue of the MFN clause in a BIT, a foreign investor can 'import' more favourable protection provisions contained in other BITs signed by the host state and use them to bring claims before arbitral tribunals.

Hence, the MFN clause creates a *de facto* multilateralisation of investment protection measures.

There are numerous recent instances where foreign investors have frequently invoked broader provisions in other treaties through an MFN clause. They have successfully used the MFN clause to import substantive protection clauses from other BITs on a wide range of matters, ranging from fair and equitable treatment to "umbrella clauses" to "effective means of asserting claims and enforcing rights" to dispute settlement procedures.

To a large extent, India has removed the MFN obligation in the wake of the first investment arbitration award (*White Industries Australia Limited v. Republic of India*) rendered against it.

In July 2010, the White Industries Australia Limited (WIAL) had invoked arbitration against the Indian Government under the India-Australia BIT and argued that the judicial delays over the enforcement of its ICC (International Chamber of Commerce) award amounted to a denial of justice in violation of several provisions of the treaty. It specifically argued that India had failed to provide WIAL with "effective means of asserting claims and enforcing rights." But the India-Australia BIT (1999) does not contain "effective means of asserting claims and enforcing rights" standard or any other obligation dealing with delays in court process. However, this treaty contains the MFN clause, which allowed WIAL to import a favourable provision under Article 4 (5) of the India-Kuwait BIT. This obliges India to provide "effective means of asserting claims and enforcing rights with respect to investment." By relying on the MFN clause, WIAL was successful in seeking a similar level of protection that Kuwaiti investors are given in India.

No umbrella and stabilization clauses

Another notable exclusion is the so-called "umbrella clause." Commonly found in investment treaties, umbrella clauses are usually broadly written to provide additional protection to investors.

An umbrella clause guarantees compliance with contractual obligations. Under an umbrella clause, a violation of an investment contract

between the host state and an investor can be considered as a violation of the BIT. In other words, it can convert a contract claim into a treaty claim. Because of its catch-all nature, umbrella clauses have become very controversial in recent years.

In addition, India's new model BIT does not contain any stabilization clauses that prohibit the host state to unilaterally change the laws and regulations related to an investment project.

Expropriation

India's new model BIT does not allow nationalisation or expropriation of an investment except for reasons of public purpose, in accordance with procedures specified in the domestic laws and on payment of adequate compensation. In order to prevent foreign investors from bringing frivolous claims, it adopts a case-by-case test approach to determine whether government measures have an effect equivalent to expropriation. It further clarifies that an action taken by a government in its commercial capacity will not constitute expropriation.

Additionally, India has inserted a clause to maintain regulatory space. The Article 5.5 of new model BIT explicitly states that non-discriminatory regulatory measures taken to "protect legitimate public interest or public purpose objectives such as public health, safety and the environment, shall not constitute expropriation."

The new model permits payment of compensation keeping in view the fair market value of expropriated investment. The compensation will include simple interest at a commercially reasonable rate from the date of expropriation until the date of payment.

Transfers

The new model BIT permits investors to freely transfer funds related to their investments into and out of the host country. It provides a list of funds that are eligible for unrestricted transfer. These include contributions to capital, profits, dividends, capital gains, interest, royalty payments, technical assistance fees, payments related to contracts and loans.

Nevertheless, the new model permits the imposition of temporary restrictions on the transfer of funds in the event of serious balance-of-payments difficulties or in cases where capital movements pose serious difficulties in the management of monetary and exchange rate policies. Similar to the Japan-Korea BIT (2002), the new model treaty allows the host country to delay or prevent a transfer related to bankruptcy, insolvency or compliance with judicial decisions and awards.

India should have adopted a more cautious approach towards free transfer of capital because of its external sector vulnerabilities. India is among the countries that are most vulnerable to capital outflows. In the aftermath of the global financial crisis (2008), many countries imposed restrictions on both capital inflows and outflows to maintain financial and macroeconomic stability. Even the International Monetary Fund (IMF) these days endorses the use of capital controls, albeit temporarily, and subject to certain circumstances. In a post-crisis world, financial stability must be treated as a public good just like the maintenance of law and order and national defense.

Investor obligations

India's new model BIT contains obligations on investors concerning their conduct in the host state. Such obligations were completely missing in the 1993 model BIT as well as previously concluded treaties by India. This is a new approach adopted by India to address the balance of the rights and responsibilities of investors because Indian BITs usually do not impose obligations on the part of foreign investors.

The inclusion of investor obligations is significant because these provisions are in addition to Article 1.4, which states that that an enterprise must be "constituted, organized and operated in compliance with the law of a Party." Article 11 requires investors to comply with host country laws related to taxation, disclosure of information. It further bars investors from give bribes to public servants in the host state as an inducement or reward for doing or forbearing to do any official act. While Article 12 encourages investors to voluntarily adopt corporate social responsibility principles to address issues such as labour, environment and human rights.

It is worth noting that the draft model text (April 2015) also included obligations on the home state under which the home state was obliged to ensure that its laws enable efforts to pursue legal actions against investors in its domestic courts. However, home state obligations have been completely dropped in the final model text.

Unlike the final model text, the draft text even allowed the state parties to initiate a counterclaim against the investor for a breach of obligations related to corruption, disclosures and taxation matters before an arbitral tribunal and seek monetary compensation or enforcement action from foreign investors for breach of such obligations. It is not clear why these innovative provisions have been altogether dropped by the Indian authorities in the final model text.

Investor-state dispute settlement (ISDS): exhaustion of local remedies

The investor-state dispute settlement (ISDS) system was created 50 years ago to give protection to foreign investors against the arbitrary behaviour of host states. However, in practice, this system displays structural deficiencies as numerous cases have been filed against a wide range of policy measures (related to health and safety, environment and taxation) that may have an adverse impact on a foreign investment. The growing number of arbitration cases has brought the ISDS system under the spotlight.

India's new model BIT contains ISDS provisions that allow investors to initiate international arbitration over treaty breaches. However, access to ISDS mechanisms has been made conditional on the exhaustion of local remedies.

In other words, the investor will have to first approach the relevant domestic courts or administrative bodies of the host state for the resolution of an investment dispute. If no satisfactory resolution is reached after exhausting all local remedies for five years, or if the investor can prove that continued pursuit of domestic relief would be futile because of non-availability of domestic legal remedies or undue delays, the investor can commence international arbitration under the Treaty by is-

suing a notice to the host state. The investor will have to submit a claim within one year from the date of measure in question.

This is an entirely new approach adopted by the Indian Government to plug loopholes embedded in the current ISDS system of country's BITs, which provide recourse to both international arbitration and domestic courts. The India-UAE BIT (2013) is the only exception. It contains the so-called 'fork-in-the-road' clause under which an investor can choose to pursue a claim either in domestic courts of the host country or international arbitration. The choice of any of these two options shall be final.

The new model provides a mandatory 'cooling off' period of six months during which both parties would engage in consultations to resolve the dispute. If the dispute cannot be resolved through consultations within this time period, the investor can submit a claim to international arbitration under the Treaty with the following conditions:

- The investor will have to issue a notice of arbitration to the host country at least 90 days before submitting a claim to internationa arbitration. This condition is important as there are multiple instances where investors did not give the host country any notice at all or very short notice of its claim before commencing arbitration.
- The investor will have to initiate international arbitration within six years from the date of measure in question or within 12 months from the conclusion of domestic proceedings.
- No parallel dispute settlement proceedings would be pursued by the investor.
- No claim shall proceed unless the State Parties have given consent for the submission of a claim to arbitration.

An investor can submit the claim to arbitration under the UNCITRAL Arbitration Rules or the ICSID Convention or the Additional Facility Rules of ICSID. Currently, India is not a signatory to ICSID Convention but can use the Additional Facility Rules of ICSID which allow settlement of investment disputes where either Party (not both) is a member of the ICSID Convention.

The conduct of arbitral tribunal

The new model BIT adds detailed procedural rules on the appointment of arbitrators, the conduct of arbitral proceedings, transparency, award, costs and related matters. For instance, an early review mechanism has been introduced to prevent frivolous claims based on weak grounds.

Further, to ensure arbitrators are impartial and free of any conflict of interest, strict disclosure norms have been introduced under which arbitrators will have to disclose in writing their existing or past relationships with any of the parties. Similarly, all documents (except confidential information) related to investment disputes will be made available to the public and the tribunals shall make logistical arrangements to facilitate public access to hearings through video links and other means. The introduction of such rules is a welcome development given the lack of transparency in investor-state arbitration processes to date.

Already questions are being raised about the necessary impartiality and independence of arbitrators in resolving investment disputes. In 2013, the President of the International Court of Justice, Peter Tomka, removed Francisco Orrego Vicuña as an arbitrator in *CC/Devas and others v. India* (an UNCITRAL arbitration case under the India-Mauritius BIT) because of "issue conflict" as he had expressed a fixed position in three previous decisions and an academic paper on the application of essential security clauses.

The conduct of arbitral tribunals could have been further improved by limiting the choice of arbitrators to a fixed pool of arbitrators appointed by the Parties. To ensure a high degree of transparency, the civil society groups have been demanding that the tribunals should accept amicus curiae (friend of the court) submissions, similar to transparency rules of the UN Commission on International Trade Law (UNCITRAL).

Besides, there is no reference to the 'loser pays' principle in the new model text so as to discourage frivolous claims brought by investors under the ISDS system.

Appeals facility

Interestingly, the new model treaty allows the establishment of an institutional mechanism to develop an appellate body to review awards rendered by arbitral tribunals. Several civil society groups and academics have been supporting the idea of an appeal mechanism under which the decisions taken by the arbitral tribunals can be subject to review through an appellate mechanism. Recently, the EU has proposed such mechanism in its ongoing discussions on ISDS under the Transatlantic Trade and Investment Partnership (TTIP) and some developing countries are also exploring this provision in their future BITs.

State-state dispute settlement

India's new model BIT calls for settlement of disputes related to the interpretation or application of Treaty through consultation and negotiation between the state parties. If a dispute is not settled within six months, either party can submit it to an arbitral tribunal for resolution The new model provides procedural rules regarding the setting up o an arbitral tribunal.

Some analysts expect that the inclusion of state-state dispute settlement mechanisms in BITs may gain grounds in future, as it offers a better alternative to highly controversial investor-state arbitration mechanisms (See paper by Nathalie Bernasconi-Osterwalder in this book). Nevertheless, managing both mechanisms with varying procedures is a challenging task for policy-makers.

Exception clauses

Unlike the 1993 model text, which allows exceptions to protect essential security interests, the new model treaty text provides an exhaustive list of economic, environmental and social measures that shall be exempted under the Treaty. The scope of these measures has been broadened to safeguard the policy space that may be required to pursue legitimate public welfare objectives. The following is a list of general exceptions listed in the new model text.

- Measures taken to protect public morals or maintaining public order;
- Measures taken to protect human, animal or plant life or health;
- Measures taken to protect and conserve the environment, including all living and non-living natural resources;
- Measures taken to protect national treasures or monuments of artistic, cultural, historic or archaeological value;
- Measures taken by a central bank or monetary authority of a Party in pursuit of monetary and related credit policies or exchange rate policies.

Review, amendments and termination

India's new model text for BIT allows periodic review of a treaty every five years once it is signed besides regular consultations and exchange of information between parties on the interpretation, application and implementation of the treaty's provisions. Under Article 37, the new model allows amendments in the treaty's provisions at any time at the request of either party. The amendments would be binding on the arbitral tribunals and their awards "must be consistent with all amendments."

As per the new model text, the treaty will remain in force for a period of ten years and shall lapse thereafter unless the parties seek its renewal in writing. Further, the BIT can be terminated anytime (after ratification) "if either Party gives to the other Party a prior notice in writing twelve months in advance stating its intention to terminate the Treaty. The Treaty shall stand terminated immediately after the expiry of the twelve month notice period."

The new model text contains the so-called "sunset clause" continuing the investment protection even after the termination of the BIT. The investments made prior to termination of the BIT will get protection for a further period of five years after its termination. In contrast, the 1993 model text provided the investment treaty to be effective for a further period of 15 years.

To sum up, India's new model BIT is a major departure from the 1993 model treaty. Under the new model text, India has opted for limited investment protection besides interpretative clauses that have been incorporated to clarify the meaning and intention of several treaty provisions. Some vague and controversial provisions have been dropped or clearly defined. The new model also contains safeguard measures with due emphasis on procedural requirements. These amendments are primarily intended to preserve the policy space so as to pursue developmental and other objectives that may be difficult to reconcile with the framework of investment treaty obligations.

What next?

Now the attention of Working Group should turn to two important tasks, namely, a detailed roadmap for re-negotiation of existing 83 standalone BITs; and the harmonization of provisions of standalone BITs with investment chapters of FTAs signed by India. Both these tasks entail important legal issues that need to be addressed by the authorities.

The renegotiation of standalone BITs may appear to be the most effective course of action but it may take considerable time to re-negotiate all existing 82 bilateral investment treaties. Further, there are several legal and practical implications of re-negotiation (or unilateral termination) of treaties that should be taken into account. For instance, most Indian treaties contain survival clauses that extend treaty protection for a period of 10 to 15 years. Based on previous treaty's survival clauses, those investors that have made an investment when the previous treaty was in force would get protection for a period defined in that treaty.

Apart from 83 standalone BITs, investment chapters of India's FTAs with Singapore, Japan and South Korea also contain investment protection measures. It is not clear what would be the government's approach towards investment chapters of FTAs. Whether it will re-negotiate or terminate investment chapters of FTAs? The re-negotiation of an investment chapter of a free trade agreement can also be a complex and tedious process.

While the process of termination of investment chapters of FTAs is fraught with legal hurdles. As pointed out by Abdulkadir Jailani (in this book) and other analysts, the termination of an investment chapter of FTA may not be legally possible unless it is done altogether with all chapters of that agreement. Hence, the scope for unilateral termination of investment chapters of India's FTAs is limited by the wider implications for country's trade policies. All such legal and political factors will have to be taken into consideration in deciding about renegotiation or termination of investment chapters of country's FTAs.

Needless to say, there is an urgent need for regular review of India's approach towards the bilateral investment treaty regime. Apart from involving state governments, the central government should conduct wider public consultations and seek inputs from domain experts, think-tanks, business associations, legal community and civil society groups on a regular basis.

Finally, it must be emphasised that the Indian government should not solely rely on a treaty-based approach to address concerns of foreign investors. Rather the government should initiate other policy reforms such as easing issuance of business visas, speeding up judicial proceedings and fixing the domestic arbitration ecosystem. To remove barriers that make the cost of doing business in India high, greater attention needs to be given on investment facilitation by simplifying administrative procedures and enhancing transparency in the public administration. Such policy reforms would address concerns of all investors (foreign or domestic) and would also be politically acceptable in India.

India's Bilateral Investment Treaty Programme – Past, Present and Future

Prabhash Ranjan

The purpose of this paper is to discuss India's Bilateral Investment Treaty (BIT) programme looking at how it started, its current status and its future direction. Accordingly, Part I discusses India's initial approach to foreign investment, from 1947 until the late 1980s when India didn't enter into BITs. Part II discusses the developments in 1990s, which brought about a change in India's approach to foreign investment and led to the launch of India's BIT programme. In Part III, we discuss the current status of India's BIT programme focussed at revisiting its existing treaty practice. Part IV discusses the possible future direction of the Indian BIT programme looking at the draft text of the new Indian model BIT.

I. India's initial approach to foreign investment

In the initial years after independence, India's attitude towards foreign direct investment (FDI) was receptive[1] although India's policy was characterised by import substitution and focused on developing indigenous industries. FDI was sought in the 1950s in mutually advantageous ways with conditions like joint ventures with local industries,

1. Nagesh Kumar, (1988), "Liberalisation and Changing Patterns of Foreign Direct Investments" (1998) 33 (22) *Economic and Political Weekly*, p. 1321.

local content clauses and export obligations.[2] However, FDI during this period was also subject to careful scrutiny due to India's fragile Balance of Payment (BoP) position.[3]

This receptive attitude to foreign investment started to change in 1970s when there was a more conscious shift towards adopting protectionist and inward looking economic policies to protect India's infant industries that had developed in the 1950s and 1960s. Laws having a detrimental impact on foreign investment were enacted such as the Foreign Exchange Regulation Act (FERA), which required a foreign company to convert foreign equities into minority holdings. Only if a foreign company diluted its equity to a minority holding of 40% would it get national treatment. This led to transnational corporations like IBM and Coca Cola exiting India.

Low economic growth in the 1970s led to limited liberalisation and de-regulation in the 1980s. A somewhat more receptive attitude towards FDI was adopted by introducing flexibility in foreign ownership and exceptions to the 40% ceiling rule. On the whole, foreign investment didn't figure very prominently in India's economic policy until about the mid-1980s. The Indian economic model was characterised by inward-looking economic policies focussing on indigenisation and self-reliance.

This economic policy rooted in economic nationalism explains India's approach to international law on foreign investment during this period. India, and other newly independent countries of Asia and Africa, in the 1950s and 1960s, strived to build a new international legal order emphasising their sovereign status.[4] A key development in the 1950s was the

2. R. Nagaraj, (2003), "Foreign Direct Investment in India in 1990s" (2003) 38 (17) *Economic and Political Weekly*, p. 1701.
3. Amitendu Palit, (2009), "India's Foreign Investment Policy: Achievements and Inadequacies" (2009) <http://www.ifri.org/?page=contribution-detail&id=5569&id_provenance=97> accessed on 10 June 2013.
4. Work of Indian scholars of that time reflect this – Ram Prakash Anand, (1962), "The Role of New Asian-African Countries in the Present International Legal Order" (1962), 56 *American Journal of International Law*, 383; S N Guha Roy, (1961), "Is the Law of Responsibility of States for Injuries to Aliens a Part of Universal International Law?" (1961), 55 *American Journal of International Law*, 863.

setting up of Asian Legal Consultative Committee (ALCC) on 15 November 1956 with India – along with six other Asian countries – being the founding member.[5] In 1958, African countries also became members of this group and later this group came to be known as the Asian-African Legal Consultative Organization (AALCO) with its primary objective being to act as an advisory body to member states on international law matters. At the fourth session of this committee, member countries adopted a document called "Principles Concerning Admission and Treatment of Aliens."[6] Article 11 of this document states, "Subject to local laws, regulations, and orders and subject also to the condition, imposed for his admission into the State, an alien shall have the right to acquire, hold and dispose of property." Further Article 12 (1) states "The State shall, however, have the right to acquire, expropriate or nationalise the property of an alien. Compensation shall be paid for such acquisition, expropriation or nationalisation in accordance with local laws, regulations and orders." This language clearly signalled that the treatment of an alien would be as per the national laws of the host country. Also, India rejected concepts such as "state responsibility for injuries to aliens" and "direct individual rights of investors to bring disputes against states" under the Convention on the Settlement of Investment Disputes between States and Individuals of Other States of 1965 (ICSID Convention).[7]

II. Liberalisation of Indian economy and advent of India's BIT programme

However, things started to change from 1991 when India decided to lift its self-imposed exile and insulation from the global economy. A severe BoP crisis in 1990-91, with foreign exchange reserves worth only two weeks of imports, forced India to unleash major structural adjustments

5. For more on ALCC (now called AALCO) see - http://www.aalco.int/.
6. Principles Concerning Admission and Treatment of Aliens, Asian Legal Consultative Committee (ALCC) (Adopted in the fourth session) <http://www.aalco.int/PRINCIPLES%20CONCERNING%20ADMISSION%20AND%20TREATMENT%20OF%20ALIENS.pdf> accessed on 31 August, 2014.
7. Convention on the Settlement of Investment Disputes between States and Nationals of Other States (opened for signature 18 March 1965, entered into force 14 October 1966) ("ICSID Convention") <http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf>

and macro-economic reforms, of the kind never undertaken before. For example, India gradually dismantled quantitative restrictions on imports, bringing down tariff rates from a peak of 300% to a peak of 35%; undertook comprehensive reform of the exchange control regime; and introduced measures aimed at liberalising FDI and foreign institutional investment (FII) inflows to overcome the problem of over-dependence on debt. Bold measures aimed at liberalising FDI included automatic approval of FDI up to 51% in high priority industries; 100% foreign equity in the energy sector; setting up of a Foreign Investment Promotion Board (FIPB) to act as a single window clearance for foreign investment proposals; opening up new sectors such as mining and telecommunications for foreign investment; amendment of the foreign exchange regulation act to treat foreign companies with more than 40% ownership on a par with fully owned Indian companies.

India started signing BITs, or bilateral investment promotion agreements (BIPAs) – as they are called in India – in the early 1990s, as part of the overall strategy of economic liberalisation unleashed in 1991, with the clear objective of attracting foreign investment.[8] FDI flows[9] to India increased massively from US$4,029 million in 2000-01 to $46,556 million in 2011-12.[10] After 2011-12, FDI flows fell to $36,046 for the year 2013-14 (up to 31 March 2014),[11] which is still about nine times the FDI flow in 2000-01. However, there is no evidence to prove that heightened FDI flows were due to India's BITs or to what extent India's BITs were responsible for the high FDI flows to India.[12]

India signed the first BIT with the United Kingdom (UK) in 1994. Since then India has entered into BITs with more than 80 countries, out of

8. For a full discusion on the Indian BIT programme, including its origin and evolution, see Prabhash Ranjan, "India and Bilateral Investment Treaties – A Changing Landscape" (2014) 29 (2) *ICSID Review – Foreign Investment Law Journal*, 419-458.
9. This includes FDI Equity flows, reinvested earnings and other capital flows. See Fact Sheet on Foreign Direct Investment (FDI) from April 2000 to September 2014, DIPP, Government of India <http://dipp.nic.in/English/Publications/FDI_Statistics/2014/india_FDI_September2014.pdf> accessed on 25 December 2014.
10. Ibid.
11. Ibid.
12. See Ranjan, above n 8, p. 428-429.

which more than 70 have already come into force.[13] From 1994 to 2000, India entered into BITs with almost all major European countries like France, Germany, Italy, the Netherlands, Belgium, Denmark, Poland, Switzerland and Sweden. From 2000 onwards, India entered into BITs with many developing countries like Argentina, Mexico, China, Thailand, Indonesia, Saudi Arabia, as well as with least developed countries (LDCs) like Bangladesh, Sudan and Mozambique. All these BITs are for a ten-year period and are deemed to be automatically extended after this period unless either state gives notice in writing to terminate the treaty. Even if the treaty is terminated, the protection for the existing investments made in India will continue to apply for the next 15 years.

From 1994 until 2004, India's investment treaty practice was restricted to stand-alone BITs. After 2004, India continued signing stand-alone BITs[14] and also started entering into Free Trade Agreements (FTAs)[15] containing a chapter on investment. The first such FTA, with an investment chapter, was signed with Singapore[16] in 2005. Subsequently, India entered into FTAs containing a chapter on investment with Korea,[17] Malaysia[18] and Japan.[19] Recently, India formally signed the Trade in

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13. The Full list of India"s BITs is available at <http://finmin.nic.in/bipa/bipa_index.asp?pageid=2> accessed on 2 July 2014.
14. India's BITs enforced after 2004 are with the following countries – Turkmenistan, Turkey, Serbia, Armenia, Sudan, Hungary, Bahrain, Saudi Arabia, Bosnia & Herzegovina, Slovak Republic, China, Jordan, Trinidad & Tobago, Hellenic Republic, Mexico, Iceland, Macedonia, Brunei Darussalam, Syria, Myanmar, Senegal, Mozambique, Latvia and the, United Arab Emirates.
15. In India, these FTAs are known as Comprehensive Economic Cooperation/Partnership Agreements – CECAs or CEPAs.
16. India-Singapore Comprehensive Economic Cooperation Agreement (signed 29 June 2005, entered into force 1 August 2005) available at <http://www.fta.gov.sg/fta_ceca.asp?hl=6> accessed on 7 March 2015.
17. India-Korea Comprehensive Economic Cooperation Agreement (signed 7 August 2009, entered into force 1 January 2010) available at <http://commerce.nic.in/trade/india%20korea%20cepa%202009.pdf> accessed on 7 March 2015.
18. Comprehensive Economic Cooperation Agreement between India and Malaysia (signed 18 February 2010, entered into force 1 July 2011) available at <http://commerce.nic.in/trade/IMCECA/title.pdf> accessed on 7 March 2015.
19. Comprehensive Economic Partnership Agreement between India and Japan (signed 16 February 2011, entered into force 1 October 2011) available at <http://commerce.nic.in/trade/IJCEPA_Basic_Agreement.pdf> accessed on 7 March 2015.

Services and Trade in Investment Agreement with the Association of Southeast Asian Nations (ASEAN).[20] India is in the process of negotiating many FTAs with investment chapters with the European Union (EU), the European Free Trade Association (EFTA), Thailand, New Zealand and Australia.[21] India is also negotiating a BIT with the US.[22] Thus, currently, India's investment treaty programme stands on two legs – with both stand-alone investment treaties (BITs) and investment chapters in Free Trade Agreements (FTAs).[23]

India's stand-alone BITs are based on India's earlier model BIT,[24] which contains many substantive and procedural assurances for the protection of foreign investment, with scant exceptions, reservations and carve-out provisions. These stand-alone Indian BITs resemble the European-style lean BITs developed by capital-exporting countries of Western Europe to safeguard their investments in developing countries. This shows that India has primarily been a rule-taker in international investment law.

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20. Press Information Bureau, Government of India, India Formally Signs Trade in Services and Trade in Investment Agreement with ASEAN (9 September 2014) available at < http://pib.nic.in/newsite/PrintRelease.aspx?relid=109489> accessed on 7 March 2015.
21. Economic Survey (2013-14), 133. The list of India's current engagements in RTA is available at <http://commerce.nic.in/MOC/international_trade_agreements_current.asp> accessed on 7 March 2015.
22. Sanjay Jog, (2014), "Bilateral Investment Treaty Between US and India to transform Economic Relations, says US Official" *Business Standard* (15 November 2014) <http://www.business-standard.com/article/current-affairs/us-india-to-soon-restart-talks-on-bilateral-investment-treaty-says-us-official-114111401181_1.html> accessed on 1 December 2014; Prabhash Ranjan, (2015), "Reviving the Indo-US BIT Dialogue" *The Financial Express* (26 January 2015) <http://www.financialexpress.com/article/fe-columnist/reviving-the-indo-us-bit-dialogue/34946/> accessed on 5 March 2015.
23. Prabhash Ranjan, (2011), "Object and Purpose of Indian Investment Agreements: Failing to Balance Investment Protection and Regulatory Power" in Vivienne Bath and Luke Nottage (eds.), *Foreign Investment and Dispute Resolution: Law and Practice in Asia* (Routledge, London 2011) p. 192.
24. Indian Model Text of Bilateral Investment Promotion and Protection Agreement, Ministry of Finance, <http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA.asp?pageid=1> accessed on 7 March 2015.

III. India's decision to revisit BITs

After negotiating and signing such stand-alone BITs for almost two decades, recently, India decided to put all on-going BIT negotiations on hold[25] after a spate of BIT arbitration notices were issued to India by many foreign corporations. Towards the end of 2011, an arbitral tribunal in *White Industries v. India*[26] found that India violated its obligations under the India-Australia BIT.[27] Much has already been written about this award[28] and hence this paper does not discuss the award. Suffice to say that this award is significant because it is the first known ITA award against India holding the country responsible for violating international law on foreign investment. This case resulted in greater demands on India to revisit its BIT programme.[29]

25. Shutapa Paul, (2013), "Cornered Government Puts all BIPA Negotiations on Hold," *The New Indian Express* (23 March 2013); Sujay Mehdudia, (2013), "BIPA Talks Put on Hold" *The Hindu* (22 January 2013). An exception to this was India's BIT with UAE, which was negotiated and signed in 2013 and enforced in 2014, despite the decision to put all ongoing BIT negotiations on hold – see Kavaljit Singh, (2014), "Assessing India's Bilateral Investment Protection Agreement with UAE" Madhyam (27 October 2014)<http://www.madhyam.org.in/assessing-indias-bilateral-investment-protection-agreement-uae/> accessed 20 November 2014. Also, India continues to negotiate FTAs with investment chapters. For example, see the recent joint statement of Prime Ministers of India and Australia renewing support for an early conclusion of the India-Australia FTA (5 September 2014) <http://www.pm.gov.au/media/2014-09-05/joint-statement-prime-minister-modi-new-delhi-india> accessed on 7 March 2015.
26. *White Industries Australia Limited v. Republic of India*, UNCITRAL, Final Award, 30 November 2011.
27. Agreement between India and Australia on The Promotion and Protection of Investments (signed 26 February 1999, entered into force on 4 May 2000).
28. See Prabhash Ranjan, (2012), "The White Industries Arbitration: Implications for India's Investment Treaty Programme" (2012) 2 (3) *Investment Treaty News*, 13; Manu Sanan, (2012), "The White Industries Award: Shades of Grey" (2012) 13(4) *Journal of World Investment and Trade*, p. 661; P Nacimiento and S Lange, (2012), "White Industries Australia Limited v. Republic of India" (2012) 27(2) *ICSID Review: Foreign Investment Law Journal*, p. 274.
29. See Biswajit Dhar, Reji Joseph and T C James, (2012), "India's Bilateral Investment Agreements: Time To Review" (2012) XLVII *Economic and Political Weekly*, p. 113; Smitha Francis and Murli Kallummal, (2013), "India's Comprehensive Trade Agreements: Implications for Development Trajectory" (2013) 48 (31) *Economic and Political Weekly*, p. 109; Prabhash Ranjan, (2013), "More than BIT of a Problem" *The Financial Express* (27 April 2013).

Civil society organisations (CSOs) also started demanding that India should review its existing BIT programme.[30] CSOs argue that the threat of BIT arbitration, in the long run, "will have a chilling effect on the ability of different ministries (of the Indian government) to regulate different social and economic needs."[31]

This was followed by a number of foreign corporations slapping ITA notices against India – Vodafone has issued an arbitral notice to India under the India-Netherlands BIT for retrospective taxation measures;[32] Germany's Deutsche Telekom has issued a notice of arbitration to India under the India-Germany BIT over a cancelled satellite venture;[33] ByCell, another foreign investor, has issued an arbitral notice against India under the India-Cyprus BIT for withdrawal of approval to grant telecom licences;[34] Devas Multimedia has also issued an arbitration notice against India under the India-Mauritius BIT.[35]

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30. An open letter to the Indian Prime Minister on India-US BIT <http://www.madhyam.org.in/admin/tender/August_7_Letter_to_PM%20(1).html> accessed on 26 August 2014.
31. Letter written by many civil society organisations to the Indian Prime Minister expressing concerns about India's BITs <http://donttradeourlivesaway.files.wordpress.com/2012/06/civil-society-letter-on-us-india-bit.pdf> accessed on 2 July 2014.
32. *Vodafone v. India*, United Nations Commission on International Trade Law (UNCITRAL, Notice of Arbitration (not public), 17 April 2014 <http://italaw.com/cases/2544> accessed on 7 March 2015. Also see "Vodafone Seeks Arbitration in India Tax Dispute" BBC News Business (8 May 2014) <http://www.bbc.com/news/business-27321208> accessed on 7 March 2015.
33. *Deutsche Telekom v. India*, ICSID Additional Facility, Notice of Arbitration (not public), 2 September 2013 <http://italaw.com/cases/2275> accessed on 7 March 2015. Also see "Breaking: A New Treaty Claim against India. Yet Again!" *Lex Arbitri – The Indian Arbitration Blog* (1 November 2013) <http://lexarbitri.blogspot.in/2013/11/breaking-new-treaty-claim-against-india.html> accessed on 7 March 2015.
34. *Bycell (Maxim Naumchenko, Andrey Polouektov and Tenoch Holdings Ltd) v. India*, Notice of Dispute (not public) <http://italaw.com/cases/1933> accessed on 7 March 2015. Also see Shauvik Ghosh, "Now, ByCell threatens Government with International Arbitration" Livemint (18 July 2012).
35. *CC/Devas (Mauritius) Ltd., Devas Employees Mauritius Private Limited and Telecom Devas Mauritius Limited v. India,* UNCITRAL <http://italaw.com/cases/1962> accessed on 10 October 2014. For a list of cases where arbitration notice has been issued against India, see Investment Treaty Arbitration, Respondent State, India <http://www.italaw.com/cases-by-respondent?field_case_respondent_tid=622> accessed on 10 October 2014.

On the basis of these notices, India seems to have come to the conclusion that the current investment treaty regime unfairly restricts the sovereign right of the host state to exercise their regulatory power.[36] India is of the view that investment treaties have been used as tools for reviewing not just regulatory measures of general application, such as environment and public health, but also decisions handed down by the highest court of the land.[37] Consequently, India has decided to review its BITs by examining each treaty individually in order to assess its provisions.[38] The objective behind this review is two-fold: first, to comprehend and find the legal/policy challenges from the existing BITs to India's regulatory power; and second, to revise the Indian model BIT.[39]

IV. India's future BIT practice

In 2015, India adopted a new model BIT. The 2015 model BIT replaces the 2003 model treaty and heralds a new era in India's engagement with foreign investment. In early 2015, the government had unveiled the draft of the new model BIT for comments. The draft model failed to balance protection of foreign investment with India's right to regulate and was diametrically opposed to government's pet projects to woo foreign investors like 'Make in India.' The 20th Law Commission of India, in its 260th report, recommended to the government to amend many provisions in the draft model BIT.

One does not know whether the recommendations of the Law Commission were taken into account in revising the draft model BIT. While the final model BIT retains many things from the draft model such as

36. Statement by India at the World Investment Forum 2014, UNCTAD available at <http://unctad-worldinvestmentforum.org/wp-content/uploads/2014/10/Mayaram.pdf> accessed on 21 October 2014.
37. Ibid.
38. Ibid.
39. Ibid. Also see Press Information Bureau Press Release, "Bilateral Investment Treaties" (6 May 2013) <http://pib.nic.in/newsite/erelease.aspx?relid=95593> accessed on 21 August 2014; S Mehdudia, (2013), "BIPA Talks Put on Hold" *The Hindu* (21 January 2013); "Government to Review Bilateral Treaties To Avoid Legal Battle with Telcos" *The Indian Express* (13 April 2012); V Beniwal, "Centre Mulls Renegotiating Bilateral Investment Pacts" *The Business Standard* (23 July 2012).

excluding subsidies and taxation from the purview of the treaty, some changes have been made. For instance, in the draft model, the provision on expropriation recognised that host state can expropriate investment indirectly. However, proving this required not just permanent and complete deprivation of foreign investment but also transfer of the value of foreign investment to the expropriating country or its agency. Indirect expropriation is rarely accompanied by appropriation of the value of investment by State. Consequently, this would have made it almost impossible for foreign investors to prove indirect expropriation even when there was substantial deprivation. The final model has done the right thing by removing the requirement of appropriation of value of investment and limiting the test of indirect expropriation to substantial or permanent deprivation of foreign investment.

On definition of investment, the final model has retained the 'enterprise' based definition of investment. Thus, only foreign enterprises legally constituted in India can bring a BIT claim. However, a welcome change is that the final model has done away with the requirement that only those foreign enterprises that have real and substantial business operations in India, which included proving the undefined requirement of engaging a 'substantial number of employees', could benefit from treaty protection. This would have knocked out a large part of foreign investment from the ambit of treaty protection and thus diluted its significance.

A key feature of the model BIT, like the draft model, is an exhaustive general exceptions clause that allows host State to deviate from protection of foreign investment to meet other compelling public policy objectives such as public health. However, the model BIT has not made this provision 'self-judging.' Accordingly, any such regulatory measure is subject to arbitral review. This is in consonance with the Law Commission's suggestion and reconciles investment protection with host State's right to regulate.

The model BIT, like the draft version, does not have the most favoured nation (MFN) provision – a cornerstone of non-discrimination in international economic relations. The absence of the MFN provision is a direct consequence of India loosing the dispute to White Industries in 2011. White Industries used the MFN provision to import a beneficial

provision from India-Kuwait BIT into India-Australia BIT. The use of the MFN provision by foreign investors for such purposes is a genuine concern. However, as the Law Commission had suggested, the objective to disallow treaty shopping can be achieved by restricting MFN's applicability to actual cases of discrimination in application of domestic measures. Throwing the baby out with the bathwater might send negative signals to foreign investors.

On certain issues, such as issuance of compulsory licenses (CL), the language in the draft model BIT was better but has been changed in the final model. The draft model BIT provided that issuance of compulsory licenses (CL) (such as a CL being issued on a patented drug) would be outside the ambit of the treaty, if such issuances were consistent with domestic law. In the final model BIT this has been changed to issuance of CL being outside the BIT provided such issuance is consistent with the WTO treaty. Assuming a foreign pharmaceutical company was to challenge issuance of CL, which has been upheld by Indian courts, before a BIT tribunal. Under the draft model BIT, the tribunal would give deference to the decision of the Indian courts because Indian courts are better placed to judge issues of compliance with domestic law. However, under the final model BIT, the tribunal will have the jurisdiction to examine whether the CL has been issued in accordance with WTO's agreement on trade related aspects of intellectual property rights (TRIPS). The tribunal will be less deferential to Indian courts because here the issue is compliance with international law. Apart from concerns such as whether investment tribunals have the capacity to judge such questions, this will, unnecessarily, expose India's patent laws to international judicial scrutiny. Surely India does not want this as it runs the risk of opening a Pandora's box on extremely sensitive and contentious issue of intellectual property protection.

The adoption of the model BIT is just the first step. The government now needs to think about the future course of action. Since the 2015 model BIT gives more room for host State's regulatory power, whether India will use this model to renegotiate existing BITs with countries where it is a net capital importer or whether it will be used to renegotiate all BITs? Also, what impact will this have on the ongoing India-US BIT negotiations because India's model is different from the 2012 US model BIT? The US model includes MFN, recognises that taxation

measures could result in expropriation, does not have either an enterprise-based definition of foreign investment or an exhaustive general exception clause.

V. Conclusion

India's BIT practice is on the verge of undergoing massive transformation if the new model BIT is anything to go by. One concedes that the role of BITs in attracting foreign investment should not be exaggerated. Nevertheless, BITs act as a 'signaling device' to foreign investors about congenial investment environment. This is more so for a country like India, which is ranked abysmally low at 142, out of 189 economies, in the World Bank's index of ease of doing business. India's current BITs fail to balance investment protection with host country's right to regulate and thus, India's new BIT practice should aim at striking a balance between these two compelling objectives rather than going to the other extreme, as the draft model BIT does. Also, India's BIT practice should be developed keeping in mind the fact that there are many Indian companies investing abroad who would need an effective treaty framework to safeguard their investment when subjected to arbitrary state action overseas.

Indonesia's Perspective on Review of International Investment Agreements

Abdulkadir Jailani

Introduction

Following the contemporary discourse surrounding international investment agreements (IIAs), Indonesia is currently undergoing a thorough review of its 64 bilateral investment treaties (BITs) as well as five investment chapters under various free trade agreements (FTAs).[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 fine-tuned in favor of its interest in pursuing national development goals. Within this context, Mrs. Retno Marsudi, Indonesia's Minister for Foreign Affairs, specifically emphasized in her 2015 Annual Press Statement that economic diplomacy carried out by Indonesia will also aim to create a new regime for investment agreements between Indonesia and other countries.[2] This paper attempts to share the Indonesian experience in undertaking such an intention.

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 to Indonesia and also to introducinge a simplified permit procedure for foreign investors. See Annual Press Statement of the Minister for Foreign Affairs of the Republic of Indonesia, 8 January 20105. Available at http://www.kemlu.go.id/Documents/PPTM%202015/PPTM%202015%20ENG%20FINAL%20PDF.pdf

With this in mind, this paper 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 paper will also attempt to present a set of critical outlooks regarding some outstanding issues that appear during the review.

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, International Institute for Sustainable Development (IISD) and United Nations Conference on Trade and Development (UNCTAD).[3]

Second, most provisions of the existing IIA 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 for states to exercise their regulatory and policy space.[4]

Third, one of Indonesia's greatest concerns regarding IIAs is the provision of the 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

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-modelsja-karta-report-2015.pdf (Accessed on 6 April 2015).
4. Losari, J.J. and Ewing-Chow, M. (2015), "Reflective or Reactionary? Indonesia's Approaches to International Investment Agreements and Recommendations for the Future," *Transnational Dispute Management*, Vol. 12 (1), p. 4.

their benefits are far from clear. They also create uneven playing fields 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 encouraged by a billion-dollar lawsuit by the UK-listed Churchill Mining and a frivolous claim arising from a bail-out following the collapse of a private bank (*Rafat Ali Rizvi v. Indonesia*).[6] Because of this, Indonesia's then-President, Mr. Susilo Bambang Yudhoyono, stressed that the Government will 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 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 may possibly

5. Indonesia has the highest number of ISDS cases among ASEAN member states, which amount to six cases to date. The Philippines comes in second place among ASEAN member states 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 claims came to the surface. The claim – which arose under the Indonesia-UK IIA made by the investor – was deemed frivolous, or not having legal merit, by the 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/sbyfrets-over-int-l-arbitration.html.
8. Jan Knoerich and Axel Berger, (2014), "Friends or Foes? Interactions between Indonesia's International Investment Agreements and National Investment Law," Studies (Bonn, Deutsches Institut fur Entwicklungspolitik), p. 7.

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 be safely assumed that Indonesia has not lost faith in IIAs in general. Indonesia merely intends to modernize and 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 reexamined. The new investment regime should aim to foster investments that do not only reap benefits for the host state but also contribute to the overall development of that particular state. Such review processes also include the need to place procedural and substantive restraints on foreign investors from lodging international claims against Indonesia.

The review process

The review process is undertaken through three steps: namely, the discontinuation of existing IIAs, reassessing the provision of the existing IIAs and developing a new IIA treaty model. In pursuing those steps, Indonesia's Government 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 17 out of 64 IIAs.[10] It is important to underline that this discontinuation process is being done gradually by means of discontinuing IIAs that are due to expire according to the requirement period set in the termination clause of

9. Ibid., p. 78.

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 Viet Nam.

the IIA, 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.

This 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 the agreement 'by- the-book' according to the provisions set in the agreement, which was of course agreed bilaterally, Indonesia need not be concerned about such a backlash.

However, during the review process, there has been an emphatic call to look at this approach again. As the ripe periods of many IIAs concluded by Indonesia would be many years to come, such as the Indonesia-Russia IIA that will end in 2024, it has been suggested that Indonesia should consider an earlier discontinuation. If its counterpart disapproves 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, although the period of validity of these IIAs still remains in place for a long time.

The second step that Indonesia has taken completely relates to the fact that the core gravity of the review is the reassessment of the existing provisions. Every single IIA is dissected to find the most problematic provisions such as the 'scope' and 'definition of investment,' the 'Most-Favored-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 that will serve as the Government's new position on IIAs. The assessment particularly looks into the extent to which those provisions provide protection to investors and its impact to the policy space of the Government.

11. '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 ten years.

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 had 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 envisage 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 create less flexibility in negotiations.

Challenges of IIA review

Conducting an all-encompassing review of the whole IIA regime proves to be a very challenging endeavor. We have identified a number of challenges, ranging from concerns about scaring off investors to the more technical challenge of how to further address the survival clause issue. The detailed explanation of each challenge is as follows:

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. Indonesia's Government 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 confirmed that the review process will 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]

12. Kavaljit Singh, "The very model of a modern Indian investment treaty." Available from http://www.eastasiaforum.org/2015/02/06/the-verymodel-of-a-modern-indian-investment-treaty/. Southern African Development Community Model (http://www.iisd.org/itn/wpcontent/uploads/2012/10/sadc-model-bit-templatefinal.pdf, accessed on 7 April 2015).
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/wpcontent/uploads/2014/10/Wibowo.pdf (accessed on 6 April 2015).

It is a matter of fact 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 (FDI) to Indonesia hit a record high of US$78.7 trillion, according to the latest data by the Indonesian Investment Coordinating Board (BKPM).[14]

Balance between protection of investors and preserving policy space for states

The second challenge that comes to the fore is the question about 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 the balance between the two interests. Yet, it is indeed a complicated task, as the interest of investor protection and policy preservation seem to be irreconcilable.

The temptation to include broadly drafted clauses on public policy exceptions is very obvious among the policy-makers. 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 were 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 IIA as an instrument in attracting higher amounts of foreign investment.

Nevertheless, this concern has also been questioned on the basis of two strands of arguments. First, the assumption that IIA will increase FDI inflow in many countries, including in Indonesia, is empirically disputed. Therefore, the existence of such clauses should not correlate

14. Badan Koordinasi Penanaman Modal, "Foreign Direct Investment in Indonesia Hit Record High in 2014." Available from http://www.indonesia-investments.com/news/newscolumns/foreign-direct-investment-in-indonesia-hit-recordhigh-in-2014/item5262 (accessed on 6 April 2015).

with FDI. 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 in setting out legitimate regulations of the activities of the 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 could not 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 altogether with all chapters of those FTAs or EPAs. Article 44 (1) of the Vienna Convention on the Law of Treaties clearly provides that the 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 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. However, the problem does not lie in the technical context. Discontinuing the whole chapters of FTAs or EPAs will certainly require much more extensive consideration of wider bilateral relations, 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 should include a clause allowing partial termination of a chapter, particularly the investment chapter.

Survival clause

One of the most interesting notions in reviewing and discontinuing IIAs is that the IIA will not necessarily cease to have any effect on the existing investments, even after they have been discontinued, due to a provision commonly known as the 'survival clause.' This clause allows foreign investors, who have had their investments made or acquired prior to the date of termination, to enjoy prolonged protection for a certain amount of time (usually 10 to 15 years) even after the treaty has been terminated.

The clause has posed substantial challenges during the review process. It means that all possible legal risk posed by the discontinued IIAs will remain intact, despite the fact that the treaty is not in force anymore. Thus, the question of the survival clause needs to be assessed and revised with a view to shortening the time period of such a clause. Also, particular consideration of different survival clause durations for different sectors of investment needs to be taken.

Challenge of drafting a treaty model

The review process envisages development of an IIA model that 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] That being said, 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 to this process. First, due to the vast number of stakeholders involved in drafting the model, a model will take a long time to develop. Second, by having a basic text, we are somehow reducing our flexibility in negotiations.

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.

Different counterparts 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 negotiation 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 negotiation.

In addressing this challenge, Indonesia is now considering developing a set of basic elements of a position that would be translated by an illustrative model treaty. Therefore, the illustrative model treaty in one way or another can be modified during negotiation, bearing in mind that some fundamental principles shall be strictly upheld and are off-limits to any kind of compromise.

Most outstanding issues

The review process undertaken by Indonesia has addressed almost all the common provisions included in IIAs. Yet, the most outstanding issue in the review process is the ISDS. In spite of this, excluding ISDS provisions altogether might not be a wise approach. Therefore, Indonesia considers 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 very essential, as it will determine the scope of the protection rendered under the IIA. A narrower definition of investment will also narrow down the possible number of cases brought via the ISDS mechanism. Therefore, the review has led Indonesia to reform its position into a more limitative definition (a combination between an asset-based and enterprise-based approach that 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. By doing so, not all investments may enjoy benefits under an IIA unless such investments also contribute to national development of the host state.[16]

16. *Salini Costruttori SpA and Italstrade SpA v. Morocco* (ICSID Case No. ARB/00/4). Available from http://www.italaw.com/cases/958 (accessed on 6 April 2015).

Furthermore, the current scope of the National Treatment (NT) clause also needs to be reduced. The NT clause in existing IIAs by Indonesia 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 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 right to enter Indonesia and make investments in any sector on the same terms as domestic investors.[17] The clause provides both protection and liberalization undertakings. Having said that, 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 special treatment in favor of domestic small- and medium-sized enterprises. measures affecting certain sectors related to development needs, pa ticularly natural resources and sectors that have close ties to nation security.

Likewise, restricting the scope of Most-Favored-Nation (MFN) clause is also necessary for limiting the possible application of ISDS. The MFN clause in existing IIAs that Indonesia is party to 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 include:

- pre-establishment measures;
- any existing or future regional FTAs and EPAs;

17. Organisation for Economic Co-operation and Development (OECD), 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.

- existing and future IIAs;
- ISDS provisions; and
- any preferential system for any least-developed countries.

The inclusion of the clause on Fair and Equitable Treatment (FET) has brought about a high degree of unpredictability, particularly with respect to ISDS. In that regard, the FET clause has been numerously and successfully used by investors as a basis of their claim against states.[18] The FET clause was initially introduced to provide a just and equal treatment to foreign investors, as if they were domestic investors. However, due to its over-extensive 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 favor 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 the 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 were made regarding the fact 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 investors and/or investment.

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 US$935 million plus interest, the second highest known award in history. See UNCTAD, (2014), *"Recent Developments in Investor-State Dispute Settlement,"* IIA Issues Note No. 1, April 2014, p.10, available at http://unctad.org/en/publicationslibrary/webdiaepcb2014 d3_en.pdf.
19. UNCTAD, *"Fair and Equitable Treatment,"* p.3. Available from http://investmentpolicyhub.unctad.org/Upload/Documents/PACER_6%20Fair%20and%20Equitable%20Treatment.pdf.

As far as expropriation is concerned, Indonesia still maintains the clause of expropriation. In that regard, a distinction is made between direct expropriation, and indirect expropriation, which is entirety excluded.

Direct expropriation shall only be made for the purpose of public interest and shall be carried out with due process of law and followed by prompt and adequate compensation. Yet, 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 the provision on indirect expropriation. This also means that any measures that have effect or consequences that amount to expropriation shall be excluded from the clause of direct expropriation. This is done to preserve a greater degree of regulatory space for Indonesia to pursue its development goals without facing the legal risk of challenges through the ISDS mechanism.

Procedural limitation

Imposing procedural limitations is a useful way to minimize the legal risk of ISDS. In most IIAs, the host states have already given their consent that an investor may bring any dispute against the host state to

20. Indirect expropriation in principle include 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, (2012), "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.

international arbitration without requiring further consent from the host state. This is also the case in Indonesia's IIAs.[21] The approach has become a grave concern for Indonesia as it will pose great legal risk to the country. As a solution to this legal risk, Indonesia is considering introducing separate consent requirements 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 settle the case through arbitration. A special agreement to settle a dispute through international arbitration would be required on a case-by-case basis. This approach would be expected to cut down 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 resolutions.

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 provisions and the development of a new IIA model. The effort has met several challenges, including whether the review will scare off investors, how to strike the 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 focuses 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

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 either to the judicial procedures provided by the Contracting Party concerned or to international arbitration or conciliation."

by Indonesia will require a special agreement between the investor and Indonesia for bringing a case to international arbitration.

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 urgently needed to further fine-tune Indonesia's new approach, which will be crystallized in the new treaty model.

Assessment of Indonesia's Recent Investment Policies and Recommendations for its International Investment Agreements

Junianto James Losari and Michael Ewing-Chow

I. Introduction

Indonesia's announcement to terminate more than 60 bilateral investment treaties[1] (BITs) has triggered mixed reactions from academics and the business community around the world. There has been speculation that this is a knee-jerk reaction by Indonesia's government, which has recently faced several investor-state arbitration cases.[2]

In fact, the announcement reminds us of the actions of several other

1. Ben Bland and Shawn Donnan, "Indonesia to terminate more than 60 bilateral investment treaties," *Financial Times* (26 March 2014) http://www.ft.com/cms/s/0/3755c1b2-b4e2-11e3-af92-00144feabdc0.html#axzz35Qatebp7.
2. *Rafat Ali Rizvi v. Republic of Indonesia*, ICSID Case No. ARB/11/13, Award on Jurisdiction, 16 July 2013 [Rafat Ali v. Indonesia]; *HeshamTalaat M. Al-Warraq v. Republic of Indonesia*, UNCITRAL Arbitration, Final Award, 15 December 2014; Churchill Mining PLC, ICSID Case No. ARB/12/14, Decision on Jurisdiction, 24 Feb 2014 [*Churchill Mining v. Indonesia*]; *Planet Mining Pty Ltd v. Indonesia*, ICSID Case No. ARB/12/40, Decision on Jurisdiction, 24 Feb 2014 [*Planet Mining v. Indonesia*].

governments that have terminated BITs[3] or denounced the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention)[4] in order to reduce their legal exposure to international claims before arbitral tribunals. In contrast, statements from Indonesian government officials suggest that they are going through a review of the country's BITs by letting the old ones lapse so that new and better ones can be renegotiated. This is mainly because the old ones were concluded when the investment policy landscape was very different.[5]

To set the context, Indonesia is a major market with a population of more than 240 million people and a robust natural resources sector that contributed to one quarter of its Gross Domestic Product (GDP).[6]

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3. Lendi Kolver, "SA proceeds with termination of bilateral investment treaties," *Engineering News* (21 October 2013) <http://www.engineeringnews.co.za/article/sa-proceeds-with-termination-of-bilateral-investment-treaties-2013-10-21; United States, *Federal Register*, "Notice of Termination of United States-Bolivia Bilateral Investment Treaty," 23 May 2012 <https://www.federalregister.gov/articles/2012/05/23/2012-12494/notice-of-termination-of-united-states-bolivia-bilateral-investment-treaty>; *Global Arbitration Review*, "Ecuador terminates BITs with eight LatAm states," 5 November 2008 <http://globalarbitrationreview.com/news/article/14919/ecuador-terminates-bits-eight-latam-states/>.
4. International Centre for the Settlement of Investment Disputes (ICSID), "Venezuela Submits a Notice under Article 71 of the ICSID Convention," *ICSID News Release* (26 January 2012) <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=Announcements&pageName=Announcement100; ICSID, "Ecuador Submits a Notice under Article 71 of the ICSID Convention," *ICSID News Release* (9 July 2009) <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Announcement20>; ICSID, "Bolivia Submits a Notice under Article 71 of the ICSID Convention," *ICSID News Release* (16 May 2007) <https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=OpenPage&PageType=AnnouncementsFrame&FromPage=NewsReleases&pageName=Announcement3>.
5. Mahendra Siregar, "Keynote Speech in National Seminar on Settlement of Investment Disputes: Indonesia, ASEAN, and International" (5 June 2014). Based on our interviews with several government officials, the government has held several internal meetings to draft its new model BIT.
6. Indonesian Statistic Bureau, "GDP Distribution based on Current Price 2000-2014)," <http://www.bps.go.id/tab_sub/view.php?kat=2&tabel=1&daftar=1&id_subyek=11&notab=5>. For more figures: Indonesian Investment Coordination Board (BKPM), Facts of Indonesia: Natural Resources, <http://www2.bkpm.go.id/contents/general/7/natural-resources>.

While there have been arguments that Indonesia does not need International Investment Agreements (IIAs)[7] because investment will come in due to its natural resources, as can be seen in Brazil, government officials seem conscious that the Brazilian example does not reveal the counterfactuals.[8] That is, Brazil potentially could have received even more foreign direct investment (FDI) if it had had IIAs in place. Some economists have also shown direct correlations between the presence of IIAs and higher premiums paid by foreign investors from essentially similar investments in countries without any IIA.[9] The United Nations Conference on Trade and Development (UNCTAD) suggests that this reflects the potential contribution of IIAs to coherence, transparency, predictability and stability of the investment frameworks of host countries.[10]

In this paper, we will first explore whether the previous cases facing Indonesia before investor-state arbitration tribunals can provide inputs to Indonesia's new model BIT. We will also analyze the issues that have been facing Indonesia with regard to its investment policies and investor-state arbitrations. Then, we will suggest the policies for Indonesia to consider, as well as options for drafting its future IIAs to deal with some of the issues at stake.

II. Lessons from jurisprudence and Indonesia's problems

Indonesia has been a party in at least six investor-state arbitration disputes before ICSID, as can be seen in Table 1. This involvement has increased only recently. Indonesia has not lost many cases nor did it have to pay substantial amounts of compensation to the investors. The

7. IIAs refers to investment agreements in general that include BITs, regional investment agreements, and investment chapters in free trade agreements (FTA).
8. Siregar, supra note 85.
9. Srividya Jandhyala and Robert J. Weiner, "*Institutions sans frontières*: International agreements and foreign investment" (2014) 45 *Journal of International Business Studies*, 650. Jandhyala and Weiner examine data for sale of petroleum assets in 45 countries and find that multinational enterprises (MNEs) pay significantly higher amounts for those protected by IIAs than similar but unprotected assets; see also UNCTAD, *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries* (UN 2009), p. 24-26.
10. UNCTAD, supra note 12 9.

cases below reflect some of the difficulties that foreign investors often face when they invest in Indonesia.

In this section, we identify three main problems, namely: a) the desentralisasi system (similar to a federal system); b) corruption and due process issues; and c) the lack of capacity and coordination within the government.

Table 1: Indonesia's Involvement in Cases before ICSID

Case Name	Disputed Matter	Winning Party	Awarded Damages (if any)
Amco Asia v. Indonesia (re-submitted after annulment)	Lease and Management Agreement and investor's license to manage a hotel	Investor	US$2,696,330
Cemex Asia v. Indonesia	Shares and an option to purchase shares in a state-owned company	Settled between the parties	
East Kalimantan v. PT Kaltim Prima Coal	Divestment requirement in the concession contract	The tribunal declined jurisdiction	
Rafat Ali v. Indonesia (Jurisdiction)	Shares, loans and financing agreements in several banks	The tribunal declined jurisdiction	The case is being submitted to the ICSID Annulment Committee. Claim by Rafat Ali totaled $75 million
Churchill Mining v. Indonesia *Planet Mining v. Indonesia*	Exploration and exploitation licenses over a Coal Project Area	The tribunal found jurisdiction and the case is ongoing. Claim of Churchill Mining totals $1.05 billion	
Newmont v. Indonesia[11]	Export ban of raw minerals	Registered with the ICSID Secretariat on 15 July 2014. Withdrawn on 25 August 2014	

11. *Nusa Tenggara Partnership B.V. and PT Newmont Nusa Tenggara v. Republic of Indonesia*, ICSID Case No. ARB/14/15, registered on 15 July 2014, withdrawn on 25 August 2014.

A. *Desentralisasi*: a constitutional pathology

Cemex Asia v. Indonesia, *Churchill Mining v. Indonesia*, *Planet Mining v. Indonesia*, and to a certain extent, *East Kalimantan v. PT KPC* reflect the difficulty that the central government often faces when dealing with the regional governments or other organs of the government. This problem becomes greater with the desentralisasi system, which is similar to the federal system and provides for the delegation of authority from the central government to regional governments.[12] Despite its good goals, the implementation of desentralisasi has been problematic due to lack of coordination between the central and regional governments.[13]

B. Corruption and due process issues

Indonesia was ranked 114th out of 175 countries in the Corruption Perception Index 2013.[14] This is the case partly because there is a lack of transparency, leaving lots of matters to the discretion of certain government officials. For example, Foxconn (a major electronic manufacturing company) recently planned to invest in Indonesia. This was lauded by the government (President) as a step towards Indonesia's value added industrialization.[15] Unfortunately, however, Foxconn decided to postpone its investment due to the lack of clarity in the country's procedures. This undermines the rule of law in Indonesia, and it is reflected in the rule of law index below.

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12. Constitution of the Republic of Indonesia (second amendment), Article 18(2); Law No. 22 of 1999 on Regional Governments as amended by Law No. 32 of 2004, as amended by Law No. 23 of 2014.
13. Directorate of Regional Autonomy (National Planning and Development Institution), *Analysis of Formulating Mid-term Policies in Revitalizing Decentralization and Regional Autonomy Processes 2010-2014 (Kajian Perumusan Arah Kebijakan Jangka Menengah Bidang Revitalisasi Proses Desentralisasi dan Otonomi Daerah Tahun 2010-2014)* (Badan Perencanaandan Pembangunan Nasional 2009) IV-80 - IV-85.
14. Transparency International, "Corruption Perception Index 2013," <http://www.transparency.org/cpi2013/results>.
15. "Foxconn is confused when Investing in Indonesia (*Foxconn Kebingungansaat Berinvestasi di Indonesia*)" Tempo: 26 April 2014 <http://www.tempo.co/read/news/2014/04/26/090573337/Foxconn-Kebingungan-Saat-Berinvestasi-di-Indonesia>.

Table 2: World Justice Project's 2014 Rule of Law Index for Indonesia

Factors	Scores	Global Rankings
Limited government powers	0.64	31/99
Absence of corruption	0.36	80/99
Order and security	0.77	42/99
Fundamental rights	0.54	65/99
Open government	0.54	29/99
Regulatory enforcement	0.52	46/99
Civil justice	0.47	67/99
Criminal justice	0.37	71/99

Source: Rule of Law Index, World Justice Project, 2014.

C. Lack of capacity and coordination

By June 2013, Indonesia was a party to more than 60 BITs.[16] However, it appears that not all government officials understand the commitments they have made under these agreements. The recent export ban of raw minerals is a good example. We do not take a position here on whether the measure is lawful because we recognize that the government should have policy space to regulate matters in its own territory. However, Indonesia could have managed the passing of the new regulations better.

The issuance of the obligation to domestically process and refine raw materials prior to exportation can be traced back to 2009.[17] However, the details about the obligations only appeared in 2014, a couple of days prior to its implementation.[18] Press reports also suggest that the

16. UNCTAD, Full List of Bilateral Investment Agreements concluded (Indonesia), 1 June 2013, <http://unctad.org/Sections/dite_pcbb/docs/bits_indonesia.pdf>.
17. Law No. 4 of 2009 on Minerals and Coal, Article 103.
18. Government Regulation No. 23 of 2010 on the Implementation of Minerals and Coal Mining Business Activities as amended by Government Regulation No. 1 of 2014, Article 93; Regulation of the Minister of Energy and Mineral Resources No. 1 of 2014 on Increasing Mineral Value-Added through Processing and Refining of Minerals Domestically.

implementation of the export ban seems not to be sufficiently coordinated between ministries. Instead, some reporters have suggested that the Ministry of Trade has taken a wait-and-see approach, rather than actively coordinating with the other ministries, such as the Ministry of Finance (which is in charge of issuing the regulation about the export tax) and the Ministry of Energy and Mineral Resources (which issued the implementing regulation of the export ban).[19]

III. Policy recommendations

The problems that we have highlighted above could potentially result in aggravated foreign investors bringing claims against Indonesia before international arbitral tribunals. For this reason, in this section we are recommending several reforms. Within the domestic context, we suggest the government should: 1) conduct capacity building and increase coordination among its government officials; and 2) improve the management of investment disputes. On the other hand, we recognize that the government has the legitimate right to regulate within its territory. Since Indonesia is reassessing its BITs, we suggest: 3) refinement of its future investment agreements; and 4) preservation of the investor-state dispute settlement mechanism (ISDS).

A. Conduct capacity building and increase coordination

Indonesia needs to build the capacity of its officials, not only in litigating investor-state arbitration cases, but also in appreciating the legal ramifications of regulations affecting investments at all levels. Prior to implementing a measure – either by central or regional governments – that may affect foreign investors, the government should make its policy goals clear and conduct an assessment of the legitimacy and the

19. Fauzul Muna, "Mineral Export: the Ministry of Trade is waiting for the Ministry of Economic Coordination regarding the Letter of Approval to Export for Freeport and Newmont (*Ekspor Mineral: Kemendagtunggu Kemenkosoal SPE Freeport and Newmont*)," Bisnis.com (20 June 2014) <http://m.bisnis.com/industri/read/20140620/44/237555/ekspor-mineral-kemendag-tunggu-kemenko-soal-spe-freeport-dan-newmont>.

legality of the measure according to Indonesia's obligations under its IIAs or other relevant instruments, including the mechanism to implement the measure. The scrutiny over the proposed measure should continue by holding public hearings with interested parties, including investors or the community that might be impacted by the measure. During this process, the government should consider the inputs and comments provided. This can effectively help to avoid disputes or at the very least prepare the government if disputes arise as a result of a necessary measure. Sometimes, it is the way things are done rather then what is done that aggravates the conflict.

The government also needs to increase coordination among the central and regional governments, as well as among all relevant ministries. This can be done by creating an online database of various regulations that a ministry or a regional government is going to implement. Then, the relevant ministry or regional government may flag this to the relevant institutions at the central level for further consultation. Where necessary, they can hold a coordination meeting to discuss the measure further prior to its implementation. This ensures that all government officials are on the same page as regards the measure's implementation.

B. Improve the management of investment disputes

While ISDS should be treated as the last resort, an alternative dispute resolution mechanism should be introduced.[20] Echandi suggests that the 'interest-based' dispute resolution – a mechanism that relies on the reconciliation of the different interests of the parties involved in a conflict – has not been used as often because of its novelty, the

20. Todd Weiler and Freya Baetens (eds.), (2011), *New Directions in International Economic Law: In Memorium Thomas Wälde* (Leiden: Martinus Nijhoff, 2011); Thomas Wälde, "Pro-active mediation of international business and investment disputes involving long-term contracts: from zero-sum Litigation to Efficient Dispute Management," (2004) 1(2) *TDM*; M. Clodfelter, "Why Aren't More Investor-State Treaty Disputes Settled Amicably?," in UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration II* (UN, 2011).

private-public nature of treaty-based disputes, and the lack of clarity and evolving nature of international investment law.[21] This does not mean that the mechanism has not existed in the past.[22]

Creating this conflict management system will be useful for Indonesia to prevent a conflict turning into a dispute before investor-state arbitration tribunals. Similarly, it is beneficial for foreign investors because their problems can be resolved more quickly, and if resolved, they can continue their investments in the country.

C. Refinement of Indonesia's IIAs

Indonesia's BIT review is timely. The clauses in Indonesia's existing BITs lack clarity and this can potentially lead to difficulties for tribunals in interpreting the provisions. It can also leave tribunals with wide discretion to interpret the provisions, thus making states feel unfairly bound by 'imposed obligations' that they did not envisage when they drafted their IIAs.

The opportunity provided by the lapsing old BITs is also one that merits deep consideration of the need to provide policy space for the government, the importance of signaling to foreign investors that Indonesia welcomes such investments, and the importance of protecting Indonesian investors when investing abroad.[23]

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21. Roberto Echandi, "Complementing Investor-State Dispute Resolution" in Roberto Echandi and Pierre Sauvé (eds.), *Prospects in International Investment Law and Policy* (CUP 2013) 277-286.
22. Ibid., 287; some examples: Office of the Foreign Investment Ombudsman, "Grievance Resolution Processes" <http://www.i-ombudsman.or.kr/eng/ogc/index.jsp?num=1&s_unit=&no>; UNCTAD, *How to Prevent and Manage Investor-State Disputes: Lessons from Peru, Best Practices in Investment for Development Series* (UN 2011).
23. Michael Ewing-Chow and Junianto James Losari, "Indonesia should not withdraw from the ICSID," *Jakarta Post* (24 April 2014) <http://www.thejakartapost.com/news/2014/04/24/indonesia-should-not-withdraw-icsid.html>.

There are several provisions that Indonesia could also look at clarifying, refining, or adding, so as to ensure that the balance is properly set, including fair and equitable treatment, expropriation, exception clauses, denial of benefits clauses, etc. This paper does not discuss the refinement in greater detail.

D. Preservation of ISDS

ISDS has often been the scapegoat of the criticisms against IIAs, including in Indonesia.[24] In particular, one scholar suggests that Indonesia should withdraw from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States based on criticisms targeted against ISDS in general.[25] We have addressed some of these criticisms in our response[26] by analyzing ICSID as one of several ISDS mechanisms available.

Some foreign investors and states often view ISDS as a fair, independent, transparent and neutral mechanism to resolve their disputes.[27] Others completely oppose such a view and claim that it is not independent and not transparent enough.[28] Nonetheless, in a relative sense: 1) ISDS mechanisms still make the host states accountable under IIAs; 2) the provisions in IIAs protect the fundamental rights of investors and ensure procedural fairness; and 3) the adjudication through ISDS in-

24. Based on interviews with several Indonesian government officials who requested to remain anonymous.
25. Hikmahanto Juwana, "'Indonesia should withdraw from the ICSID,'" *Jakarta Post* (2 April 2014) <http://www.thejakartapost.com/news/2014/04/02/indonesia-should-withdraw-icsid.html>, accessed 21 October 2014.
26. Ewing-Chow and Losari, supra note 2623.
27. Office of the United States Trade Representative, "*The Facts on Investor-State Dispute Settlement: Safeguarding the Public Interest and Protecting Investors*," 27 March 2014 <http://www.ustr.gov/about-us/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors>.
28. Marta Latek, "*Investor-State Dispute Settlement (ISDS): State of play and prospects for reform*," European Parliamentary Research Service, 21 January 2014 <http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2014/130710/LDM_BRI(2014)130710_REV2_EN.pdf>, 4-5; UNCTAD, "Reform of Investor-State Dispute Settlement: In Search of A Roadmap," (2013) *IIA Issues Note No. 2* <http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d4_en.pdf>.

volves arbitrators who are not formally connected to the parties to the dispute. This demonstrates that ISDS can contribute to the rule of law.

We believe that Indonesia's new IIAs should continue to have ISDS mechanisms, either institutional or non-institutional arbitration. The experience of other countries suggests that ISDS mechanisms, including ICSID arbitration, may actually contribute to better governance. In Mexico, after some measures by local authorities resulted in awards against the state, the central government thereafter would often cite these awards in negotiations with the local authorities about the need to comply with domestic and international legal obligations.[29] This often resulted in compromises once the local authorities realized that their position could have fiscal implications for the state. In the case of recalcitrant local authorities, it may even be possible to create a mechanism where the liability for such a breach of an investment obligation is taken from the regional budget.

IV. Conclusion

Indonesia is currently at a cross-roads with regard to its policy on IIAs. On the one hand, as a major market with significant natural resources, Indonesia looks to Brazil, which does not have any IIAs and wonders if it still needs them. And yet, Indonesia is aware that the Brazilian example does not take into account the counterfactuals. Moreover, Indonesia seeks to diversify its investment and to move gradually from receiving investments in the extractive industry to receiving investments with higher value-added activities in the country.

At the same time, most policy-makers in Indonesia would like to see the rule of law and better governance in the country. The recent election of Joko Widodo as the President of Indonesia is seen as a consolidation of this reform.[30] Indonesia also realizes it has a corruption problem and appears to see both domestic and international legal reforms as a way to address this problem.

29. This is based on on one of the authors' a conversation by one of the authors with several Mexican government officials.
30. Michael Schuman, "Indonesia's Moment: Joko Widodo's election marks a break with a dark past," *Time Magazine* (18 August 2014) 16.

The specter of looming litigation casts a chill over Indonesia's investment policies. Churchill v. Indonesia has shaken the confidence of some policy-makers in the IIA regime. The recent case of *Newmont v. Indonesia* has added to it.[31] Few civil servants would ever like to be responsible for advising governments to sign agreements that open them up to liability. The recent decision of the tribunal in *Yukos v. Russia*,[32] awarding $50 billion against Russia based on a treaty (the Energy Charter Treaty)[33] – signed, but not ratified, by Russia – must worry Indonesia. Therefore, we believe that a decision about the issues we have talked about in this paper should be made at the highest political level, and that the decision should be one that balances the need for capital for the development of Indonesia, the need to attract value-added investment into Indonesia, the need to protect Indonesian investors who are increasingly going abroad, and the need to develop good governance domestically.

We hope that a wise approach will be taken so that Indonesia will ontinue to signal its support for foreign investments and good gov- rnance by developing and negotiating IIAs that benefit both the state and foreign investors.[34] This will probably be a brave political position because inevitably, litigation will occur. However, Indonesia can mitigate the potential liabilities by refining its agreements to ensure more policy space and by developing a quick response feedback mechanism in the way that some scholars have suggested.[35] In the end, history has shown us, if anything, that fortune favors the brave.

31. *Newmont v. Indonesia*, supra note 1114.
32. *Yukos Universal Limited (Isle of Man) v. the Russian Federation*, PCA Case No. AA 227, Final Award, 18 July 2014.
33. Energy Charter Treaty, 2080 UNTS 95; 34 ILM 360 (1995).
34. Michael Ewing-Chow, Junianto James Losari, and Melania Vilarasau Slade, "The facilitation of trade by the rule of law: the cases of Singapore and ASEAN," in Jansen, M. Jallab, *Connecting to Global Market* (WTO 2014) <http://www.wto.org/english/res_e/booksp_e/cmark_chap9_e.pdf>.
35. Ibid., Echandi, supra note 241.

Brazil's Cooperation and Investment Facilitation Agreements with Mozambique, Angola, and Mexico: A Comparative Overview

Martin Dietrich Brauch

On 30 March 2015, Brazil and Mozambique signed the first Cooperation and Investment Facilitation Agreement (CIFA – the Portuguese acronym is "ACFI") based on Brazil's new model bilateral investment treaty (BIT). Brazil signed similar agreements with Angola on 1 April 2015 and with Mexico on 26 May 2015. Unlike traditional BITs, which are geared towards investor protection, the CIFAs focus primarily on cooperation and investment facilitation. They promote amicable ways to settle disputes and propose state-state dispute settlement as a backup; notably, they do not include provisions on investor-state arbitration.

CIFA negotiations were initiated in 2013. Negotiations with Malawi are reported to have been concluded,[1] but the text has yet to be published. Brazil is also negotiating with Algeria, Chile, Colombia, Morocco, Nigeria, Peru, South Africa and Tunisia.[2]

1. Brazilian Ministry of Foreign Relations. (2015, March 31). Brasil e Moçambique assinam Acordo de Cooperação e Facilitação de Investimentos. *Blog Diplomacia Pública*. Retrieved from http://diplomaciapublica.itamaraty.gov.br/22-assuntos-economicos-e-financeiros/124-brasil-e-mocambique-assinam-acordo-de-cooperacao-e-facilitacao-de-investimentos.
2. Presidency of the Federative Republic of Brazil. (2015, January). *Mensagem ao Congresso 2015*, p. 44. Retrieved from http://www.casacivil.gov.br/acesso-a-informacao/mensagem-presidencial/mensagem-ao-congresso-2015.pdf/@@download/file/Mensagem%20ao%20Congresso%202015.pdf.

While Brazil has not published a template, the texts of the CIFAs concluded allow us to draw the main lines of the new model that Brazil has been promoting in recent years.[3] Building on earlier work,[4] this article compares and provides an overview of the concluded CIFAs.

Preamble

All CIFAs have similar preambular text. The parties express their wish to deepen the bonds of friendship and the spirit of cooperation between them, broadly reaffirming their legislative autonomy and public policy space. The CIFA with Mexico brings improved language on the sovereign right to regulate investment in pursuit of national policy objectives. In all CIFAs, the parties recognize the importance of a transparent, swift and friendly investment environment. They seek technical dialogue and government initiatives to increase investments between the countries.

Strengthening the ties between private sector and government is another goal expressed. Furthermore, the parties acknowledge the "essential role of investment in the promotion of sustainable development" and other public policy objectives, and express their understanding that a strategic partnership on investment *will* bring broad benefits to both parties.

3. The text of the Brazil-Mozambique CIFA is available at http://www.itamaraty.gov.br/index.php?option=com_content&view=article&id=8511&catid=42&Itemid=280&lang=pt-BR; the text of the Brazil-Angola CIFA, at http://www.itamaraty.gov.br/index.php?option=com_content&view=article&id=8520:acordo-brasil-angola-de-cooperacao-e-facilitacao-de-investimentos-acfi-luanda-1-de-abril-de-2015&catid=42&lang=pt-BR&Itemid=280; the text of the Brazil-Mexico CIFA, upon request to the Government of Brazil.
4. Brauch, M. D. (2015, May). The Brazil-Mozambique and Brazil-Angola Cooperation and Investment Facilitation Agreements (CIFAs): A Descriptive Overview. *Investment Treaty News*, 6 (2). Geneva: IISD. Retrieved from http://www.iisd.org/itn/2015/05/21/the-brazil-mozambique-and-brazil-angola-cooperation-and-investment-facilitation-agreements-cifas-a-descriptive-overview.

Objective

The objective of the Angola CIFA is *to facilitate and foster investments*, with a view to intensifying and increasing business opportunities and activities between the parties. Different phrasing is found in the Mozambique and Mexico CIFAs, the objective of which is *cooperation* between the parties to facilitate and foster investments.

Implementation mechanisms

The national institutions of the parties and the Joint Committee created under the CIFA (described below) are in charge of implementing the agreement. They have a mandate to develop thematic agendas for cooperation and facilitation, risk reduction and dispute prevention mechanisms, amongst other instruments.

Definitions

Under the Angola agreement, domestic law regulates all definitions.

The Mozambique CIFA adopts an asset-based definition of "investment" similar to the US Model BIT: investment is "any type of asset or right owned or controlled directly or indirectly by an investor of one of the Parties in the territory of the other Party." Instead of using the characteristics of investment presented in the US Model BIT, however, the CIFA qualifies investment as having "the purpose of establishing long-lasting economy relations" and being "aimed at the production of goods and services." A non-exhaustive list of assets follows, including partnerships, enterprises, equity, property, and amounts invested in business concession rights.

The Mexico CIFA also adopts an asset-based definition of "investment" but with a list of assets based on the Canadian model BIT, including intellectual property rights. Another difference is a list of exclusions, also based on the Canadian model: government-issued debt securities, loans to a government, and portfolio investments are among excluded assets.

Under the Mozambique CIFA, "investors" may be: (i) natural persons who are nationals of the parties; (ii) legal persons structured under the law of the host state; (iii) legal persons controlled by an investor under (i) or (ii); (iv) legal persons having their headquarters and the center of their economic activities in the territory of a party; (v) natural or legal persons making an investment and authorized to do so when required by the law of a party.

In the Mexico CIFA, "investors" are natural and legal persons who are nationals of one state (including permanent residents, in the case of Brazil) and who make an investment in the other. Legal persons must both be structured in accordance with home state law and have the centre of their economic activities in home state territory. Legal persons established in a third state can also qualify if a natural or legal person of the home state controls them.

Institutional management

Joint Committee

Each CIFA creates a Joint Committee of government representatives of both parties, which is responsible for monitoring the implementation of the CIFA, discussing and sharing investment opportunities, and coordinating the implementation of the cooperation and facilitation agendas.

The Joint Committee may invite the private sector and civil society to participate when appropriate. The parties may also create *ad hoc* working groups, in which, with the Joint Committee's permission, the private sector may participate. Another function is seeking consensus and amicably resolving investment questions or conflicts.

The Angola CIFA expressly allows the Joint Committee to invite non-governmental organizations (NGOs) to deliver presentations on certain matters. It also directs the Joint Committee to define or develop a state-state arbitration procedure.

Focal Points or Ombudsmen

Each party will establish a Focal Point within the government to provide support to foreign investors, following the recommendations of the Joint Committee. The Focal Points will interact with each other and with other government authorities, recommending and reporting to the Joint Committee on measures taken to address suggestions and complaints received from foreign investors. They must supply information to the parties on investment-related legal matters and respond swiftly and attentively to their requests. Finally, they have an important role to play in preventing, facilitating, and resolving disputes.

Exchange of information

The parties commit to exchanging relevant information on business opportunities and procedures and conditions for investment, particularly by means of the Joint Committee and the Focal Points. To this end, the parties commit to sharing information that may create favourable investment conditions, such as treaties, laws and policies on various matters (investment, foreign exchange, labour, immigration), specific incentives, customs and tax regimes, statistical information on markets, available infrastructure and public services, and regional investment projects. They also agree to discuss how to strengthen investment in Public-Private Partnerships through greater transparency and swifter access to regulations. All information sharing is subject to the level of protection requested by the supplying state.

Relationship with the private sector

In the Mozambique and Angola CIFAs, the parties agree to disseminate among the pertinent business sectors information on investment, laws in force and business opportunities in the territory of the other party. They also encourage the engagement of the private sector, "as a fundamental intervener." The Mexico CIFA includes similar language, but avoids the latter term, while acknowledging the fundamental role of the private sector.

Thematic agendas

The Joint Committee has a mandate to develop thematic agendas of cooperation and facilitation in areas relevant to promoting and increasing investments. Annex I of CIFAs presents initial lists of topics and objectives, which the states will discuss with a view to achieving common understandings and entering into additional agreements.

Risk mitigation and dispute prevention

Expropriation, nationalization and compensation

The CIFAs include an article on expropriation modelled after Article 6 of the US Model BIT. Overlooking some small differences in wording, the three treaties prohibit expropriations or nationalizations of foreign investments, except: (i) for purposes and by reasons of public interest or utility; (ii) in a non-discriminatory manner; (iii) on payment of fair, adequate and effective compensation; and (iv) in accordance with the principle of due process or with due process of law. The treaties include further details on how the compensation must be calculated and paid, subject to the law of the host Party.

The language in the treaties refers only to "expropriation." While Brazil has clarified in the past that it wishes to cover only direct expropriation in its treaties, this formulation could be interpreted as including and extending to indirect expropriation.

Corporate social responsibility

According to this provision, foreign investors and investments "shall strive to carry out the highest level possible of contributions to the sustainable development of the host State and the local community." It indicates that this can be done by means of adopting "a high degree of socially responsible practices" and indicates voluntary principles and standards as a reference. These principles and standards are included in Annex II to the Mozambique and Angola treaties; in the treaty with Mexico, they were included in the main body of the text. In all CIFAs,

these principles and standards are the same: they guide businesses to engage in protecting the environment, promoting sustainable development, respecting human rights, strengthening local capacities, among other concerns. This best-efforts obligation is a first step towards establishing mandatory commitments for investors and investments.

Treatment of investors and investments

Under the Mozambique CIFA, each party, in accordance with its domestic law, commits to allow and encourage investments of the other party and to create favourable conditions for such investments. The equivalent provision in the Angola CIFA states that "each party shall promote and accept investments of investors of the other Party, and may restrict certain investments in accordance with its laws" (para. 1).

The National Treatment (NT) provision determines that "each Party, in accordance with the applicable law, shall allow the investors of the other Party to establish investments and conduct businesses in conditions no less favourable than those available to domestic investors." The most-favoured-nation (MFN) obligation provides that "each Party shall allow the investors of the other Party to establish investments and conduct businesses in conditions no less favourable than those available to other foreign investors." Thus, NT relating to establishment seems to be subject to domestic law, while MFN is not.

Regarding both NT and MFN, the Mexico CIFA guides interpret to consider as "less favourable" any treatment that changes the conditions of competition in favour of domestic investors. The treaty also adds a caveat to NT: host states are allowed to adopt and implement new, non-discriminatory legal requirements or restrictions to foreign investors or investments.

Notably, unlike many recent treaties, the Mozambique and Angola CIFAs contain no explicit exception to MFN in relation to substantive or procedural treatment granted under other investment treaties. The Mexico CIFA brings the welcome clarification that MFN does not allow an investor to import dispute settlement provisions contained in other investment-related agreements concluded by the host state.

The three CIFAs ensure that the NT and MFN obligations are not interpreted as an obligation to grant to investors of the other state the benefit of any treatment, preference or privilege resulting from any existing or future free trade area, customs union, common market or double taxation agreement to which the host state is or becomes a party.

The Angola CIFA has three additional paragraphs:

- The host state may provide, under domestic law, special formalities relating to the investment activities of the investors of the other state, as long as that these formalities do not affect the substance of their rights and the principle of non-discrimination (para. 6).
- The host state must grant the investors of the other state NT or MFN "with respect to the access to courts of law and administrative agencies, or, furthermore, to the defense of the rights of such investors" (para. 7).
- Paragraph 8 states that "[e]ach Party shall comply with the obligations expressly assumed in relation to the investments of investors of the other Party." This is an umbrella clause, which has been interpreted to equal the breach of an investment contract between the host state and the investor to a treaty breach.

Compensation

This article is modelled after paragraphs 4 and 5 of Article 5 (Minimum Standard of Treatment) under the US Model BIT for cases of armed conflict and similar situations. It provides that foreign investors who suffer losses of their investments in the territory of the other party due to war or other armed conflict, state of emergency, revolt, insurgency or disorders shall be granted – with respect to restitution, compensation or other solution – the most favourable of either NT or MFN. Foreign investors who suffer damages must receive prompt, adequate and effective restitution or compensation in a freely usable currency.

Transparency

The parties agree to ensure that measures affecting investments are administered in a reasonable, objective and impartial manner. They also guarantee that investment-related laws and regulations are published promptly and, whenever possible, in electronic format. In addition, they agree to a best-efforts commitment to give reasonable opportunity for relevant stakeholders to be heard on proposed investment-related measures. Finally, they commit to giving publicity to the CIFA.

Transfers

Similarly to provisions on transfers in traditional BITs, the article provides that each party will allow the transfer of funds related to the investment, subject to compliance registration and authorization procedures established under domestic law. Among the funds that may be transferred are contributions to capital, profits directly related to the investment, proceeds from its total or partial sale or liquidation, amortization of loans and the amount of compensation for expropriation or requisitioning of the investment.

The treaties safeguard the right to adopt non-discriminatory regulatory measures restricting transfers during balance-of-payment crises, the right to use exchange measures and other rights under the Articles of Agreement of the International Monetary Fund (IMF). The Mexico text adds language based on the US Model BIT to allow the host state to prevent a transfer through the equitable, non-discriminatory, and good faith application of its laws relating to bankruptcy, creditor protections, among others.

Prudential measures and security exceptions

The Brazil-Mexico CIFA includes an article on prudential measures that the parties may adopt to protect investors and depositors or to ensure the integrity and stability of the financial system. This language appears to be inspired by the US Model BIT.

It also includes an article on security exception to safeguard the right of the parties to adopt measures to preserve national security or public order, or to apply their criminal law; however, it removes these measures from the scope of the dispute settlement mechanism.

Dispute prevention and resolution

The CIFAs mandate the Focal Points and the Joint Committee to prevent, manage and resolve disputes between the states. In particular, prior to the initiation of an arbitral proceeding, any dispute is subject to assessment, by means of consultations and negotiations, and to a preliminary examination by the Joint Committee.

A proceeding for a state to submit a claim to the Joint Committee on behalf of an investor is also established, the main lines of which are the following:

- To initiate the proceeding, the home state of the investor presents a written request to the Joint Committee, specifying the name of the investor and the challenges or difficulties faced. Under the Mexico CIFA only, the home state may summon a meeting of the Joint Committee within 30 days.

- The Joint Committee has 60 days, extendable by mutual agreement and upon justification for another 60 days, to present information pertinent to the case. Under the Mexico CIFA, this is also the time limit for the Joint Committee to issue its summary report.

- Representatives of the investor, of government entities and NGOs involved may participate in the meetings.

- The proceeding of bilateral dialogue and consultations is concluded by the initiative of either state with the presentation of a summary report in the subsequent meeting of the Joint Committee. The Mexico text clarifies that the final meeting will be summoned on the final date of the Joint Committee's period to present information and prepare the summary report.

- The summary report must include the identification of the state

and of the investors involved, the description of the challenged measure and the position of the states regarding the measure.

- The Joint Committee holds extraordinary meetings to consider the issues before it and may issue a recommendation.
- Except for the summary report, all documents and meetings of the proceedings are confidential.

The three CIFAs concluded define the above procedure to settle "questions of interest of an investor" in general terms; the Joint Committees under each treaty would need to elaborate on the procedural details. The agreement formalizes Brazil's promise of a swift and friendly mechanism for the settlement of investment disputes, which remains to be tested in practice.

The Mozambique and Angola treaties indicate that, if the dispute is not resolved by the recommendation, the two parties may resort to state-state arbitration. The Mexico text takes a step further and includes a stand-alone article on dispute settlement.

Settlement of disputes between the parties (state-state arbitration)

If the proceeding before the Joint Committee is exhausted without resolution, either state may resort to arbitration against the other state. The CIFA clarifies that the objective of the arbitration is to bring any non-conforming measures into conformity with the treaty. Only upon specific agreement of the parties may the tribunal assess damages and grant compensation. If granted, the state must transfer it to the holder of the rights to the investment after deducing arbitration costs. Arbitration may not be invoked regarding disputes that have arisen or measures adopted before the CIFA entered into force.

The states may submit the dispute to a permanent institution or mechanism to settle investment-related disputes between states or constitute a specific tribunal. In the latter case, each state nominates an arbitrator, and the two arbitrators nominate a third-state national to serve as president of the tribunal, subject to approval by the disputing states.

Failing any of the necessary nominations, the President of the International Court of Justice (ICJ), its Vice-President or its most senior judge are successively invited to make these appointments. As usual in state-state arbitration mechanisms, the CIFA ensures that the appointing authority may not be a national of either of the disputing states.

Arbitrators must be people of high moral level, with the necessary experience or specialization in public international law and recognized experience in the area of the dispute. They must also be independent and not connected to either party, to the other arbitrators or witnesses, and may not receive instructions from the disputing states. They are bound by the World Trade Organization (WTO) Rules of Conduct for the Understanding on Rules and Procedures Governing the Settlement of Disputes, or another standard of conduct established by the Joint Committee.

Arbitral tribunals are given the power to determine their own procedure and to issue a majority decision that is binding on both parties. They must issue their decision within six months of the nomination of the president of the tribunal, unless the parties agree otherwise.

Application or scope of the agreement

The Mozambique and Mexico CIFAs expressly apply to all investments, whether made before or after their entry into force. Since this provision does not appear in the Angola CIFA, its scope of application is unclear.

Common to all CIFAs is the prohibition to invoke the agreements to question disputes finally resolved before their entry into force and the provision to the effect that the agreements do not restrict the rights of benefits of foreign investors under domestic law.

The Angola CIFA has a denial-of-benefits clause: a party may deny the benefits of the CIFA to a natural person who is not a national or permanent resident of the other party. The party may also deny the application of the CIFA to a legal person which: (a) is not constituted under the law of the other party, is not headquartered in the other party and does not carry out substantial activities there; or which (b) is

not effectively owned or controlled, directly or indirectly, by nationals or permanent residents of the other party.

Finally, the Mexico CIFA establishes a "statute of limitations" (common law) or "prescription" (civil law) period of five years from the date on which the investor acquired or should have acquired knowledge of the facts leading to the dispute. After this period, the CIFA may not be invoked to resolve an investment dispute.

Final and provisional provisions

The Joint Committee and Focal Points do not replace diplomatic exchanges. Their purpose is "the encouragement of institutional government of investment, by means of the establishment of a specific forum and of technical channels that act as facilitators between the governments and the private sector," as outlined in the Mozambique and Angola texts.

While the Mozambique and Angola CIFAs have limited durations, the Mexico CIFA will remain in force for an indefinite period, and provides for a general review of its implementation by the Joint Committee five years after its entry into force. Any of the treaties may be denounced with minimum advance notice of a year.

Final remarks

As promised, Brazil's CIFAs introduce a new model BIT focusing on cooperation and investment facilitation. The CIFAs rely on the activities of the Joint Committees of the bilateral partners and country-specific Focal Points in developing and implementing thematic agendas, reducing risks, and preventing disputes. Moreover, they encourage close cooperation with the private sector, and allow for the participation of NGOs and civil society representatives. Even if fine-tuning would be welcome with respect to specific aspects, the existence of potential for improvement should not be seen as cancelling the merits of the novel approach that the CIFAs bring into the realm of international investment law and policy. In the context of increasing criticism of the investor protection paradigm and the flaws in investor-state arbitration, Brazil's CIFAs boldly divert from the traditional BIT-ISDS regime.

An Account of the EU's Engagement with Bilateral Investment Treaties

Burghard Ilge

Introduction

There is a growing consensus that the current international legal system that governs international investment flows no longer serves its purpose and needs to be changed profoundly. Not only is it questionable whether international investment agreements (IIAs) encourage international investment flows, the current generation of IIAs has also failed to address the uneven balance of rights and responsibilities between foreign investors and host governments.

It would be fair to describe Europe as the mother of the current international investment regime, since bilateral investment treaties (BITs) as well as investor-state dispute settlements (ISDS) are European inventions. Europe is also still the main user of the wide network of IIAs. Whereas until now most known ISDS cases have been brought by US investors, ISDS claims from the EU as a collective of individual member states still far outstrip the US-based cases.

Based on this legacy, Europe has a special responsibility to ensure that international investment rules are supportive of governments' ambitions to regulate investment in the public interest.

While international investment rules were not the topic of public or political debate in Europe in the past, this has changed dramatically with the launch of the Transatlantic Trade and Investment Partnership (TTIP) negotiations between the European Union (EU) and the United States (US). In order to contribute to the ongoing debate, this paper takes a closer look at the EU role in the creation of international rules for the protection of foreign investment and the more recent development.

The BITs

The BIT between Germany and Pakistan – signed on 25 November 1959 – is regarded as the first bilateral investment treaty. However, it is a frequently reported misconception[1] that it was also the first BIT to include an investor-state dispute mechanism. Instead the German BIT with Pakistan only provides for a state-to-state dispute resolution mechanism, a situation that has not been revised since then.

ISDS only became a more common feature of BITs after the International Centre for Settlement of Investment Disputes (ICSID) was established at the end of 1966. The first BITs to include an ISDS mechanism was the one signed in 1968 between the Netherlands and Indonesia and the one between Italy and Chad that entered into force the following year. Since then the international legal system governing investment flows has emerged through an increasingly complex network of 2,923 BITs and 345 other IIAs. However, any number cited here will be quickly outdated since currently a new IIA gets signed every two weeks (UNCTAD, 2015).

In the early days, the ISDS mechanism in such treaties was hardly ever used. Until 1997, there were only 19 known cases of foreign investors suing their host state. However, from the late 1990s onward, this has changed dramatically. Since the beginning of this year (2015), at least one new ISDS case has been published every week.

1. See, for instance, (*The Economist*, 2014).

While cases in the past were mainly brought against developing countries and countries in transition, this trend has undergone a dramatic transformation in recent years.

In fact, EU member states now seem to have become the main target of ISDS cases. For example, in August 2015 all of the five new ISDS cases registered by ICSID had an EU member state as a respondent. A significant number of such cases are based on Intra EU BITs – a development that has led the European Commission to initiate infringement proceedings against five EU member states requesting them to terminate the BITs between them (EC, 2015a).

Another source of ISDS cases against EU members is the Energy Charter Treaty (ECT). This was a treaty that was originally created by EU governments at the end of the Cold War with the aim of integrating the energy sectors of the Soviet Union and Eastern Europe into the broader European and world markets. In particular, the two ECT cases of the Swedish company Vattenfall against Germany have become notorious (Bernasconi-Osterwalder & Hoffmann, 2013). The growing number of ECT cases against EU member states will not be without consequences. In January 2015, Italy already created a precedent when it delivered, its official notice of withdrawal from the Energy Charter Treaty, without much public notice (NLR, 2015).

However, the cases against EU member states are not only related to energy. Measures taken in the aftermath of the financial crisis are now also being challenged. While Belgium narrowly escaped a billion dollar claim by a Chinese investor over the rescue of Fortis Bank, the deliberations of ISDS cases challenging the sovereign debt restructuring of Greece and Cyprus are still ongoing (for more information, see paper by Kevin P. Gallagher in this book).

At the time of writing nearly all EU member states have had to defend themselves at least once against an ISDS case. Until now only Portugal, the Netherlands and the Nordic countries still seem to have been spared from this.[2] However, if the recent trend of at least one new

2. As far ISDS cases are known against: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, France, Germany, Hungary, Italy, Latvia, Lithuania, Malta, Poland, Romania, Slovak Republic, Slovenia, Spain and United Kingdom.

known ISDS case being lodged every week should continue, it remains to be seen how long this situation can be maintained.

Multilateral approaches

As well as in the bilateral field, the EU also has a long tradition of efforts that aim to create a multilateral investment agreement. After it had become clear in 1994 that efforts to widen the scope of the General Agreement on Tariffs and Trade (GATT) to include a multilateral investment agreement failed, the EU and US – together with other like-minded countries such as Japan – started to move the negotiation to the Organisation for Economic Co-operation and Development (OECD). It was hoped that once a new 'high standard model' was agreed between OECD members, this could become the new global standard that non-OECD members would also join after the negotiations had been concluded.

In May 1995, the 29 member states of the OECD started to negotiate a multilateral treaty – the Multilateral Agreement on Investment – or in short the MAI. The MAI was intended to be a binding IIA that was planned to 'govern' international investment flows and to establish enforceable rights for foreign investors.

The content and structure of the MAI was inspired by the investment provisions of the North American Free Trade Agreement (NAFTA), which had entered into force in 1994.

There was little public awareness of the MAI negotiations. This changed in March 1997, when a draft of the agreement was leaked shortly before the expected conclusion of the negotiations. The leaked material prompted wide criticism from a broad range of civil society. As a result, the negotiations failed in 1998 when France withdrew from the negotiations due to growing public opposition. In April 1998, the negotiations were formally suspended for six months and on 3 December 1998, the OECD announced that "negotiations on the MAI are no longer taking place."

A newly proposed investment agreement at the WTO?

The first World Trade Organization (WTO) ministerial conference, which was held in Singapore in 1996, established permanent working groups on four issues – the so-called 'Singapore issues'[3] – including one on trade and investment. Since then the EU has pushed at successive ministerial meetings to start negotiations on investment at the WTO.

The launch of new WTO negotiations that were to be called the Millennium Round were intended to start at the ministerial conference of 1999 in Seattle. However, for various reasons, including massive protest activity outside the conference (the so-called 'Battle of Seattle'), it was decided that no negotiations would start until the next ministerial conference in 2001 in Doha, Qatar.

After the successful launch in 2001, the WTO ministerial conference in Cancún, Mexico intended to forge concrete agreement on the objectives of the so-called Doha Development Round. The EU and some other countries argued that, after seven years of study and analysis, ministers should now launch negotiations for a WTO agreement on foreign direct investment (FDI). They argued that the existing international regime of individual bilateral investment treaties plus regional investment agreements leads to confusion and that a WTO agreement would establish a stable, non-discriminatory environment that would increase investment flows. However the Cancún talks collapsed after four days during which the members could not agree on a framework to continue negotiations. In particular, differences over the Singapore issues turned out to be impossible to resolve. In 2004, the WTO then agreed that "no work towards negotiations on trade and investment will take place within the WTO" during the Doha Round (WTO, 2004).

The game changer TTIP

The start of negotiations of a Transatlantic Trade and Investment Partnership (TTIP) between the EU and US was announced in February 2013.

3. The four Singapore issues were: transparency in government procurement; trade facilitation (customs issues); trade and competition; and trade and investment.

The idea of an integrated transatlantic market is not new and can be traced back to the 1960s, when the US proposed a North Atlantic Free Trade Area to bolster the North Atlantic Treaty Organization (NATO)'s efforts to win the Cold War. As was the case five decades ago, geopolitics is again one of the main arguments used by the proponents of TTIP (Van Ham, 2013). The TTIP is building on successive initiatives such as the New Transatlantic Agenda (1995), and the New Transatlantic Economic Partnership (2007), which aimed to revive EU-US relations in the post-Cold War period.

While the expected economic benefits of a deeper economic transatlantic integration are still the main argument used in support of TTIP, a perceived crisis of multilateral negotiations of new international trade and investment rules is also frequently used to make the case for needing this bilateral initiative. It is believed that, once the EU and US can reach a consensus on international trade and investment rules, that this can then be extended to the global level.

However, the ideas behind TTIP have been challenged from the very beginning of negotiations. While the focus of the critique was first on overstretched predictions of the economic benefits of the agreement, the criticism has now broadened out to the regulatory effects of TTIP.

From the very beginning of the negotiations, the inclusion of an ISDS mechanism has been the key issue that mobilised massive public opposition in Europe. Public protest reached such a level that, in the summer of 2014, the European Commission (EC) announced it would halt the investment negotiations on TTIP and first hold a public consultation on what the chapter on investment protection in TTIP should look like. For this, the EC used draft texts of a similar chapter for the proposed EU free trade agreement with Canada (CETA), which was close to conclusion at that time, and allowed text-based comments and suggestions for specific provisions for the foreseen ISDS mechanism in TTIP. However, the unintended outcome of this consultation was that 97% of all submissions declined to give any comment on what such an ISDS mechanism should look like and instead clearly stated their fundamental rejection of any form of ISDS. Since then the opposition to TTIP and ISDS in particular has been snow balling.

Proposed ISDS reform under TTIP

On 16 September 2015, the EC adopted a proposal (EC, 2015) for the further reform of the investor-state dispute settlement mechanism – or ISDS – that had been proposed for inclusion in the TTIP.

Based on this, an initial EU proposal for Investment Protection and Resolution of Investment Disputes was tabled for discussion with the US and made public on 12 November 2015. While there are several significant adjustments to the currently dominant model of EU IIAs, these reform proposals still do not go close to resolving the ISDS problem.[4]

Most of the ideas of the new proposal were already launched in spring and are about the appointment of arbitrators and the arbitration procedures, the introduction of a new appeals mechanism and improvements related to transparency.[5] It includes some quite significant changes from the current praxis under most of the BITs of the EU member states or the Energy Charter Treaty. Furthermore the EU proposal suggests a new name for the ISDS mechanism in TTIP: Investment Court System, or in short 'ICS.'

It is the clear intention of the EC that the proposed Investment Court System would replace the current model investor-to-state dispute settlement mechanism in all ongoing and future EU investment negotiations.

Since a full discussion of this new proposal is beyond the scope of what can be presented here,[6] we will limit ourselves to a few aspects that are not related to the procedural element of the current investor-state arbitration mechanism in EU IIAs.

Essence of the ISDS problem stays untouched

First of all, the proposed ICS still gives foreign companies the possibility of ignoring the domestic legal system and instead requesting

4. The text of the proposal on Investment Protection and Resolution of Investment Disputes and Investment Court System in TTIP is available at http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf.
5. The EU proposal goes beyond the minimum standard of the UNCITRAL transparency rules of the Mauritius Convention.
6. For a first preliminary discussion, see, for example, S2B, 2015.

financial compensation for government measures at an international arbitration tribunal. While text has been included to prevent the possibility of having parallel claims in domestic courts, it does not contain, as previously suggested, a 'Fork-in-the-Road' (FITR) clause. Fork-in-the-Road clauses require that the claimant investor must make a choice between pursuing its claims against the state either through the arbitration mechanisms provided in the relevant IIA or in local courts. Instead the current text would allow a foreign investor to move at any time from a claim in national courts to the dispute resolution mechanism of the IIA – an option that would only be available to foreign but not domestic investors. Exhausting local remedies is not required.

Furthermore the current proposal does not only give foreign investors access to special tribunals and compensation not available to others, but any alleged breaches of their rights by governments are also judged based on other criteria.

For example, a clear formulation that foreign investors have no greater substantial rights under the IIA than domestic investors is missing in the new proposal. For ISDS cases against the EU or its member states such a clause would, for example, have forced arbitrators to take account of how conflicts between private and public interests is regulated in the Treaty on the Functioning of the European Union (TFEU).[7]

The proposed new Investment Court System would still give foreign investors and large enterprises a powerful instrument with which to put pressure on governments and legislators and to demand compensation for actions taken in the public interest.

In its public communication, the EC stresses that the new text would provide sufficient safeguards to preserve a government's right to regulate. However, it is the very purpose of the presented new model for EU IIAs to reduce the policy space of governments when it affects investors' rights granted in the IIA. The current proposal, for example, would restrict policies that aim to support national industrial sectors and economic sectors that could be directly or indirectly seen as dis-

7. In particular, in the sense of Art. 340(2) of the TFEU regarding compensation for damage caused by unlawful acts and conduct committed by Union institutions and bodies, in case of non-contractual liability of the Union.

criminatory with respect to foreign companies. The precise demarcation lines for the limits of policy space of government will, as always, depend on the fine print of the IIA in its entirety.

Loopholes in the EU proposal

Two articles (Article 3.4 and Article 7) in the EC's proposal make it possible that agreements made elsewhere (such as those covered in secret contracts) get a binding effect under the treaty and can be enforced accordingly.

For example, Article 7 requires the observance of written commitments made by governments and states:

> "Where a Party [..] has entered into any contractual written commitment with investors of the other Party or with their covered investments, that Party shall not, either itself or through any such entity breach the said commitment through the exercise of governmental authority." (ICS text)

Such a so-called 'umbrella clause' would mean that, in addition to affording foreign investors protection under international law standards, the proposed ICS would also provide the right for foreign investors to arbitrate contract disputes with sovereign states.

There are various problems with such umbrella clauses. The most obvious one is that, during contract related conflicts or renegotiation, only one party to the contract (the foreign investor) will be able to raise the conflict to the international level of investor-state dispute settlement.

Umbrella clauses are also problematic when it comes to the right to regulate in the public interest. Long-term investment or concession contracts in particular in the field of the energy sectors or the extractive industries frequently contain so-called 'stabilisation clauses' that aim to insulate the project from changes in laws and regulations that may be adverse to the economics of the project. The scope and depth of these stabilisation clauses vary but are not limited to adverse changes in tax law or the fiscal environment. Standstill provision related to changes in social and environmental laws and requirements are also frequently included.

While defenders of the current IIA system frequently quote from the finding of arbitrators in Methanex vs United States (2005) to make the case that "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensable," they frequently skip how this sentence in this ruling continues. By this they omit the important qualification that any regulation is still deemed expropriator and compensable if specific commitments had been given by the regulating government to the foreign investor that the government would refrain from such regulation.[8]

This problem was also recognised by the US, which amended the country's ISDS model accordingly during a review of their model BIT in 2012. Since then, large companies such as Chevron have made a lot of effort to get such umbrella clauses reinstated, with the investment chapter of TTIP as one of their key lobby and advocacy targets.[9]

The concerns about umbrella clauses are also shared by the European Parliament (EP). In a letter to the EC from 11 November , Bernd Lange, Chair of the EP's International Trade Committee (INTA) criticised the inclusion of an umbrella clause to the recently tabled EU proposal for an ISDS mechanism in TTIP. Lange warned that such a mechanism "can have an important negative impact on the right to regulate" and can "discriminate against domestic investors who would have to rely on local remedies or the contractual dispute settlement mechanism" (EU Trade Insight, 2015).

8. As cited in (EC 2013): "As a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation."
9. See, e.g. for example, their letter from 2013 to the US Trade Representative USTR (Chevron, 2013).

Protecting 'legitimate expectations'

Besides the umbrella clause in Article 7, there is another loophole in the current proposal by the EC. Article 3.4 states:

> "When applying the [...] fair and equitable treatment obligation, a tribunal may take into account whether a Party made a specific representation to an investor to induce a covered investment, that created a legitimate expectation, and upon which the investor relied in deciding to make or maintain the covered investment, but that the Party subsequently frustrated."

Besides the question of the precise understanding of what is meant by "a specific representation," a key problem of the proposed new ICT system would be that it not only would protect the rights of foreign investors but also their "legitimate expectation."

Including text such as currently found in Article 7 and Article 3.4 ir a future International Investment Court would introduce serious le gal uncertainties and obstacles to regulating foreign investment in the public interest.

Towards a permanent International Investment Court?

The EC also announced that it will start work to set up a permanent International Investment Court. The stated objective of this effort is "that over time the International Investment Court would replace all investment dispute resolution mechanisms provided in EU agreements, EU Member States' agreements with third countries" but also "in trade and investment treaties concluded between non-EU countries" (EC, 2015).

Critics of the current IIA system might regard the globalisation of the proposed Investment Court System as an opportunity to lock in the procedural improvements of this new proposal that would then overwrite the current BITs of EU member states.

As well as doubts about whether any such procedural improvements go far enough (Van Harten, 2015), one should also be aware that future

reform of a permanent International Investment Court – if it should ever come into being – would be hard if not impossible. Due to its multilateral character, any future reforms would require the full consent of all parties to the treaty.

Those who are specifically concerned about the BITs of EU member states should also be aware of the huge differences between different members. For example, Ireland has no BIT at all. Any new EU-wide IIA would therefore not only lead to a 'reform' of existing BITs, it would also lead to a significant increase in the scope of foreign investment covered.

In the case of TTIP, it is important to note, for example, that there are currently only nine BITs in place between the US and EU member states and that FDI stock held by US investors in these nine countries equals only 1% of the total US FDI stock in the EU (UNCTAD, 2014).

There are also huge differences between the different BITs of individual countries. For example, even the BITs of the Netherlands – which are considered to offer some of the highest protection to investors worldwide[10] – reveal huge differences. It is not well known that even the Netherlands has BITs that do not include an ISDS mechanism. The Dutch BIT with Malta, for example, only contains a state-to-state-dispute settlement mechanism. The same is true for 10% of the Dutch IIAs with countries in Africa that in certain aspects are also more similar to the new model of Cooperation and Investment Facilitation Agreements (CIFA) of Brazil (for more information, see paper by Martin Dietrich Brauch in this book).

Balancing property rights

The EU is based on a strong commitment to promoting and protecting human rights, democracy and the rule of law worldwide. Human rights are a central part of EU relations with other countries and regions.

10. 10% of all known ISDS cases are based on a Dutch BIT, second only after the IIAs of the US.

Fundamental rights are not only guaranteed nationally by the constitutions of individual countries but also at the EU level by the EU Charter of Fundamental Rights that is binding since 2009. However, individuals seeking redress must go through the courts in their own country and only as a last resort can they lodge an appeal with the European Court of Justice (ECJ).

Regrettably the EU's commitment to human rights seems not to be so well reflected in ongoing efforts at the international level. The creation of a new international legally-binding treaty to hold transnational corporations (TNCs) accountable for human rights abuses – a proposal that has been gathering momentum at the UN Human Rights Council (UNHRC) in Geneva – met with severe opposition from the European side (Deen, 2014).

At the United Nations (UN), there is growing recognition that the international legal system on foreign investment reflects an asymmetry between rights and obligations of Transnational Cooperation (TNCs). On 26 June 2014, the United Nations Human Rights Council (UNHRC) decided to establish an open-ended inter-governmental working group for a new international treaty on transnational corporations and human rights. At its first meeting, the working group underlined the existing gaps in the international legal framework when it comes to the duty to protect human rights in business activities. It emphasised that existing instruments in this respect are all concentrated in 'soft law,' meaning non-binding regulations such as the OECD's Guidelines for Multinational Enterprises. The Chairperson of the UN Working Group, Maria Fernanda Espinosa, stated: "While TNCs are granted rights through hard law instruments, such as bilateral investment treaties and investment rules in free trade agreements, and have access to a system of Investor State Dispute Settlement, there are no hard law instruments that address the obligations of corporations to respect human rights."

Governments and parliaments in Europe therefore need to reconsider whether their current focus on developing a new internationally binding legal system to protect the profit interests of foreign investors is justifiable. Or whether the right to property should not be better addressed in the wider context of human rights and sustainable development.

Conclusion

It is clear that Europe is currently standing at a critical crossroads. It has to decide which path to pursue. Does it want to maintain a focus on the reform of an old model of international investment agreements that solely focus on the self-interest of foreign investors? Or to instead choose a more holistic approach? Alongside current efforts at the UN level to balance the rights and obligations of foreign investors or the approach in the new Cooperation and Investment Facilitation Agreements (CIFA) of Brazil, even EU BITs that were drafted before ISDS and were seen as 'the state of the art' might still act as an inspiration.

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Dutch Investment Treaties: Socialising Losses, Privatising Gains

Roos Van Os*

1. Introduction

Over the past two decades a complex web of more than 3,200 investment agreements has developed globally, mostly in the form of bilateral investment treaties (BITs). The Netherlands takes a central position in the current debate around BITs and international investment agreements (IIAs). More than 10% of all known investment treaty claims make use of Dutch BITs.The growing controversy surrounding BITs – and in particular the mounting critique of Dutch BITs as being excessively investor-friendly to the detriment of the policy space of developing countries – has led the Dutch authorities to announce a review of Dutch BITs with developing countries. In addition, the Dutch government is a vocal supporter of the current reform agenda of the European Commission.

This paper shows how (the threat of) lawsuits taken to the Interna-

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tional Centre for Settlement of Investment Disputes (ICSID) and other fora, using Dutch BITs, have effectively blocked policy-making for development in host countries. It also discusses the risks that the extensive Dutch BIT network poses for the Netherlands itself and examines the flaws in the investor-state dispute settlement (ISDS) system and the adverse impacts of the broad set-up of Dutch BITs. It looks at the shortcomings of recent proposals for reforming the ISDS system that have emanated from the European Commission and have been embraced by the Dutch authorities. The paper concludes with concrete recommendations to the Dutch government for a more sustainable and inclusive investment policy.

2. The Netherlands as a major player in foreign investment protection

2.1. A treaty haven for foreign investors

The Dutch government actively works to create a competitive and attractive business climate in the Netherlands.[1] Foreign transnational corporations (TNCs) often set up financing structures that route investment through the Netherlands because the country offers a profitable fiscal climate with a reduction of tax charges on dividends, interest, royalties and capital gains income. The Netherlands also offers political weight, guaranteeing action will be taken when host states attempt to challenge treaty protection. Dutch investor-friendly bilateral investment treaties are an additional trump card used to attract multinationals to incorporate within Dutch borders. Together, the business-friendly Dutch tax system and the Dutch framework for investment protection have attracted an estimated 12,000 letterbox companies.[2] As a result of these policies, the Netherlands ranks as one of the largest investors worldwide in terms of foreign investment flows. The Netherlands has headed global investment rankings in the last decade as a

1. Ministry of Economic Affairs website: http://www.rijksoverheid.nl/ministeries/ez.
2. SOMO, *Private Gains-Public Loss: Mailbox Companies, Tax Avoidance and Human Rights*, Amsterdam, July 2013, available at http://somo.nl/publications-en/Publication_3975/at_download/fullfile.

result of the vast amounts of capital flowing through so-called special purpose vehicles (SPVs) and mailbox companies. At the end of 2012, the total inward foreign direct investment (FDI) position of the Netherlands totalled almost €3,700 billion, 80% of which was attributable to SPVs. At approximately 85%, the share of SPVs in the Dutch outward FDI position was even larger.

2.2. Pro-business bias in the Dutch position on investment protection

The Netherlands currently maintains an extensive BIT network of over 95 investment protection agreements, 12 of which are so-called intra-EU BITs,[3] which are characterised by broadly phrased and open-ended protections that the Netherlands proudly refers to as the 'gold standard' in investment protection.[4] The Netherlands continues to negotiate its BITs on the basis of a model treaty developed in 2003 in close cooperation with Dutch industry.[5] Recently it concluded a BIT with the United Arab Emirates (UAE). However, in 2014 the Ministry of Foreign Affairs indicated that all other ongoing BIT negotiations have been postponed, pending the outcome of a reappraisal of the Dutch BIT model by Trade Minister Lilianne Ploumen. Minister Ploumen announced a reassessment of the Dutch framework for investment protection in response to the same growing public concerns over the potentially harmful effects of ISDS that galvanised the European Commission into drafting proposals for a reform of the system.

3. According to the official list of Dutch BITs, the Netherlands maintain BITs with EU Member States – Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovenia and Slovakia. The Dutch government's list of BITS (IBO Landenlijst), 22 February 2010, available at http://www.rijksoverheid.nl/documenten-en-publicaties/rapporten/2010/02/22/ibo-landenlijst.html.
4. For an overview of BITs signed by the Netherlands, see http://www.rijksoverheid.nl/onderwerpen/internationaal-ondernemen/documenten-en-publicaties/rapporten/2010/02/22/ibo-landenlijst.html.
5. Evaluation report of the Ministry of Economic Affairs on trade politics, Ministerie van Economische Zaken (2007), Beleidsdoorlichting handelspolitiek: Eindrapport, Tweede Kamer, vergaderjaar 2007-2008, 30 991, nr. 3, The Hague.

While the European Commission launched a consultation about its reform agenda in relation to the proposed inclusion of ISDS in the Transatlantic Trade and Investment Partnership (TTIP), Minister Ploumen, prompted by a parliamentary motion, initiated her own investigation into ISDS in TTIP. In her appraisal to Parliament, she downplayed the occurrence of regulatory chill. She further dismissed the financial risks from ISDS for the Netherlands as negligible, while embracing proposals for reform of the ISDS mechanism put forward by the European Commission.[6]

Until now most Dutch BITs published on the government website[7] follow (with variations) the Dutch investor-friendly model treaty. Dutch investment treaties are characterised by their broadly phrased and expansively interpretable definitions of investors, investment and ISDS. The goal of sustainable development is only mentioned in the non-binding preamble of the model BIT.

- Definition of investor: The Dutch model BIT qualifies indirectly controlled foreign investors as 'national' investors, entitled to the full protection of Dutch bilateral investment agreements.[8] The Netherlands facilitate easy establishment of mailbox companies, which allows entities with no substantial ties to the Netherlands to avail themselves of the treaty protections that their own state of origin may not be willing to extend to investors from the state actually hosting their investments. Some 12,000 foreign investors are known to have restructured their investments both to take advantage of the corporate-friendly Dutch fiscal climate and to avail themselves of the protections offered by the broad scope and

6. Kamerbrief over studie naar investeerder-staat geschillenbeslechting in TTIP, 25 June 2014. Available at http://www.rijksoverheid.nl/documenten-en-publicaties/kamerstukken/2014/06/25/kamerbrief-over-studie-naar-investeerder-staat-geschillenbeslechting-in-ttip.html (accessed 24 November 2014).
7. See:https://www.rijksoverheid.nl/onderwerpen/internationaal-ondernemen/documenten/rapporten/2010/02/22/ibo-landenlijst (accessed 24 June 2011).
8. It provides in Article 1.b: "the term 'nationals' shall comprise with regard to either Contracting Party: natural persons having the nationality of that Contracting Party; legal persons constituted under the law of that Contracting Party; Legal persons not constituted under the law of that Contracting Party but controlled, directly or indirectly, by natural persons as defined in (i) or by legal persons as defined in (ii)."

definitions of Dutch BITs, including bringing investment claims even against their own countries of origin.[9]

- Definition of investment: The Dutch model BIT of 2004 continues to rely on the widest possible definition of investment that covers 'every kind of asset.'[10] It uses an open-ended non-exclusive list, that not only covers any type of 'property' or 'claims to money' but also 'any performance having an economic value' and unusual asset categories such as 'good will' and 'knowhow.' In addition, any rights (whatever they might be) granted in a commercial contract are covered as an investment that is protected under the treaty. The Dutch model BIT does not attach any conditionality to investments that are protected under the treaty. While some countries include language in their BITs to ensure that the covered investment contributes to the host country's economic development.[11]

- Dispute settlement: The Dutch Model BIT includes a wide ISDS clause that grants greater private property rights – without corresponding responsibilities – to foreign investors than are enshrined in national constitutions or EU law. Under the current investment framework, national courts are easily sidelined: the Dutch model BIT does not include requirements to exhaust local remedies

9. See, for instance, deliberations in Decision on Respondent's Preliminary Objections on Jurisdiction and Admissibility of *The Rompetrol Group N.V. v. Romania* (ICSID Case No. ARB/06/3) as discussed by Van Os R. and Knottnerus R. in *Dutch Bilateral Investment Treaties: A gateway to 'treaty shopping' for investment protection by multinational companies,'* October 2011, available at http://www.somo.nl/publications-en/Publication_3708/at_download/fullfile.
10. "Article 1. For the purposes of this Agreement: (a) the term 'investments' means every kind of asset and more particularly, though not exclusively: movable and immovable property as well as any other rights in rem in respect of every kind of asset; rights derived from shares, bonds and other kinds of interests in companies and joint ventures; claims to money, to other assets or to any performance having an economic value; rights in the field of intellectual property, technical processes, goodwill and know-how; rights granted under public law or under contract, including rights to prospect, explore, extract and win natural resources."
11. For a discussion of 'in accordance with host State law' clauses in BITs, see e.g. Ursula Kriebaum, Chapter V: Investment Arbitration – Illegal Investment, in Christian Klausegger, Peter Klein , et al. (eds.), *Austrian Arbitration Yearbook 2010*, (C.H. Beck, Stämpfli & Manz, 2010) pp. 307–335.

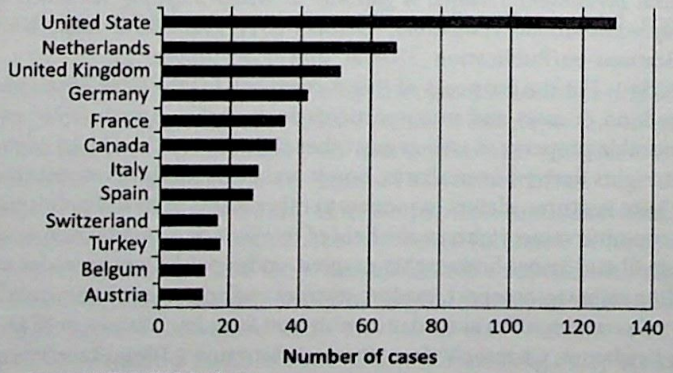
before reverting to international arbitration, and a ruling by an investment arbitration panel overrides national legal decisions.

BITs are easily entered into, but not so easy to terminate when adverse and unintended impacts emerge. The Dutch model BIT gives a standard duration of 15 years after signing, during which no one-sided change or withdrawal is allowed. Unless notice of termination is given by either contracting party at least six months before the date of the expiry of its validity, the BIT is tacitly extended for periods of ten years, whereby each contracting party reserves the right to terminate the agreement upon notice of at least six months before the subsequent date of expiry. The model treaty further contains a clause whereby, upon termination of the treaty, any investment made prior to termination will continue to be protected by the treaty's provisions for a further 15 years.

2.3. The Netherlands: the most frequent home state in arbitration after the US

As a preferred investment jurisdiction, the Netherlands is a frequent home state for arbitration cases. With 73 known cases up to 2014 – over 10% of known investment cases – the Netherlands is the most frequently used jurisdiction for arbitration cases after the US. Treaty shopping – structuring investment to benefit from foreign investment treaties – emerges as a very real problem in relation to Dutch BITs.

Figure 1: Most Frequent Home States (total as of end 2014)[12]



Source: UNCTAD, ISDS database.

12. UNCTAD, *Recent Trends in IIAs and ISDS*, IIA Issues Note No.1, February 2015.

Research by the Centre for Research on Multinational Corporations (SOMO) analysing the 73 known Dutch BIT arbitration cases clearly shows that a substantial majority of investors that have sought arbitration through a Dutch investment treaty are foreign (i.e. the country of the ultimate or controlling parent is not based in the Netherlands).[13] Dutch BITs have even been used by foreign investors to bring lawsuits against their own country of origin.[14] SOMO's assessment of the available data relating to Dutch BIT cases shows that over 75% of Dutch BIT cases were brought by mailbox companies with no real economic substance in the Netherlands. Overall, foreign investors have used Dutch BITs to claim over US$100 billion from states (claims are often not disclosed at all).

Box 1: Dutch BIT cases

Newmont v. Indonesia

The case Newmont v. Indonesia shows how the mere threat of an ISDS claim can affect development policies in recipient countries. Newmont mining, one of the biggest mining companies in the world, sued Indonesia under its BIT with the Netherlands after Indonesia announced mining Law No. 4/2009 on Mineral and Coal, which came into force in 2014. It requires mining companies to partially process raw materials in Indonesia before exporting and seeks to limit foreign ownership by requiring mining companies to sell up to 51% of their shares to the Indonesian government or local businesses in ten years' time. These policies aim to boost domestic employment and the local economy and help Indonesia to become less dependent on the export of raw materials. Newmont was able to sue the Indonesian government under the Dutch BIT because its majority shareholder is based in the Netherlands un-

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13. Van Os R. and Knottnerus R., op.cit. October 2011.
14. Ibid.

der the name Nusa Tengara Partnership BV – with zero employees and more than a billion euros in assets. Newmont withdrew its case within a month of reaching an agreement with the Indonesian government that gives the company special exemptions from the contested mining law.[15] The Newmont case clearly shows how companies may wield the threat of a billion dollar claim in response to a (proposed) new policy. Dutch BITs have also been used to sue Zimbabwe over its agrarian reforms,[16] Bolivia over its re-municipalisation of water resources[17] and Venezuela over the nationalisation of coffee[18] and oil production.[19]

Achmea and Eastern Sugar, using 'illegal' intra-EU BITs

The Netherlands maintains a number of BITs with Eastern European countries, signed before they joined the European Union (EU). These BITs have been used to bring cases against both the Czech Republic (six times) and Slovakia. Often claims arise when a new member state is adapting its regulatory framework to comply with EU laws. A case in point: Dutch investor Eastern Sugar suing the Czech Republic under the Netherlands-Czech Republic BIT when the Czech government passed regulations to comply with the EU's Common Agricultural Policy.

15. Transnational Institute (TNI), Indonesia for Global Justice (IGJ) and EU-ASEAN FTA Network "Indonesia BIT rolls back implementation of new Indonesian mining law," November 2014, available at http://www.tni.org/briefing/netherlands-indonesia-bit-rolls-back-implementation-new-indonesian-mining-law.
16. Bernardus Henricus Funnekotter and Others v. Republic of Zimbabwe, ICSID Case ARB/05/6, Award, 22 April 2009.
17. Aguasdel Tunari SA v. Republic of Bolivia, ICSID Case No. ARB/02/3.
18. GAR, Venezuelan coffee claim grinds on, February 2014, available at http://globalarbitrationreview.com/news/article/32424/venezuelan-coffee-claim-grinds-on/.
19. IA Reporter, "Arbitrators in Exxon vs Venezuela case award $1.6 billion with an asterisk, and part ways with Conoco tribunal in deeming expropriation to have been lawful," available at http://www.iareporter.com/articles/20141010_1.

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The European Commission (EC) has argued that these intra-EU BITS are in conflict with EU law and incompatible with the EU single market and should therefore be terminated. The Dutch government, however, has been one of the most outspoken EU member states against this proposal. In the case of Achmea vs Slovakia, Dutch insurer Achmea is using the Dutch-Slovak BIT to fight government plans to bring the health insurance system back into public hands. In this context, the Slovak government intends to expropriate Achmea's share as foreign investor in a Slovak insurance company. The government has the legal right to do so, provided certain conditions are met. Achmea argues inter alia that the precondition that the public interest is served by the measure was not met.[20] The case is highly controversial because it creates several precedents: Achmea is suing over a proposed policy and, instead of compensation, demands withdrawal of the plan. As such, the case is a clear example of how ISDS could be used to restrict public policy space.

In a prior case, Achmea has already been awarded US$22 million (plus $3 million for legal fees) in compensation for Slovakia's policy to curb profit repatriation opportunities for health insurers. The tribunal ruled that this was a violation of Achmea's property rights.[21] When the issue came up during the dispute that Slovakia might unilaterally terminate the treaty, Solvakia was 'kindly reminded' by the Dutch Ministry of Economic Affairs that any such effort would be futile since the protection for investors as included in the treaty would remain valid for a further 15 years as stipulated in its so-called 'survival clause.'[22]

20. Achmea, "Achmea undertakes legal steps against Slovak Republic," November 2013, available at http://news.achmea.nl/achmea-undertakes-legal-steps-against-slovak-republic.
21. Thomson G, "Investor-state dispute settlement (ISDS) and the Transatlantic Trade and Investment Partnership (TTIP)," December 2013, available at http://www.parliament.uk/briefing-papers/SN06777.pdf.
22. TNI, "A test for European Solidarity: The case of Intra-EU Bilateral Investment Treaties," January 2013, available at http://www.tni.org/sites/www.tni.org/files/download/briefing_on_intra-eu_bits_0.pdf.

2.4. Mounting critique triggers a reassessment of Dutch investment policy

Based on their own assessments that investment protection backed by ISDS poses unacceptable risks to policy space and public budgets, both South Africa and Indonesia have notified the Dutch government of their wish to cancel bilateral investment agreements with the Netherlands. The Minister of Trade and Development has since – and in response to parliamentary questions – announced a reappraisal of investment protection as laid down in Dutch BITs in relation to policy space and the freedom to regulate in countries hosting Dutch investments.[23] The outcome of this appraisal is pending. The Ministry for Foreign Affairs, Trade and Development Cooperation has indicated that, for the time being, all BIT negotiations have been put on hold.

In her earlier appraisal of ISDS in TTIP, the Minister positioned herself firmly behind the EU reform proposals, which are under strong criticism for failing to address the systemic flaws in the current investment protection framework. With policy-makers also failing to recognise the tension between Dutch investment policy and the Dutch government's own development objectives and CSR policies, it is to be feared that proposals to revise the Dutch bilateral investment agreement network will fall short of what is needed to ensure one of the principles underpinning Dutch policy coherence for sustainable development.

2.5. Recent policy proposals: too little and too late

In line with the proposals of the EC, the Dutch government declares its ambition to make the system 'more transparent and impartial,' 'build a legally water-tight system,' and 'close the legal loopholes once and for all.' In addition, based on these objectives, the Dutch government aims to renegotiate its current BIT network, starting with the BIT with Ghana at the end of 2015.

23. Answers to questions of Members of Parliament, Van Oijk and Van Dijk (SP) about investment treaties, 9 May 2014, available at http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/kamerstukken/2014/05/09/beantwoording-kamervragen-over-investeringsverdragen/beantwoording-kamervragen-over-investeringsverdragen.pdf.

There remains a growing concern from environmental and farmers' groups, trade unions, consumer organisations[24] and academics[25] that the EC's approach does not adequately recognise or address the fundamental flaws in the system.

The reform proposals fail to protect the 'right to regulate' as a general right and as a component of the fair and equitable treatment (FET) and expropriation standards of protection of investors. In its ISDS consultation text, the EC indicates that it will safeguard the right to regulate in relation to investment protection by ensuring 'that all the necessary safeguards and exceptions are in place.'[26] But there is no mention of unequivocally safeguarding the right to regulate as a sovereign right, as, for example in Protocol 1, Article 1 of the European Convention on Human Rights, which states that:

> "(1) Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.
>
> (2) The preceding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties."[27]

24. TNI and others, "Trading Away Democracy," November 2014, available at http://www.tni.org/sites/www.tni.org/files/download/ceta-isds-en_0.pdf.
25. Muchlinski P., Muir Watt H. et al., 'Statement of concern about planned provisions on investment protection and Investor-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP),' date unknown, available at https://www.kent.ac.uk/law/isds_treaty_consultation.html.
26. EC, public consultation on ISDS, Question 5: Ensuring the right to regulate and investment protection, available at http://trade.ec.europa.eu/doclib/docs/2014/march/tradoc_152280.pdf.
27. Enforcement of certain Rights and Freedoms not included in Section I of the Convention, available at http://www.hri.org/docs/ECHR50.html#P1.

The EU states it will strive to "ensure that investment protection standards cannot be interpreted by arbitral tribunals in a way that is detrimental to the right to regulate." Despite the systemic flaws in the arbitration system, the EU still intends to trust commercial arbitrators with the task of weighing sovereign states' right to regulate against the property rights of foreign investors. Arbitrators are left to determine whether state measures are 'necessary' and whether their impacts on foreign investors are 'manifestly excessive' or 'more burdensome than necessary to achieve their aim.' Arbitrators only have to consider the immediate interest of the investor bringing a case and are under no obligation to take into account the wider public interest. There is no possibility of appeal.

They also continue to allow for unwarranted discretion for arbitration tribunals in various 'necessity' tests. The EU's suggested reform fails to regulate conflicts of interest in the arbitration process, continues to allow foreign investors to bypass national courts, and does not put an end to treaty shopping. Academics critical of the EU's approach further fault it, among other things, for allowing anyone with a substantial business activity in the home state that holds any 'interest' in an enterprise in the host state to bring a claim, and for failing to spell out legal duties of investors in host states.[28]

The Commission's proposals for a roster and code of conduct for arbitrators insufficiently address inherent problems relating to the independence, competence and impartiality of arbitrators. In this one-sided system, where arbitrators earn commercial fees on a case-by-case basis, there is a suspicion of potential conflicts of interest and bias in favour of the investor as the only party that bring cases. While the EU's ISDS reform agenda seeks to limit arbiters' scope for interpretation by narrowing down clauses and definitions in investment agreements, it leaves the fundamental structure of the system untouched.

28. Muchlinski P, Muir Watt H et al., op.cit.

3. Policy coherence for development demands investment policy change

3.1. International obligations and FDI for sustainable development

The Netherlands is a signatory to all major human rights conventions and an active proponent of corporate social responsibility, including the UN Business and Human Rights Framework and the 2011 Organisation for Economic Co-operation and Development (OECD) Guidelines. As such, the Dutch government operates under an obligation to ensure that its policies do not undermine the corporate ability to respect human rights.[29] At the international level, the UN Guiding Principles on Business and Human Rights stipulate that states should "[e] nforce laws that are aimed at, or have the effect of, requiring business enterprises to respect human rights, and periodically assess the adequacy of such laws and address any gaps."[30] The UN Guiding Principles specifically mention BITs as an area of concern as they can restrict a host state's policy space: "host States can find it difficult to strengthen domestic social and environmental standards, including those related

29. An influential 2011 study on CSR and European corporations notes: "Understanding how regulation of trade and investment affects the human rights and environmental impacts of European corporations operating outside the European Union is crucial for States to implement their duty to protect. However, because State measures in these areas are primarily geared towards liberalising trade and promoting investment, States often do not (fully) realise or utilise their potential to protect human rights and the environment through trade law, investment rules, and related legal measures. This can lead to substantial legal and policy incoherence and gaps in protecting human rights and the environment, which often entails significant negative consequences for victims, corporations and States themselves." Available at http://ec.europa.eu/enterprise/policies/sustainable-business/files/business-human-rights/101025_ec_study_final_report_en.pdf.
30. Principle 3 of the Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework. UN document. A/HRC/17/31, available at http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf (accessed 4 January 2013).

to human rights, without fear of foreign investor challenge, which can take place under binding international arbitration."[31]

There is an added European responsibility: The 2009 Lisbon Treaty requires the EU to take account of the objective of poverty reduction and eradication in all actions likely to affect developing countries,[32] firmly establishing policy coherence for development (PCD) as a shared responsibility of EU institutions and member states alike.

3.2. The Netherlands must recognise its responsibility

The investments of Dutch companies can potentially have negative impacts on various obligations under the human rights conventions, such as the rights to food, education, water, health care, a reasonable standard of life and work. The Netherlands is a pivotal player in this respect.

The Dutch government notes that, in the EU, there are only four countries that invest more than the Netherlands, and only six that host more investments.[33] The Dutch government is developing policies to support companies to fulfil their responsibility to respect human rights as laid down in the UN Guiding Principles on Business and Human Rights.[34] At the same time, the extensive investment protections in

31. John Ruggie, Special Representative of the UN Secretary-General on the issue of human rights and transnational corporations and other business enterprises (April 2008) 'Protect, Respect and Remedy: A Framework for Business and Human Rights,' UN document. A/HRC/8/5, paragraph 12, available at http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf.
32. Treaty on the Functioning of the European Union (TFEU) Article 208(1). Article 208 of the Lisbon Treaty implies that all EU policies must be in support of developing countries' development needs, or at least not contradict the aim of poverty eradication. Hereby Policy Coherence for Development (PCD) became a treaty obligation.
33. Fiche 10: Resolution on the transition of bilateral investment treaties, available at http://www.eumonitor.eu/9353000/1/j9vvik7m1c3gyxp/vj85mgefl6y7 Verordening overgangsregeling bilaterale investeringsovereenkomsten.
34. Response of Cabinet on the progress report of the SER on CSR, 27 April 2011, available at http://www.parlementairemonitor.nl/9353000/1/j9vvij5epmj1ey0/vip7ni13fpy8?ctx=vii16w9t8cya&sort_docs=n77j38n0j&start_tab0=60.

Dutch BITs contravene these objectives, not least by enabling mailbox companies[35] to use the Netherlands as a jurisdiction to challenge the regulatory frameworks of host states. The Netherlands has a particular responsibility to reassess its investment policy in terms of policy coherence and to ensure that businesses incorporated in the Netherlands respect human rights in their operations abroad.

A narrow understanding of investment as promoted in (Dutch) BITs disregards that investment is about the commitment of multiple resources, including natural, human, social, cultural, physical and financial. Investments that ignore the imperatives for social reproduction and that are subsidised by vast ecological debts cannot be considered as sustainable.

The Dutch model BIT and the BITs concluded on the basis of this model treaty continue to fail to adequately recognise the potential negative human rights impacts of investor protection. The Dutch model BIT follows the trend to include provisions on environmental and labour standards and other issues related to sustainable development in international investment agreements in order to address conflicts between investment promotion and other policy goals. However, these continue to be phrased in vague and non-binding language.[36] To date, no clear-cut, binding investor obligations have been included in any agreement. In the Dutch model BIT, sustainable development remains confined to the non-binding preamble, rather than being integrated into the main body of the treaty.[37]

In theory, policy coherence for development as a principle underpins all Dutch government policy. However, Dutch policy-makers are failing to take on board the fact that investor-state dispute settlement relying on broad-based BIT definitions enable easy circumvention of

35. Van Os R. and Knottnerus R., op.cit., October 2011.
36. Spears S., 'The quest for policy space in a new generation of international investment agreements,' (2010) *Journal of International Economic Law*, 13(4) p.1037–1075.
37. The relevant text states 'Recognising that the development of economic and business ties will promote internationally accepted labour standards; Considering that these objectives can be achieved without compromising health, safety and environmental measures of general application.'

economic, social or environmental conditions related to foreign investments laid down by host country authorities. Equally, there is scant recognition that investment policy is at odds with UN Guiding Principle 9, which calls on states to ensure that they retain adequate policy and regulatory ability to protect human rights under the terms of trade and investment agreements.

3.3. Recommendations for policy change: a new framework for BITs

- A revised investment policy should not be centred on the protection of investments but on the promotion of sustainable investment and the state's ability to fulfil its human rights obligations. The exclusive right of foreign investors to threaten and initiate claims against legislative, executive or judicial decisions outside of national courts contrast sharply with the lack of mechanisms for communities to address corporate impunity when violations of human and environmental rights occur. Transnational corporations (TNCs) must be held accountable for the social, environmental and human rights impacts of their operations. A modern investment framework should not privilege investors but should prioritise human rights. Effective regulation of foreign investment is required to ensure it contributes to economic development, social progress and environmental sustainability. Investment policy should favour long-term and sustainable investments and investor relationships over short-term financial gain, especially in developing countries. A modern investment protection policy must be tailored to ensure genuine sustainable development. Such a policy should be in line with the principles of human dignity, democracy and respect for human rights as enshrined in the Treaty on the European Union, which stipulates in Article 3.5 that "In its relations with the wider world, the Union [...] shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights [...]."

- With regard to development policy coherence, states should periodically review their business regulation at all levels to assess

whether it is coherent with development commitments and protection of human rights, and adapt it where needed. BITs and other international investment agreements should be subject to periodic public and independent sustainability and human rights impact assessments. Countries should retain the option to revisit or terminate trade and investment at any time, if these assessments show negative development impacts.

- A new framework for international investment should encompass and build on the UN Guiding Principles on Business and Human Rights and other frameworks for corporate social responsibility such as the OECD Guidelines for Multinational Enterprises. In a fundamental recalibration of the system, such investor obligations should be made binding and enforceable and should prioritise establishing effective avenues at the international level that provide access to justice for victims of investor crimes. The policy space of states must be independently and unequivocally established, and should take firm precedence over investor rights and privileges to ensure the unfettered ability of the state to regulate in the wider public interest.

- ISDS must be abandoned as a high-risk and unnecessary parallel legal system that is beyond reform. TNCs are perfectly able to assess the risks associated with their foreign investments and weigh them up against expected financial returns. In case of conflicts they can resort to national courts. In addition, private insurance is available to transnational investors to cover political risks. Instead of maintaining an ISDS system that allows for the transferral of the cost associated with expansively interpreted investment protections onto the tax payer, this should be the preferred option.

In the interest of policy coherence for development, the Dutch government should proactively renegotiate existing BITs along these lines and not wait their long overdue revision until they expire which may take several years.

ISDS, Intellectual Property Rights and Public Health

Brook K. Baker and Katrina Geddes

Investor-state dispute settlement (ISDS) provisions in bilateral investment treaties and other trade or investment treaties allow foreign investors to challenge, in a secretive tribunal of highly paid lawyers, any government action that interferes with investors' 'legitimate' expectations of profit. The ISDS process, despite lacking the safeguards and transparency of domestic legal systems, has the potential to drastically affect the lives of millions of people, particularly when it affects national intellectual property policies or decisions concerning public health.

Investment treaties and provisions generally protect both investors and their investments, which are often broadly defined to include intellectual property rights. In the health context, three types of claims are generally asserted by investors:[1] (i) that government action has directly or indirectly expropriated the value of their investment; (ii) that the government by its policies or decisions has failed to accord the investor fair and equitable treatment and full protection and security; and (iii) that the government unfairly discriminates in favour of domestic investors compared to foreign investors.[2] The first two types of claims

1. See for example Dearden, R. "Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement," *Journal of World Trade* 1995, Vol. 29, Issue 1, pp. 113-128.
2. Other types of claims include imposition of performance requirements, e.g., local content requirements, and restrictions on capital flows into and out of the country.

are frequently based on an investor's assertion that its legitimate expectations of future profits have been adversely affected. These types of claims can severely deter governments from protecting public health in their policies and practices.[3] Although all such possible claims have not yet been brought, the types of health-related claims that might be asserted are broad indeed: (i) tobacco and fast-food regulation; (ii) product safety, disclosure, and content requirements affecting food and other consumer products and industrial inputs; (iii) environmental and workplace safety rules and decisions; (iv) decisions affecting the registration status of medicines and other health technologies;[4] (v) health product price controls, reimbursement schemes, and placement on therapeutic formularies; and (vi) controls on the advertising of medicines.

A particularly pernicious feature of investment protections arises in the intellectual property arena where ISDS claims might be brought with respect to alleged diminution of expected profits arising from trade secrets, trademarks, patents, and data protections. In the trade secret arena, foreign pharmaceutical companies might oppose government requirements that they disclose 'secret' proprietary information on clinical trials, suspected counterfeiting, or the content of regulatory filings. They might also use trade secret law to argue that trademark protections require countries to adopt data exclusivity and to not rely on previously submitted data to register generic equivalents. In the trademark context, foreign companies might argue, as they already have, that certain packaging and disclosure requirements might dilute

3. See for example: Ethyl-Canada dispute over gasoline additive MMT; Pacific Rim-El Salvador dispute over the contamination of water supplies from a local mine; the Renco Group-Peru dispute over a metal smelter causing Peruvian children to suffer from lead poisoning; and the claim brought by Swedish energy company Vattenfall against Germany for closing its nuclear power plants.
4. One of the first such cases was *Apotex v. United States*, a case dismissed on jurisdictional grounds, which sought damages because the US Food and Drug Administration refused to grant regulatory approval on two imported medicines. *Apotex Inc. v. The Government of the United States of America* (UNCITRAL), Award on Jurisdiction and Admissibility, 14 June 2013. Although the applicant was deemed to be an 'exporter' rather than an investor, there is no guarantee that a similar complaint might not be brought with respect to denials of marketing approvals or regulatory labelling restrictions.

the value of their trademark investments. Finally, in the patent sphere, foreign pharmaceutical companies might raise ISDS challenges to (i) adverse patent decisions and revocations; (ii) granting of compulsory and government-use licenses; (iii) allowance of parallel importation; (iv) adoption of exemptions, limitations, and exceptions affecting medicines; and (v) inadequate enforcement of patents by governments through border measures, anti-counterfeiting rules, and even criminal enforcement.

The threat of legal action has a powerful deterrent effect on governments considering the introduction of pro-public health measures,[5] particularly in low- and middle-income countries that can least afford expensive and protracted litigation.[6] The deterrent effect is significant given the readiness with which investors launch such disputes, their relatively high success rate, and the costs involved in defending the dispute. In 2012 alone, 58 new cases were initiated, representing the highest number of known treaty-based disputes ever filed in one year.[7] In 70% of the public decisions addressing the merits of the dispute, investors' claims were accepted, at least in part.[8] The costs associated with defending these disputes can reach astronomical heights as arbitrators are paid $600-700 per hour, with little incentive to expedite matters.[9] The highest known award of damages in the history of investment treaty arbitration featured in the 2012 case of *Occidental v. Ecuador II* where the investor was awarded US$1.77 billion plus pre- and post-award compound interest.[10] The *Occidental* award demonstrates

5. Gleeson, D. & Friel, S. "Emerging threats to public health from regional trade agreements," *The Lancet* 2013, available at http://www.nzcphm.org.nz/media/61306/emerging_threats_to_public_health_from_regional_trade_agreements_-_gleeson_friel_-_lancet_2013__2_.pdf.
6. Ibid.
7. UNCTAD, "Recent developments in investor-state dispute settlement," IIA Issues Note, May 2013, available at http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d3_en.pdf.
8. Ibid.
9. *The Economist*, "The arbitration game," 11 October 2014, from the print edition, available online at http://www.economist.com/news/finance-and-economics/21623756-governments-are-souring-treaties-protect-foreign-investors-arbitration.
10. Above, n 3.

the power of arbitration tribunals to radically alter the wealth of shareholders as well as the well-being of respondent citizens.

What has developed into a lucrative business of raiding government treasuries has had a chilling effect on the introduction and implementation of pro-public health measures worldwide. In Australia, for instance, the introduction of plain packaging laws to reduce the use of tobacco products triggered a trademark-related legal action by a multinational tobacco corporation. In 2011, Philip Morris Asia (PMA), a subsidiary of Philip Morris International (PMI), launched an investor-state dispute against the Australian government through an ISDS clause in a bilateral investment treaty signed between Australia and Hong Kong in the early 1990s. This is the second investor-state dispute to arise over tobacco labelling; PMI is bringing a similar case against Uruguay through a Swiss subsidiary.[11]

PMA argues that Australia's plain packaging measure: (a) constitutes an expropriation of its Australian trademark-related investments in breach of Article 6 of the Hong Kong Agreement (HKA); (b) is in breach of its commitment under Article 2(2) of the HKA to accord fair and equitable treatment to PMA's investments; and (c) constitutes an unreasonable and discriminatory measure, depriving PMA's investments of full protection and security in breach of Article 2(2) of the HKA.[12]

Australia rejects these claims. It argues that "plain packaging legislation forms part of a comprehensive government strategy to reduce smoking rates in Australia. This strategy is designed to address one of the leading causes of preventable death and disease in Australia, which kills around 15,000 Australians each year, causes chronic disease for many others and is a significant burden both on productivity and on Australia's health care system. The implementation of these measures is a legitimate exercise of the Australian Government's regulatory powers to protect

11. Gleeson, D. et al. "Challenges to Australia's national health policy from trade and investment agreements," *MJA Online*, 29 February 2012.
12. Attorney-General's Department, Australian government, "Tobacco plain packaging – investor-state arbitration," Summary of arbitration, available at: http://www.ag.gov.au/tobaccoplainpackaging.

the health of its citizens."[13] PMI's blanket disregard for Australia's public health prerogative raises concerns that other corporations could bring similar investor-state disputes against national governments for food nutrition or GM food labelling laws that prioritise public health over corporate profits.

The slow creep of corporate tentacles into the intellectual property policy sphere has even reached a nation's sovereign right to set and enforce its own patent policy. US-based Eli Lilly is suing the Canadian government for invalidating its patents for two drugs, Strattera and Zyprexa, for want of utility. It brings the suit under Chapter 11 of the North American Free Trade Agreement (NAFTA), claiming that Canadian patent law contravenes both the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and NAFTA by imposing "onerous and additional utility requirements that have had the effect of denying patent rights for inventions which meet the conditions precedent to patentability" embodied in international agreements.[14] Eli Lilly claims that Canadian patent law not only contravenes its treaty obligations but also is "discriminatory, arbitrary, unpredictable and remarkably subjective." It claims, inter alia, that the invalidation of both patents constitutes an "expropriation" of "intangible property acquired in the expectation or used for the purposes of economic benefit."[15]

Canada has defended its position by arguing, *inter alia*, that court decisions invalidating a patent do not amount to the expropriation of property but to the determination of whether property rights exist at all.[16] It argues that judicial decisions concerning the existence of rights under domestic law are not subject to review by international investment tribunals save in the extraordinary circumstance of gross procedural

13. Australia's Response to the Notice of Arbitration, 21 December 2011, available at: http://www.ag.gov.au/Internationalrelations/InternationalLaw/Documents/Australias%20Response%20to%20the%20Notice%20of%20Arbitration%2021%20December%202011.pdf.
14. *Eli Lilly and Company v. The Government of Canada*, Notice of Intent to Submit a Claim to Arbitration Under NAFTA Chapter Eleven, 7 November 7, 2012, available at: http://italaw.com/sites/default/files/case-documents/italaw1172.pdf.
15. Ibid.
16. *Eli Lilly and Company v. Government of Canada*, Statement of Defence, 30 June 30, 2014, available at: http://italaw.com/sites/default/files/case-documents/italaw3253.pdf.

misconduct amounting to a denial of justice or the bad faith exercise of decision-making power to mask a violation of international law – neither of which is alleged here. In defence of its particular system of patent examination, Canada argues that, given the high social and economic costs associated with granting patent-owners a monopoly on their invention, "a patent cannot be granted or its validity confirmed lightly."[17] Canada denies any breach of its international treaty obligations.

Eli Lilly's investor-state dispute marks the first attempt by a pharmaceutical company to use investor-state privileges to appeal against unsuccessful outcomes at the domestic judicial level.[18] It also represents an unprecedented attack on national sovereignty over public health policy – a reserved power of sovereignty on which the US has consistently relied. Professor Reichman summarizes the situation in the following words:

> "The hard truth that Big Pharma cannot swallow is that U.S. patent law did not become global law under TRIPS, and that the United States cannot prescribe universal patent standards for the rest of the world any more than France could prescribe uniform patent law in 1883, when the Paris Convention was first adopted … Instead, under both TRIPS and NAFTA there is built-in flexibility to implement patent eligibility standards in each WTO member's domestic laws so as to advance states' own technological and economic development needs. No huffing and puffing about investment treaties will change these facts of life under international law as currently adopted."[19]

17. Ibid.
18. Brook K. Baker, Threat of Pharmaceutical-Related IP Investment Rights in the Trans-Pacific Partnership Agreement: An Eli-Lilly v. Canada Case Study, *Investment Treaty News*, 30 September 30, 2013, available at http://www.iisd.org/itn/2013/09/20/threat-of-pharmaceutical-related-ip-investment-rights-in-the-trans-pacific-partnership-agreement-an-eli-lilly-v-canada-case-study/.
19. Reichman, J. "Compliance of Canada's Utility Doctrine with International Minimum Standards of Patent Protection," 2014, Proceedings of the 108th Annual Meeting of the American Society of International Law, available at: http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=6067&context=faculty_scholarship&sei-redir=1&referer=https%3A%2F%2Fscholar.google.com%2Fscholar%3Fq%3D%2522eli%2Blilly%2522%2Bcanada%2Bstrattera%2Bpatent%26btnG%3D%26hl%3Den%26as_sdt%3D0%252C22#search=%22eli%20lilly%20canada%20strattera%20patent%22

There is concern that the Eli Lilly case will encourage other pharmaceutical companies to resort to investor-state arbitration to remedy lost expectations of profit arising out of government measures to improve public health, such as issuing compulsory licences, controlling the price of medicines, and requiring disclosure of clinical trial data. The pharmaceutical industry has strong economic interests in expanding its intellectual property (IP) protections in so-called 'pharmerging' countries where the bulk of its earnings growth is likely to occur.[20]

Despite the rhetorical support of the 2001 Doha Declaration, developing countries may be reluctant to issue compulsory licences for much-needed medication due to the threat of investor-state arbitration. The issuance of a compulsory licence, while TRIPS-compliant, may be viewed as an indirect expropriation of intellectual property in violation of an international investment treaty.[21] In 2007, for example, Brazil's decision to issue a compulsory licence on the patented anti-HIV drug Efavirenz prompted a hostile statement from Merck & Co. characterizing the Brazilian government's move as an expropriation of its property.[22] Christopher Gibson argues, however, that if a national government is able to demonstrate elements such as the non-exclusive nature of the licence, its limited scope and duration, limited use by any third parties for domestic market purposes only, and adequate remuneration, it may be able to present a solid defence against the investor's claims.[23] In the Philippines case of *Smith Kline and French Laboratories Ltd*, for instance, the issue of a compulsory licence to manufacture GlaxoSmithKline's medicine Cimetidine was successfully defended as a valid exercise of state power with just compensation (a royalty of 2.5% of the net wholesale price).[24]

20. IMS Institute for Health Informatics, Global Outlook for Medicines Through 2018, November 2014.
21. Gibson, C. "A Look at the Compulsory License in Investment Arbitration: The Case of Indirect Expropriation," *American University International Law Review*, 2010, Vol. 25, Issue 3.
22. Ibid.
23. Ibid.
24. Vadi, V. "Access to Essential Medicines & International Investment Law – The Road Ahead," *The Journal of World Investment & Trade*, 2007, Vol. 8, pp. 505-531.

Like compulsory licensing, the disclosure of clinical trial data may also be deterred by the threat of investor-state disputes launched by foreign pharmaceutical companies. In November 2010, the European Medicines Agency (EMA) adopted a policy of greater transparency in clinical trial data, triggering the release of nearly two million pages of data. In 2013, however, two US drug companies, AbbVie and InterMune, obtained an interim injunction against EMA preventing the release of "commercially sensitive" information and EMA stopped releasing trial data for fear of further legal action from other pharmaceutical companies.[25] Jerome Reichman argues that clinical trial data, as a guarantor of public safety, should be regarded as a public good instead of a second revenue stream for pharmaceutical companies with a *sui generis* data exclusivity right.[26]

Plain packaging legislation, patent invalidations, compulsory licensing and the disclosure of clinical trial data represent only a few of the infinite means by which governments attempting to improve public health may be stymied by pharmaceutical litigation. As long as intellectual property continues to fall within the definition of 'investment' in international investment treaties, any pro-public health measure implemented by national governments may be viewed as an interference with foreign pharmaceutical investments, spurring expensive and protracted arbitration.

Henning Grosse Ruse-Khan believes that IP right holders who pursue this path are unlikely to be successful. He argues that IP rights such as patents cannot reasonably be regarded as absolute rights, untouchable by the state that issued them in the first place. On the contrary, states are entitled and expected to impose reasonable limitations on the use of those rights within the host state.[27] Measures supported by the pub-

25. Dyer, C. "European drug agency's attempts to improve transparency stalled by legal action from two US drug companies," *BMJ* 2013, 346: f3588.
26. Reichman, J. "Rethinking the role of clinical trial data in international intellectual property law: The case for a public goods approach," *Marquette Intellectual Property Law Review*, 2009; 13(1).
27. Ruse-Khan, H.G. "Litigating Intellectual Property Rights in Investor-State Arbitration: From Plain Packaging to Patent Revocation," Fourth Biennial Global Conference of the Society of International Economic Law (SIEL) Working Paper No. 2014-21, July 2014, available at : http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2463711.

lic health flexibilities in TRIPS are internationally accepted elements of the IP system. Compulsory licences, for example, were recognised in the Doha Declaration as a legitimate policy tool to improve access to medicines. Other forms of limitations to IP rights – such as parallel imports or higher standards of patentability – are equally legitimate exercises of the flexibility inherent within TRIPS. Ruse-Khan summarises his position as follows:

> "In all cases, the grant of the patent certainly does not and cannot create any legitimate expectation that the exclusivity it confers is absolute and will remain without interference from accepted checks and balances inherent in the IP system. Instead, the expectations of the patent holding investor are a priori limited by the regulatory tools the domestic IP law of the host state foresees. Even in case a host state newly introduces such tools, or changes its policy of using existing ones after the investor has obtained his patent, the general acceptance and widespread state practice vis-à-vis these measures would strongly side against findings of interference with legitimate expectations. In Eli Lilly v.. Canada, the investor hence cannot legitimately expect from the grant of patents by the Canadian Patent Office (CPO) that those remain free from any validity challenges in the courts. Also a change in how the Canadian courts apply patentability standards such as utility or the disclosure obligation as such does not affect legitimate investor expectations: No expectation for a stable and predictable business environment can go so far that the circumstances prevailing at the time the investment is made must remain unchanged. Any resort to familiar and commonly used mechanisms to limit IP exclusivity … should never be considered as a breach of [fair and equitable treatment standards]."[28]

Furthermore, Ruse-Khan argues that the negative, rather than positive, character of IP rights – which allow the right holder to prevent others from utilizing the protected subject matter but do not confer a positive right to exploit – naturally means that the government may impose further limitations on the use of the protected subject matter, in the form of regulatory controls.[29] The World Trade Organiza-

28. Ibid.

tion (WTO) Panel in EC-Geographical Indications confirmed, "The TRIPS Agreement does not generally provide for the grant of positive rights to exploit or use certain subject matter, but rather provides for the grant of negative rights to prevent certain acts. This fundamental feature of intellectual property protection inherently grants Members freedom to pursue legitimate public policy objectives since many measures to attain those public policy objectives lie outside the scope of intellectual property rights and do not require an exception under the TRIPS Agreement."[30] As Ruse-Khan concludes:

> "The negative right to exclude others from exploiting IP-protected subject matter does not entail a guarantee against state intervention which imposes conditions upon the production or limits the use and sale of the patented product. For example, the introduction of price controls for a certain patented medication does not interfere with the patent for that medicine. Since such a measure is outside the protection IP rights confer, these rights cannot create legitimate expectations as to the (continued) absence of such measures."[31]

Ruse-Khan's analysis offers a hopeful outlook on potential future disputes over patent invalidations, price controls or other government measures that may thwart pharmaceutical expectations of profit. The negative nature of IP rights should enable a sovereign state to introduce reasonable limits on the exercise or scope of those rights in the interests of public health. The outcome of ongoing disputes such as Eli Lilly-Canada and PMA-Australia will determine whether these arguments are accepted.

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29. Ibid.
30. *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs*, WT/DS174/R, Report of the Panel, 15 March 2005, at para 7.210, available at : https://www.wto.org/english/tratop_e/dispu_e/174r_e.pdf.
31. Ruse-Khan, op.cit.

The ability of ISDS provisions to distort national intellectual property policy away from the public interest and users' rights in favour of transnational corporate interests intensifies the urgency of campaigns for ISDS provisions to be removed from the Trans-Pacific Partnership Agreement (TTP) and the Transatlantic Trade and Investment Partnership (TTIP). A private, unelected tribunal of three lawyers should not have the power to sanction a sovereign state for introducing democratically enacted pro-public health policies. Equally, foreign investors should not enjoy greater legal rights than citizens of a state by virtue of their ability to bring treaty claims against government measures, which domestic citizens cannot challenge. There must be recognition that not all areas of social life should be open to the market, and these must be defined with a clear rationale.[32]

32. Crouch, C. "Democracy at a TTIP'ing point," *Juncture*, 2014, Vol. 21, Issue 3, available at: http://onlinelibrary.wiley.com.ezp-prod1.hul.harvard.edu/doi/10.1111/j.2050-5876.2014.00802.x/epdf.

International Investment Agreements and Sovereign Debt Restructuring – Mission Creep

Kevin P. Gallagher

As members of the Eurozone are now acutely aware, the lack of a sovereign debt restructuring regime is one of the most glaring gaps in the international financial architecture. That said, a 2011 decision by a tribunal of the International Centre for Settlement of Investment Disputes (ICSID) – which granted a bilateral investment treaty (BIT) jurisdiction over Argentina's restructuring of its sovereign debt in the wake of its 2001 financial crisis – shows that a *de facto* regime may be arising whereby international investment agreements (IIAs) can serve as a way for disgruntled investors to circumvent debt restructuring. This amounts to mission creep on the part of IIAs. Straying into such territory is too much to take on for the world of IIAs. Sovereign debt restructuring should be left to national governments and international financial and monetary authorities.

If managed appropriately, government borrowing can be an essential ingredient for economic development, and has been for centuries. However, as we are witnessing in Europe, even when nations manage to keep its debt-to-GDP ratio in good shape, they can still spiral into a debt crisis – simply defined, when a nation cannot (or is no longer willing) to service its debt. Contagion from other crises or herd-like bouts expressing a lack of investor confidence could prevent creditors from rolling over or increasing loans. Moreover, debt is sometimes

denominated in a foreign currency, so when interest rates rise or the value of a nation's currency falls (on its own or relative to its neighbor's), the cost of debt service can skyrocket.

Sovereign debt restructuring (SDR) is often what occurs when a nation cannot repay its debts. However, the international community views the SDR regime as greatly lacking. When a sovereign government is no longer willing or able to pay its debts, sovereign restructurings occur during what amounts to a formal change to debt contracts negotiated between creditors and debtors. SDRs (or 'workouts') often take the form of reducing the face value of the debt, 'swaps' where new bonds with lower interest rates and longer maturities are exchanged for the defaulted bonds, and so forth. Such workouts are usually highly discounted and result in a loss for bondholders. Losses or discounts are commonly referred to as 'haircuts.'

Restructuring rules

In the early 2000s, the International Monetary Fund (IMF) proposed a 'Sovereign Debt Restructuring Mechanism' (SDRM). This sought to provide a fair forum for negotiation between bondholders and governments; a standstill clause whereby bondholders can't yank their money out of a debtor nation in a herd; a facility to provide short-term financing and to prioritize a debtor nation's debt schedule; and clauses that limit the ability of disgruntled minority bondholders to file lawsuits against debtor nations. The SDRM was swiftly rejected by the US government and the business community.

Instead, the US proposed normalizing the use of collective action clauses (CACs). These have the following features: a *collective representation* component where a bondholder's meeting can take place whereby they exchange views and discuss the default/restructuring; a *majority restructuring* component that enables a 75% 'supermajority' of bondholders to bind all holders within the same bond issue to the terms of restructuring; and a *minimum enforcement* component whereby a minimum of 25% of the bondholders must agree that litigation can be taken. Unfortunately, the majority of the bonds in the Eurozone do not have CACs and, even if they did, a restructuring would not be burden

free. The International Swaps and Derivatives Association can rule out a CAC and pay out insurance to bondholders instead. CACs also do not apply across bond issuances and thus it may be hard to get agreement on a whole swath of debt that a nation in trouble would like to swap. And it may be the case that CACs are no cover for IIAs.

US trade and investment treaties that govern international investment flows cover 'any kind of asset.' What may be news to some is that a recent ICSID panel has seen Argentina's restructuring of debt in the wake of its 2001 financial crisis as falling under the jurisdiction of the Italy-Argentina BIT. Indeed, sovereign debt is 'any kind of asset' and thus a US trade and investment treaty may be a place where investors can seek to recover the full value of their bonds.

When Argentina restructured its debt in 2005, close to 180,000 Argentine bondholders filed a claim under the Italy-Argentina BIT for approximately US$4.3 billion. Some of those investors settled in a 2010 restructuring and now there are believed to still be approximately 60,000 Italian bondholders seeking upwards of $2 billion from Argentina at ICSID. In September 2014, a majority of a private World Bank tribunal decided that Argentina's bond restructuring indeed does fall under the jurisdiction of these treaties. The case will therefore continue, despite a scathing dissent from a third member of the tribunal (IAR, 2011). The bondholders seeking their investments through the trade treaty are among the few remaining holdouts.

There are also two other pending cases related to restructurings under recent Eurozone developments. Under the Greece-Slovakia BIT, the Slovak bank Postova is claiming that the Eurozone restructuring of Greek debt was tantamount to an expropriation and violated fair and equitable treatment. There is a similar case against Cyprus for its restructuring. Whereas Argentina's restructuring was a bilateral one between Argentina and its creditors, the Greek and Cyprus restructurings were negotiated by the IMF, European Central Bank (ECB), and European Union (EU).

Box 1 outlines where IIAs can tangle with sovereign debt restructuring. And it is not clear that the small number of safeguard measures in place can assure that a nation can have a debt workout without also getting snared in an ICSID process.

Box 1: IIAs and sovereign debt restructuring

Jurisdiction: If IIAs are deemed to cover "any kind of asset" then it can be argued that sovereign debt falls under the jurisdiction of the treaty.

Expropriation: SDR could be seen as an indirect expropriation because a restructuring reduces the value of the sovereign bond.

Fair and Equitable Treatment (FET): Insofar as FET is seen as protecting investors' legitimate expectations, a bond swap that was not expected during the initial investment period could be seen as a violation of that standard.

National Treatment (NT): In some financial circumstances, it may be important to treat domestic bondholders differently from foreigners. However, this could be seen as violating National Treatment.

Inadequate safeguards

The safeguards and exceptions in many IIAs are not adequate enough to provide cover for nations to restructure their debt. For most cases the only possible safeguards are 'essential security' provisions. A handful of the US treaties have an annex that discusses very limited sovereign debt restructuring.

It may be possible that a nation can claim that actions taken during a financial crisis are measures needed to protect the 'essential security' of a nation. Language like Article 18 of the US Model BIT is found in many treaties:

"... to preclude a Party from applying measures that *it considers* necessary for the fulfilment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests." (USTR, 2004)

The article does not mention economic crises *per se*, but "all tribunals that have considered the matter thus far have interpreted the rules broadly enough to include such crises" (Salacuse, 2010: 345). However,

tribunals differ greatly over how grave the difficulties may be. In Argentina, again, tribunals came to opposite conclusions, and only one of three tribunals ruled that Argentina could not be held liable for actions it took to stop its crisis. A key matter is whether or not a measure by a nation to stem a crisis can be seen as 'self-judging.' In other words, can the host nation using the control be the judge of whether or not the measure taken was necessary to protect its security? The language quoted above in the 2004 Model BIT, which says "that *it* considers" is now seen as meaning that a measure is self judging (because of the "*it*"). However, Argentina's BITs with the US and others did not include such precise language at the time (Salacuse, 2010).

Some of the recent treaties negotiated by the US clearly define sovereign bonds as covered investments and provide explicit guidelines for the interaction between SDR and certain treaties. The US is usually reluctant to negotiate such guidelines, as it sees CACs as sufficiently safeguarding sovereign debt restructuring. However, when negotiating partners insist, the US is sometimes willing to compromise with an annex.

What is found in the US-Uruguay BIT – and in Free Trade Agreements (FTAs) with Central America, Chile, Peru, and Colombia – is a special annex on sovereign debt restructuring. Although the specific text varies across the treaties with such an annex, they usually prohibit claims against 'negotiated debt restructuring,' unless an investor holds that a restructuring violates National Treatment (NT) or Most Favored Nation (MFN) status. Such treaties usually define 'negotiated restructuring' as a restructuring where 75% of the bondholders have consented to a change in payment terms. If an investor does file a claim in the event of a restructuring that is not a 'negotiated' one, s/he must honor a 'cooling off' period usually lasting 270 days before a claim may be filed. There is no cooling off period for a non-negotiated or negotiated restructuring that violates NT or MFN.

These annexes are not standard in US treaties after the North American Free Trade Agreement (NAFTA) – NAFTA excludes sovereign debt from the definition of investment altogether. Indeed, the US-Australia, US-South Korea, US-Morocco, US-Oman, US-Panama and US-Singapore agreements include bonds and debt as covered investments but do not include annexes for sovereign debt restructuring.

The Dominican Republic-Central America Free Trade Agreement resembles the Chile FTA much more closely. Like the above agreements, bonds and other debt instruments are considered covered investments under the agreement. Annex 10-A then specifies very clearly that sovereign debt restructuring is subject *only* to Articles 10.3 (NT) and 10.4 (MFN). The additional cooling off period does not seem to apply and there is no mention of 'negotiated restructuring' as a prerequisite.

A step in the right direction

These annexes can be seen as a step in the right direction given that parties to the agreement recognize that restructuring is a special case. However, they remain far from adequate for at least four reasons. First, CACs will not alleviate the possibility that nations will seek claims for restructuring. As indicated earlier, vulture funds and other holdouts can acquire a supermajority within a bond issuance and neutralize the bond issue and a 25% minority can still agree to litigate and arbitrate. Second, the definition of investment and umbrella clauses allow for investor-state arbitration under treaty obligations regardless of whether such obligations are also covered by domestic law. Third, most restructurings are multi-issue restructurings and suffer from the aggregation problem described above. Again, collective action clauses only apply within a bond issue, not across multiple issues that are often bundled together in a restructuring.

Fourth and very importantly, economists and international financial institutions have repeatedly held that, in contradiction to the national treatment principle, domestic bondholders and financial institutions sometimes need to be treated differently during a crisis. Prioritizing domestic debt may be in order so as to revive a domestic financial system, provide liquidity and manage risk during a recovery (Gelpern and Setser, 2004: 796).

Reforming IIAs for financial stability

It is in the interests of the US and its trading partners to have adequate policy space to prevent and mitigate financial crises. This last section

of the paper outlines a number of (non-exclusive) options that are possible.

With respect to regulating cross-border financial flows. First, some IMF officials have gone so far as to recommend that speculative capitals in the form of derivatives and other financial 'innovations' should be omitted from the definition of investment in treaties (Hagan, 2000). Another option, more recently advocated by the IMF, is to come up with a uniform safeguard language that can be used by all nations (IMF, 2012). More specific to US treaties, the 'exceptions' language included in these treaties could be broadened to explicitly allow for the flexibility to deploy controls and other measures now recognized as prudent in terms of preventing or mitigating a crisis. Finally, disputes over these matters should be settled by regulators of party states, not private investors.

With respect to sovereign debt restructuring, the following are three non-exclusive policy remedies that would enable IIAs to grant nations the policy space to conduct effective SDRs in the future. First, exclude sovereign debt from the treaty. The exclusion of sovereign debt from 'covered' investments under future treaties would relegate sovereign debt arbitration to national courts and to international financial bodies. Some IIAs already exclude sovereign debt, such as NAFTA and others. Argentina's new model BIT is reported to be moving in this direction as well. Second, clarify that mitigating financial crises is 'essential security.' Clarify that the essential security exceptions cover financial crises and that sovereign debt restructuring taken by host nations is 'self-judging' and of 'necessity.' Third, and this could pertain to cross-border financial regulation as well, state-to-state dispute resolution for SDR and crisis-related instances may be more prudent than investor-state arbitration given that governments need to weigh up a host of issues in such circumstances. States attempt to examine the economy-wide or public welfare effects of crises whereas individual firms rationally look out for their own bottom line. Investor-state tips the cost-benefit upside down, giving power to the 'losers' even when the gains to the 'winners' (the larger public and the future of a nation) of an orderly restructuring may far outweigh the costs to the losers.

The global financial crisis has made it all too obvious that granting our trading partners the flexibility to use legitimate policies to prevent and

mitigate financial crises is also good for the US. When its trading partners fall into financial crisis, the US loses export markets and subsequently jobs in the export sector. Capital controls can help to stabilize exchange rates, which is good for long-term investors and for exporters and importers from the US. However, when countries abroad cannot control financial bubbles that drive up currency values, American consumers may be hurt by rising prices on imported goods. As we have learned all too well, financial instability in a globalized world can be contagious, and can quickly come back to haunt the US.

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Suggestions for Incorporating Human Rights Obligations into BITs

Patrick Dumberry

There are growing concerns about the negative impact that foreign corporate activities may have on local populations with respect to human rights and related issues.[1] International law, as it now stands, does not impose any *direct* legal obligations on corporations[2] (except for *jus cogens* norms).[3] It should be emphasized,

1. Jordan J. Paust, "Human Rights Responsibilities of Private Corporations," 35 *Vanderbilt JTL* 801 (2002), pp. 817–19; Steven R. Ratner, "Corporations and Human Rights: A Theory of Legal Responsibility," 111 *Yale LJ* 443 (2001), p. 512.
2. David Kinley & Junko Tadaki, "From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law," 44(4) *Virginia JIL* 931 (2004); Clara Reiner & Christoph Schreuer, "Human Rights and International Investment Arbitration," in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann, & Francesco Francioni, eds., *Human Rights in International Investment Law and Arbitration* (New York: Oxford University Press, 2009), pp. 86–87; Howard Mann, "International Investment Agreements, Business and Human Rights: Key Issues and Opportunities," IISD (February 2008), p. 9; Adefolake Adeyeye, "Corporate Responsibility in International Law: Which Way to Go?," 11 *SYBIL* 141-161 (2007), p. 148; Luke Eric Peterson, "Human Rights and Bilateral Investment Treaties. Mapping the Role of Human Rights Law within Investor-State Arbitration," *Rights & Democracy Report* (Montreal 2009), p. 15.
3. Carlos M. Vázquez, "Direct v.. Indirect Obligations of Corporations Under International Law," 43 *Colum. J. Transnat'l L.* 927 (2005), p. 927. According to the ILC work on State responsibility (The Report of the International Law Commission on the work of its Fifty-third session, Official Records of the General Assembly, Fifty-sixth session, Supplement No. 10 (A/56/10), chp. IV.E.2, p. 208), peremptory norms include the prohibitions of aggression, genocide, slavery, racial discrimination, crimes against humanity and torture, and the right to self-determination.

however, that nothing in international law prevents countries from signing treaties (such as bilateral investment treaties or BITs) imposing human rights obligations upon corporations.

BITs, in their current form, simply do not address human rights violation issues. There are several features, typically found in the vast majority of BITs, that clearly bar host countries from initiating arbitration proceedings to claim reparation for human rights violations committed by a foreign investor in their territory. Thus, under the vast majority of BITs, arbitral tribunals only have jurisdiction to adjudicate claims *brought by investors*, and not those submitted by the host country.[4] Even in rare situations where a BIT expressly allows a host country to institute arbitral proceedings, an arbitral tribunal will normally only have jurisdiction to adjudicate disputes originating from alleged breaches of a *treaty provision*.

In their present form, BITs are asymmetrical insofar as investors are being accorded substantive rights (without being subject to any specific obligations) while countries only have obligations. In other words, an investor simply cannot breach any *rights* of the host country under these treaties since no such rights exist. Thus, while a limited number of BITs contain provisions dealing with non-investment issues,[5] they *do not* impose any *obligations* upon foreign investors.[6] The present

4. Mehmet Toral & Thomas Schultz, "The State, a Perpetual Respondent in Investment Arbitration? Some Unorthodox Considerations," in Michael Waibel, Asha Kaushal, Kyo-Hwa Liz Chung, & Claire Balchin, The Backlash against Investment Arbitration: Perceptions and Reality (Alpena aan den Rijn: Kluwer Law International, 2010) pp. 577–602.
5. For example, see: 2004 United States Model BIT, art. 12; 2004 Canada Model BIT, art. 11; Canada–Colombia Free Trade Agreement, art. 816, signed on 21 November 2008, entered into force on 15 August 2011; Canada-Peru Free Trade Agreement, entered into force on 1 August 2009, art. 810.
6. Peterson, op.cit. note 2, p. 3; Mann, op.cit. note 2, p. 9; OECD, "International Investment Agreements: A Survey of Environmental, Labour and Anti Corruption Issues," (Paris: OECD, 2008); Lahra Liberti, "Investissements et droits de l'homme," in Philippe Kahn & Thomas Waelde, eds., *New Aspects of International Investment Law* (Hague Academy of International Law, 2007) p. 820; Marc Jacob, "International investment agreements and human rights," INEF Research Paper Series (2010), p. 26; Ryan Suda, "The Effect of Bilateral Investment Treaties on Human Rights Enforcement and Realization," in Olivier De Schutter, ed., *Transnational Corporations and Human Rights* (Oxford and Portland: Hart Publishing, 2006), p. 23.

author has nonetheless identified elsewhere a number of limited circumstances in which allegations of human rights violations committed by corporations can be raised before an arbitral tribunal.[7]

There is a growing consensus amongst scholars to the effect that BITs *should* take into account human rights obligations.[8] The present paper examines concretely *how* BITs could be drafted (and existing ones could be amended) to incorporate 'non-investment' obligations,[9] including human rights obligations.[10] This approach has been favored in recent years by several scholars,[11] as well as by the United Nations Conference on Trade and Development (UNCTAD).[12] The solutions

7. Patrick Dumberry & Gabrielle Dumas-Aubin, "When and how allegations of human rights violations can be raised in investor-state arbitration," 13(3) *Journal of World Investment & Trade*, p. 349–372 (2012).
8. Jacob, op.cit. note 6; James D. Fry, "International Human Rights in Investment Arbitration: Evidence of International Law's Unity," 18 *Duke JCIL* 77 (2007–2008); OECD, op. cit. note 6; Efraim Chalamish, "The Future of Bilateral Investment Treaties: A de facto Multilateral Agreement?," 34(2) *Brooklyn JIL* 304 (2009); Mann, op.cit. note 2; Luke E. Peterson & Kevin Gray, "International Human Rights in Bilateral Investment Treaties and Investment Treaty Arbitration," Working Paper for the Swiss Ministry for Foreign Affairs (April 2003); Surya P. Subedi, *International Investment Law: Reconciling Policy and Principle* (Oxford and Portland, Oregon: Hart Publishing, 2008); Suda, op.cit. note 6; Barnali Choudhury, "Exception Provisions as a Gateway to the Incorporation of Human Rights in International Investment Law," 49 *Columbia JTL* 670 (2011); Ursula Kriebaum, "Privatizing Human Rights – The Interface between International Investment Protection and Human Rights," 5 *TDM* (2006); Abdullah Al Faruque, "Mapping the Relationship between Investment Protection and Human Rights," 11(4) *Journal of World Investment and Trade* 539 (2010).
9. It should be noted at this juncture that in this paper the expression 'non-investment obligations' will refer to human rights, labour rights and environmental obligations, while the term 'human rights obligations' will sometimes be used as shorthand to include all these 'non-investment' obligations.
10. This question has recently been examined by the author in: P. Dumberry & G. Dumas-Aubin, "How to Impose Human Rights Obligations on Corporations under Investment Treaties?," 4 *Yearbook on International Investment Law and Policy* 569-600 (2011-2012).
11. Liberti, op.cit. note 6, pp. 842, 846; Peterson & Gray, op.cit. note 8, p. 46; Vaughan Lowe, "Corporations as International Actors and International Law Makers," 14 *Italian YIL* 23 (2004), p. 31; Choudhury, op.cit. note 8; Contra: Jacob, op.cit. note 6, pp. 35–36.
12. UNCTAD, *Development Implications of International Investment Agreements*, IIA Monitor No. 2 (2007) (UNCTAD/WEB/ITE/IIA/2007/2), p. 6.

offered are meant to be practical and are limited only to those that can reasonably be expected to be adopted by States in coming years. The following four questions will be examined in this article:

- Where non-investment obligations should be located in BITs?
- What type of language should be used?
- Which international instruments should be referred to in BITs and why?
- Which enforcement mechanisms should be adopted?

A. Location of non-investment obligations in BITs

The first question to be asked is where in the BIT should non-investment obligations be found? Referring to corporations' responsibilities in the preamble of a BIT would certainly have a positive impact. Thus, according to Article 31(1) of the *Vienna Convention on the Law of Treaties*, which reflects custom, treaty terms are, inter alia, interpreted in light of a treaty's context, object and purpose. The preamble is part of a treaty's context. A reference to human rights law in a preamble could therefore serve to indicate and color the treaty's object and purpose.[13]

As stated by the NAFTA *ADF* Tribunal, such general provisions stating the object and purpose of a treaty "may frequently cast light on a specific interpretive issue; but [are] not to be regarded as overriding and superseding the [text]."[14] In other words, preamble language does not have the same weight as a substantive provision.[15] Reference in the preamble may be relevant for matters of treaty interpretation, but will not create any substantive obligations for the investors.[16] The inclusion of corporations' responsibilities in the preamble of a BIT would nevertheless certainly have a positive impact on human rights concerns.[17] It

13. *S.D. Myers, Inc. v. Canada*, UNCITRAL/NAFTA, First Partial Award (13 November 2000), at 196.
14. *ADF Group Inc. v. United States*, ICSID Case No. ARB(AF)/00/1 (NAFTA), Award (9 January 2003), at 147.
15. Jacob, op.cit. note 6, pp. 10, 34.
16. Mann, op.cit. note 2, p. 10.
17. Liberti, op.cit. note 6, p. 808.

would certainly lead tribunals to adopt more balanced interpretation of treaty clauses.[18] In fact, a limited number of BITs already contain references to non-investment issues in their preamble.[19]

Although, the inclusion of corporations' responsibilities in the preamble of a BIT may be a useful tool to enhance the applicability of human rights doctrine, there remains, in my view, a more promising avenue. I believe that human rights obligations should be expressly referred to in the main text of the BIT.

B. Type of language used

Another relevant question is what kind of language should be used in the BIT to ensure effective corporation regulation. Provisions must not only be clear and unambiguous, but they must "create specific, well-defined mandatory human rights obligations applicable to corporate activity."[20] For instance, using language similar to Section 32 of Norway's (now defunct) Model BIT would be unsatisfactory. Under that instrument, the Parties merely "agree to encourage investors" to conduct their investment activities in compliance with non-binding international instruments.[21] Merely *encouraging* investors to do something has not worked in the past and is quite unlikely be an effective remedy in the future. It is therefore paramount that a treaty provision creates mandatory legal obligations *forcing* corporations to adopt a certain behavior. The provision must also establish a mechanism whereby non-compliance is efficiently sanctioned by an arbitral tribunal (a point further discussed below).

Other options have also been envisaged.[22] One possibility would be

18. Jacob, op.cit. note 6, p. 44.
19. 2007 Draft version of the Norway Model BIT, which was later abandoned by the Norwegian government; 2002 European Free Trade Area–Singapore Free Trade Agreement, signed on 26 June 2002, entered into force on 1 January 2003; 2008 Canada–Colombia FTA.
20. Penelope Simons, "Corporate Voluntarism and Human Rights: The Adequacy and Effectiveness of Voluntary Self-Regulation Regimes" 59(1) *Industrial Relations,*101-141 (2004), p. 130.
21. Norway Model BIT, op.cit. note 19, art. 32.
22. Choudhury, op.cit. note 8, p. 25 (paper version as on file with author); Jacob, op. cit. note 6, p. 44.

to include a provision specifying that certain human rights treaties will prevail in the event of any inconsistency with the BIT. The North American Free Trade Agreement (NAFTA) contains a similar clause dealing with inconsistencies between its text and a list of environmental treaties.[23] Another option would be to clarify the scope of the country's obligations under the BIT in order to take into account human rights concerns.[24] Such clarification could take the form of a binding note of interpretation[25] or be done by a treaty amendment. There is no doubt that a clarification would be a useful tool for a tribunal when interpreting a treaty clause such as the obligation for the host country to provide a fair and equitable treatment to investors. Yet, the obvious shortcoming of such a clause is the fact that it does not impose any specific and mandatory human rights *obligations* upon corporations.

C. The international instruments that should be referred to in BITs

What should be the actual content of obligations imposed upon corporations? A pragmatic approach is to confine the scope of any future treaty to a limited number of well-defined obligations existing in only a few areas of international law. In my view, these obligations should be limited to those found in four distinct areas of law: human rights, labor rights, the protection of the environment and anti-corruption.[26] This is in fact the approach that has been adopted by the United Nations Global Compact, a non-binding initiative, under which a large number of companies have committed to respect in their business activities

23. North American Free Trade Agreement (NAFTA) 1 January 1994, art. 104.
24. This is, for instance, the option favored by Jacob, ibid., pp. 33–35.
25. Jacob, op.cit. note 6, p. 33–35; Mann, op.cit. note 2, p. 24.
26. OECD, op.cit. note 6; Mann, op.cit. note 2, p. 8.

abroad a set of ten core principles and values.[27] These ten principles are drawn from the four above-mentioned areas of international law.

There are different ways by which these obligations can be incorporated into BITs. The first obvious option is to simply let Parties determine for themselves, during treaty negotiations, which of the many fundamental human rights, labor rights, environmental rights, and anti-corruption obligations they want to include in the BIT. In other words, every single obligation to be imposed upon corporations would have to be the object of negotiation between the parties. This is not the most well suited approach as such negotiations would likely take a considerable amount of time and raise numerous controversial issues. Also, negotiation inevitably involves compromises, which may not result in an effective reinforcement of human rights obligations. For all these reasons, countries will likely be very reluctant to embark on such an uncertain journey.

There exists, however, a much more straightforward solution. Essentially, it is simpler for BITs to refer to those standards that have already been accepted by the vast majority of countries in well-recognized international treaties. In fact, it is not uncommon to find specific references to international agreements in BITs.[28] The proposed provision should therefore directly refer to the instruments that corporations must comply with.[29] In my view, BITs should specifically refer to the following instruments:

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27. United Nations, *Global Compact*, UN GA Res. 64/223, 25 March 2010. The ten principles are: Businesses should support and respect the protection of internationally proclaimed human rights; and make sure that they are not complicit in human rights abuses; Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; and the elimination of all forms of forced and compulsory labour; and the effective abolition of child labour; and the elimination of discrimination in respect of employment and occupation; Businesses should support a precautionary approach to environmental challenges; and undertake initiatives to promote greater environmental responsibility; and encourage the development and diffusion of environmentally friendly technologies; Businesses should work against corruption in all its forms, including extortion and bribery.
28. OECD, op.cit. note 6, p. 150, citing many examples.
29. One example of such a clause could be the following: "Investors and investments shall act at all time in accordance with the obligations contained in the following international instruments: [. . .]." For UNCTAD, op.cit. note 12, p. 6, one drafting option would be to include an obligation for investors to refrain from "activity that would violate human or labour rights, damage the environment, or constitute corruption."

- Universal Declaration of Human Rights (UDHR) (1948);[30]
- United Nations International Covenant on Civil and Political Rights (ICCPR) (1966);[31]
- International Labour Organization (ILO) Declaration on Fundamental Principles and Rights at Work (1998);[32]
- United Nations Convention Against Corruption (UNCAC) (2003);[33]
- Rio Declaration on Environment and Development (1992).[34]

A narrower approach has been adopted by UN Special Representative John Ruggie in his final 2011 Report (which was endorsed by the UN Human Rights Council),[35] whereby Principle 12 states that "the responsibility of business enterprises to respect human rights refers to internationally recognized human rights – understood, at a minimum, as those expressed in the International Bill of Human Rights and the principles concerning fundamental rights set out in the International Labour Organization's Declaration on Fundamental Principles and Rights at Work."[36] Ruggie therefore limits the 'list' only to human rights and labor rights instruments.

30. United Nations, *Universal Declaration of Human Rights*, adopted on 10 December 1948 by the UN General Assembly: GA Res. 271 A (III) UN Doc A/810.
31. United Nations, *United Nations International Covenant on Civil and Political Rights*, adopted on 16 December 1966, entered into force on 23 March 1976, GA Res. 2200 A (XXI) UN Doc A/6316 (1966).
32. International Labour Organization, *Declaration on Fundamental Principles and Rights at Work*, adopted on 18 June 1998 by the International Labour Conference.
33. United Nations, *United Nations Convention Against Corruption*, adopted on 31 October 2003 by the UN General Assembly: GA Res. 58/4. (2012 -10-21).
34. Adopted by consensus at the United Nations Conference on Environment and Development by 178 countries in Rio de Janeiro, Brazil, in June 1992.
35. *Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, as endorsed by Human Rights Council, A/HRC/RES/17/4 (6 July 2011).
36. Ibid., p. 14. The Commentary to Principle 12 further indicates that "An authoritative list of the core internationally recognized human rights is contained in the International Bill of Human Rights (consisting of the Universal Declaration of Human Rights and the main instruments through which it has been codified: the International Covenant on Civil and Political Rights and the International Covenant on Economic, Social and Cultural Rights), coupled with the principles concerning fundamental rights in the eight ILO core conventions as set out in the Declaration on Fundamental Principles and Rights at Work."

In my view, it is best for BITs to refer only to a handful of treaties. One inadequate option is the one taken by the *Draft Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with Respect to Human Rights*.[37] The Draft Norms, which were adopted by the UN Sub-Commission on the Promotion and Protection of Human Rights (but not by the Human Rights Commission),[38] impose *direct* obligations on corporations with respect to, inter alia, human rights, labor rights, and environmental protection.[39] These Draft Norms have been subject to severe criticisms.[40] In his Interim Report, Ruggie considered the Draft Norms a failed attempt, with "little authoritative basis in international law," to "take existing State-based human rights instruments and simply assert that many of their provisions now are binding on corporations as well."[41] In his view, international law has not been "transformed to the point where it can be said that the broad array of international human rights attach direct legal obligations to corporations."[42] The Draft Norms provide in its preamble that corporations are "obligated to respect generally recognized responsibilities and norms" that are contained in no less than 30 international instruments. It is very unlikely that countries will ever agree to impose obligations

37. UN Sub-Commission on the Promotion and Protection of Human Rights, *Draft Norms on the Responsibilities of Transnational Corporations and other Business Enterprises with Respect to Human Rights*, E/CN.4/Sub.2/2003/12/Rev.2 (26 August 2003).
38. Human Rights Commission, Decision 2004/116, 20 April 2004.
39. Although the preamble of the Draft Norms "recognize" that "States have the primary responsibility to promote, secure the fulfilment of, respect, ensure respect of and protect human rights," it adds that "transnational corporations and other business enterprises, as organs of society, are also responsible for promoting and securing the human rights set forth in the Universal Declaration of Human Rights." It also states that "transnational corporations and other business enterprises, their officers and persons working for them are also obligated to respect generally recognized responsibilities and norms contained in United Nations treaties and other international instruments." Art. 1 of the Norms states that "transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of and protect human rights recognized in international as well as national law, including the rights and interests of indigenous peoples and other vulnerable groups."
40. See, Kinley & Tadaki, op.cit. note 2, pp. 946–47.
41. *Interim Report of the Special Representative of the Secretary-General of the United Nations on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises*, John Ruggie, E/CN.4/2006/97 (22 February 2006), p. 60.
42. Ibid., p. 64.

on their national corporations that are found in 30 legal instruments.

The first reason for choosing the above-mentioned five particular instruments is because they have been ratified or endorsed by an overwhelming number of countries. It is easier to convince countries to incorporate human rights obligations when the principles contained in these few instruments are not controversial and are supported by the vast majority of them. As explained elsewhere in detail by the present author, the content of some of these instruments is considered as representing customary international law.[43] Thus, the majority of the provisions of the UDHR are generally considered to reflect customary international law.[44] Similarly, while the ICCPR as a whole is not considered as representing customary international law, it remains that some of the 'non-derogable' rights it contains are considered as custom.[45] The ILO Declaration expressly refers to four principles that are binding on the 183 ILO Member States.[46] In any event, these principles are themselves embodied in eight ILO Conventions that have

43. Dumberry & Dumas-Aubin, op.cit. note 10, pp. 584-587.
44. John Ruggie, "Current Developments. Business and Human Rights: The Evolving International Agenda," 101 AJIL 819 (2007), p. 833; Andrew Clapham, *Human Rights Obligations of Non State Actors* (New York: Oxford University Press, 2006), p. 86.
45. UN Human Rights Committee, *General Comment No. 24: Issues Relating to Reservations made upon Ratification or Accession to the Covenant or the Optional Protocols thereto, or in Relation to Declarations under article 41 of the Covenant*, UN Doc. CCPR/C/21/Rev.1/Add.6, 1994. These non-derogable rights include the "Right to Life" (art. 6), the right not to be "subjected to torture or to cruel, inhuman or degrading treatment or punishment" (art. 7), the right not to be "held in slavery" (art. 8(1)), the right not to be "held in servitude" (art. 8(2)), the right not to be "imprisoned merely on the ground of inability to fulfil a contractual obligation" (art. 11), the right not to be "held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence, under national or international law, at the time when it was committed" (art. 15), "the right to recognition everywhere as a person before the law" (art. 16) and the "right to freedom of thought, conscience and religion" (art. 18).
46. The four principles mentioned in the Declaration are the following: "(a) freedom of association and the effective recognition of the right to collective bargaining; (b) the elimination of all forms of forced or compulsory labour; (c) the effective abolition of child labour; and (d) the elimination of discrimination in respect of employment and occupation."

been ratified by most Member States and that impose mandatory legal obligations upon them.[47] The United Nations Convention Against Corruption has been ratified by 158 countries and numerous binding international treaties prohibiting bribery have also been adopted by countries at the regional level.[48] The Rio Declaration, a non-binding instrument, was endorsed by a great number of countries and some of the principles it contains are considered as representing custom.[49]

The second reason why these five instruments should be selected is simply because they are already accepted by a large number of corporations as guiding principles of conduct for their business activities abroad.[50] It is submitted that countries will be more ready to impose

47. *Convention concerning Freedom of Association and Protection of the Right to Organise* (Convention No. C087, 1948, 150 ratifications); *Convention concerning the Application of the Principles of the Right to Organise and to Bargain Collectively* (Convention no. C098, 1949, 160 ratifications); *Convention concerning Forced or Compulsory Labour* (Convention no. C029, 1930, 175 ratifications); *Convention concerning the Abolition of Forced Labour* (Convention no, C105, 1957, 169 ratifications); *Convention concerning Equal Remuneration for Men and Women Workers for Work of Equal Value* (Convention no. C100, 1951, 168 ratifications); *Convention concerning Discrimination in Respect of Employment and Occupation* (Convention no. C111, 1958, 169 ratifications); *Convention concerning Minimum Age for Admission to Employment* (Convention no. C138, 1973, 161 ratifications); *Convention concerning the Prohibition and Immediate Action for the Elimination of the Worst Forms of Child Labour* (Convention no. C182, 1999, 174 ratifications) – all available at http://www.ilo.org/ilolex/english/convdisp1.htm (last visited 22 April 2012).
48. OECD, *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, adopted by the Negotiating Conference on 21 November 1997; Council of the European Union, *Convention on the Fight against Corruption involving Officials of the European Communities or Officials of Member States of the EU*, OJ C195 (25 June 1997); Council of Europe, *Criminal Law Convention on Corruption*, opened of signature on 27 January 1999 (CETS No. 173); *Civil Law Convention on Corruption*, opened of signature on 4 November 1999 (CETS No. 174); Organization of American States, *Inter-American Convention against Corruption*, adopted at the third plenary session, held on 29 March 1996; African Union, *African Union Convention on Preventing and Combating Corruption and related offences*, adopted on 11 July 2003
49. See the list in: Philippe Sands, *Principles of International Environmental Law*, 2nd ed. (Cambridge, UK: Cambridge University Press, 2003), p. 148, 254. The issue is further discussed in: Dumberry & Dumas-Aubin, op.cit. note 10, pp. 584-587.

international legal obligations on corporations knowing that there is already widespread support for them in the business community.

The above-mentioned five international instruments are, of course, not the only ones that could be referred to in BITs. Reference could also be made, for instance, to soft law instruments that have been adopted by countries, such as the ILO *Tripartite Declaration of Principles Concerning Multinational Enterprises*[51] or the OECD *Guidelines for Multinational Enterprises.*[52] The main problem with this suggestion is precisely the non-binding nature of these instruments. It is true that these soft law instruments include some principles that are themselves contained in other international treaties that are binding on countries. In other words, while these instruments are 'soft law' by nature, some of its content may actually be 'hard' law. But this is not the case for *all principles* set out in the ILO Declaration and the Organisation for Economic Co-operation and Development (OECD) Guidelines. Some of the principles contained in these two instruments simply impose no obligation on anyone. Thus, corporations have no direct obligations to respect these principles and countries have no binding responsibilities under international law to ensure corporate compliance with them. Countries are unlikely to be willing to 'transform' these soft law instruments into hard law ones by simply incorporating them in BITs. To the extent these soft law instruments in fact refer to hard law contained elsewhere, why not make a direct reference to the binding treaty where the hard law is to be found in the first place? This is a straightforward solution more likely to be endorsed by country practice.

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50. *Interim Report of the Special Representative,* op.cit. note 41, 34. He mentions that he conducted a survey of the "Fortune Global 500," the world's largest corporations: "When asked which if any international human rights instruments the company references in its policy, three fourths say International Labour Organization (ILO) declarations or conventions, 62% cite the Universal Declaration on Human Rights, and 57% the United Nations Global Compact. The Guidelines for Multinational Enterprises of the Organization for Economic Cooperation and Development (OECD) are referenced by 4 out of 10."
51. ILO, *Tripartite Declaration of Principles Concerning Multinational Enterprises,* (MNE Declaration) – 4th ed. (1 January 2006)..
52. OECD, *Guidelines for Multinational Enterprises,* Organisation for Economic Co-operation and Development, DAFFE/IME/WPG(2000)15/ FINAL.

The same comment also applies to non-binding documents that have been developed in the context of international organizations. The ten principles established under the United Nations Global Compact is a prime example. While clearly not a treaty imposing any obligations on countries (nor on corporations for that matter), the principles have nevertheless been accepted by a large number of countries via a UN General Assembly resolution in 2010.[53] In fact, the ten principles are all drawn from international treaties whose content is binding. Again, to the extent that this 'soft law' document does refer to 'hard' law binding obligations contained in *other* international instruments, it may just be simpler to make a direct reference in a BIT to the binding treaty where the 'hard' law is found.

D. Different enforcement mechanisms

Making reference to specific international treaties in a BIT is only the first step to be considered when seeking to improve the protection of human rights in the context of BITs. The treaty's section on investor-state dispute resolution must also contain a provision indicating specifically how human rights obligations imposed upon corporations can actually be enforced before an arbitral tribunal.[54] The provision must make it clear that an arbitral tribunal has jurisdiction over allegations of human rights violations committed by corporations. Setting up a regime of direct obligations under a BIT without any enforcement mechanism will not only render these rights totally ineffective, it would in fact, as one author puts it, "not enhance human rights, but trivialize international law."[55]

There are at least three different enforcement possibilities that can be envisaged in a BIT's investor-state dispute resolution clause.[56]

53. United Nations, *Global Compact*, op.cit. note 27.
54. Jacob, op.cit. note 6, pp. 36, 45; Peterson & Gray, op.cit. note 8, p. 36.
55. Vázquez, op.cit. note 3, p. 958.
56. See, Dumberry & Dumas-Aubin, op.cit. note 10, p. 596-7, examining another inadequate option that has been put forward by writers: to allow the host country (or one of its nationals) to file an arbitration claim directly against a foreign investor who made an investment in the country and has breached non-investment obligations.

i. The clean hands doctrine

The 'clean hands' doctrine has been defined as "an important principle of international law that ha[s] to be taken into account whenever there [i]s evidence that an applicant State ha[s] not acted in good faith and that it ha[s] come to court with unclean hands."[57] As explained by the present author elsewhere, the application of the clean hands doctrine in international law is still controversial.[58] Yet, the doctrine has been recognized in the domestic orders of several countries[59] and has rightly been described by many, including Judges Schwebel[60] and Anzilotti,[61] as a "general principle of law." As such, the doctrine of clean hands is a source of law that can be applied by international tribunals in accordance with Article 38(1)(c) of the ICJ Statute.[62] Arbitral tribunals may therefore refer to the doctrine in the context of investor-state arbitration.[63]

Many BITs include a provision stating that protected investments are those made 'in accordance with the law.' The practical effect of such a provision is straightforward: an investment not made in accordance with the host State's law will not be a protected investment under the

57. Report of the International Law Commission, 57th Session, UN Doc A/60/10, 236.
58. Patrick Dumberry & Gabrielle Dumas-Aubin, "The Doctrine of 'Clean Hands' and the Inadmissibility of Claims by Investors Breaching International Human Rights Law," 10(1) *TDM Special Issue: Aligning Human Rights and Investment Protection* (2013).
59. See, Richard Kreindler, "Corruption in International Investment Arbitration: Jurisdiction and the Unclean Hands Doctrine," in Between East and West: Essays in Honour of Ulf Franke (K. Hober, A. Magnusson and M. Öhrström eds., Juris Publishing, 2010) p. 317.
60. *Military and Paramilitary Activities in and against Nicaragua* (Nicaragua vs United States of America) Dissenting opinion of Judge Schwebel, (27 June 1986), 269.
61. The Diversion of Water from the Meuse, PCIJ (1937) Series A/B No. p. 70, dissenting opinion of Judge Anzilotti, p. 50.
62. Kreindler, op.cit. note 59, p. 318.
63. This is the case when the BIT provides for 'international law' as the applicable law for the settlement of disputes.

BIT.[64] A tribunal will have to decline jurisdiction over a claim when faced with an investment not in compliance with a BIT's 'in accordance with the law' provision.[65] This is indeed a matter of *jurisdiction* rather than admissibility. The inclusion in a BIT of an 'in accordance with the law' provision is a manifestation of the doctrine of clean hands.[66] Several arbitral tribunals have, to some extent, already made use of the clean hands doctrine to determine questions of admissibility/jurisdiction.[67] Recent ICSID tribunals have thus held that they either lack jurisdiction or that a claim is inadmissible when faced with the illegal conduct of an investor, such as misrepresentations made by the claimant,[68] fraud,[69] or bribery/corruption.[70] Moreover, a number of tribunals have also held that there exists an *implicit* obligation for investors not to violate the law of the host State to be worthy of BIT protections (even when a BIT does not contain an 'in accordance with the law' provision).[71]

64. *Salini Costruttori S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, (23 July 2001), 46; *Phoenix Action, Ltd. v. Czech Republic*, ICSID Case No. ARB/06/5, Award (15 April 2009), 101; *Fraport AG Frankfurt Airport Services Worldwide v. Philippines*, ICSID Case No. ARB/03/25, Award, 16 August 2007, 397, 402. See also: *Alasdair Ross Anderson et al. v. Costa Rica*, ICSID Case No. ARB(AF)/07/3, Award (19 May 2010), 58-59.
65. Rahim Moloo, "A Comment on the Clean Hands Doctrine in International Law," 1 *TDM* (2011), p. 7, referring to *Inceysa Vallisoletana S.L. v. El Salvador*, ICSID Case No. ARB/03/26, Award (2 August 2006), 248-252.
66. Moloo, op.cit. note 65, p. 7; Rahim Moloo & Alex Khachaturian, "The Compliance with the Law Requirement in International Investment Law," 34 *Fordham ILJ* 1473 (2011), p. 1485.
67. Moloo, Ibid.
68. *Plama Consortium Limited v. Bulgaria*, ICSID Case No. ARB (AF)/03/24, Award, (27 August 2008), 130-146.
69. *Inceysa Vallisoletana S.L. v. El Salvador*, op.cit. note 65, 248-252.
70. *World Duty Free Company Limited v. Kenya*, ICSID Case No. ARB (AF)/00/7, Award (4 October 2006), 157.
71. *Phoenix Action, Ltd. v. Czech Republic*, op.cit. note 64, 101; *Gustav F W Hame.ster GmbH & Co KG v. Ghana*, ICSID Case No. ARB/07/24, Award (18 June 2010), 124; *Plama Consortium Limited v. Bulgaria*, op.cit. note 68, 138, 139, 143, 146.

I have discussed elsewhere that, based on the doctrine of clean hands, tribunals should find inadmissible claims involving human rights violations committed by corporations under BITs *as they are presently drafted*.[72] The following paragraphs look at the other question of how BITs should be drafted (and existing BITs amended) to *explicitly* introduce the doctrine of clean hands.

One drafting option would be for investors' protection under a BIT to be *conditioned* upon its respect for human rights (and other non-investment obligations).[73] Contracting Parties are indeed free to limit consent to arbitration to disputes satisfying specific characteristics.[74] Nothing therefore prevents countries from conditioning the availability of substantive protections for investors on their compliance with fundamental human rights obligations.[75] Under the proposed drafting option, a tribunal concluding that a corporation has committed human rights violations contrary to its obligations under a relevant treaty should find the investor's claim inadmissible.[76] I believe that this is a matter of *admissibility* rather than *jurisdiction*. Thus, while a tribunal would have jurisdiction over the investor's claim, it should nevertheless refuse to hear it based on the investor's breach of human rights obligations contained in the BIT. To the extent that recent tribunals have

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72. This question is examined in detail in: Dumberry & Dumas-Aubin, op.cit. note 7, p. 362-367.
73. An unambiguous reference to that effect should be expressly incorporated in the BIT's investor-state dispute resolution clause. The clause could read as follows: "Where an investor or its investment has breached any of the obligations mentioned at Article [...] of this Agreement, neither the investor nor its investment shall be entitled to the substantive protections established under this Agreement. A host or home state may raise these allegations as an objection to the admissibility in any dispute under this Agreement."
74. *Gustav F W Hamester GmbH & Co KG v. Ghana*, op.cit. note 71, 125 ("it is clear that States may specifically and expressly condition access of investors to a chosen dispute settlement mechanism, or the availability of substantive protection [...] one such common condition is an express requirement that the investment comply with the internal legislation of the host State").
75. Similarly, Jean J.A. Salmon, "Des 'mains propres' comme condition de recevabilité des réclamations internationales," 10 *Annuaire Français de Droit International* 225 (1964), pp. 225, 240, provides several examples of 19th century international treaties setting up mixed claims commissions, which specifically excluded from their jurisdiction claims by individuals who had participated in wars, revolutions, etc.
76. Liberti, op.cit. note 6, p. 839.

denied admissibility of claims based on bribery or misrepresentations made by the claimant, it is submitted that they should do the same when faced with human rights violations. In other words, the solution that prevailed so far for bribery, should, *a fortiori*, find application when a tribunal finds fundamental human rights abuses by a claimant. In my view, these are precisely the kind of investments not worthy of protection under a BIT.[77]

ii. Offsetting of damages

A second available option would be to permit an investor's claim, even in the face of human rights violations, but to allow the respondent State to raise any such allegations during the arbitral proceedings.[78] This is the 'offsetting of damages' (or 'mitigation') option. A tribunal would thus take into account such allegations when making its determination on the merits of the dispute. These allegations should also have some impact on the tribunal's assessment of compensation for damages claimed by the investor (as well as questions of allocation of costs, fees, etc). Thus, compensation should be reduced "proportionally to the investor's violation" of human rights obligations.[79] There is no doubt that a tribunal has power to take the investor's behavior into account when calculating compensation.[80] Some arbitral awards have reduced compensation based on the investor's behavior (on matters unrelated to human rights violations).[81] Also, nothing prevents a tri-

77. The other question of whether or not an investor could invoke the Most Favored Nation treatment (MFN) clause found in the basic BIT to by-pass the clean hands requirement and claim a 'better treatment' found in another BIT is examined in: Dumberry & Dumas-Aubin, op.cit. note 10, p. 594.
78. Jacob, op.cit. note 6, pp. 36, 45.
79. Knoll-Tudor, Ioana, "The Fair and Equitable Treatment Standard and Human Rights Norms," in: Dupuy et al., op.cit. note 2, pp. 75–78; Peter Muchlinski "'Caveat Investor'? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard," 55(3), *ICLQ*, (2006), p. 530.
80. Rudolf Dolzer & Christopher Schreuer, *Principles of International Investment Law* (New York: Oxford University Press, 2008), p. 273.
81. *MTD Equity Sdn. Bhd. & MTD Chile S.A. v. Chile*, ICSID Case No. ARB/01/7, Award (25 May 2004), 243; *Iurii Bogdanov v. Moldova*, Ad hoc – SCC Arbitration Rules; IIC 33 (2005), Award (22 September 2005), 84.

bunal from taking into account international obligations arising under other areas of international law than international investment law to determine the *quantum* of compensation.[82]

The investor-state dispute resolution clause should expressly mention that tribunals have the authority to take into account human rights obligations in the context of the proceedings.[83]

iii. Counterclaims

A third available option is a variant of the 'mitigation option' examined above. Under this 'counterclaim' option, a claimant investor would be permitted to file a claim, even in the face of human rights violations, but the host country would be allowed to raise human rights allegations in a counterclaim.[84]

Under the vast majority of BITs, arbitral tribunals only have jurisdiction to adjudicate claims *brought by investors*, and not those submitted by the host country.[85] Under these treaties, it is generally recognized that a tribunal's jurisdiction over a claim brought by an investor does not imply jurisdiction over a counterclaim submitted by the respondent State.[86] Thus, the respondent State will typically not be entitled to submit any counterclaim invoking human rights violations committed by an investor. In any event, even in favorable circumstances where

82. Lahra Liberti, "The Relevance of Non-Investment Treaty Obligations in Assessing Compensation" in: Dupuy et al., op.cit. note 2.
83. One example of such clause could be the following: "Where an investor or its investment is alleged by a host state to have failed to comply with its obligation mentioned at Article [...] of this Agreement, the tribunal hearing such a dispute shall consider what effect this breach, if proven, may have on the merits of a claim or what mitigating or off-setting effects this breach may have on any damages awarded in the event of such award." The clause is adapted from art. 18(B) of the *IISD Model International Agreement on Investment for Sustainable Development*, available at Investment Treaty Arbitration http://italaw.com/investmenttreaties.htm.
84. Chalamish, op.cit. note 8, p. 348; Liberti, op.cit. note 6, p. 840.
85. Toral & Schultz, op.cit. note 4, pp. 577–602.
86. Hege Elisabeth Veenstra-Kjos, "Counterclaims by Host States in Investment Treaty Arbitration," 4 *TDM* (2007), p. 9; Christoph Schreuer, *The ICSID Convention: A Commentary* (Cambridge University Press, 2009), p. 754.

a tribunal would have jurisdiction over a counterclaim, "there is still another obstacle to overcome: the requirement of the 'connexity' between the primary claim and the counterclaim."[87] Thus, under Article 46 of the ICSID Convention, a tribunal "shall determine any incidental claims or counterclaims arising directly out of the subject-matter of the dispute." A tribunal may ultimately reject a counterclaim on the ground that it is 'disconnected' with the claim submitted by the investor, and thus outside the scope of arbitration. For all these reasons, the possibility for counterclaims by host countries should be expressly provided for in the BIT's investor-state dispute resolution clause.[88]

Conclusion

Very few BITs refer to questions related to human rights. When they do, they clearly do not impose any binding obligations on foreign corporations. As a result, human rights concerns can only be raised in a very limited number of circumstances before arbitral tribunals in the context of BIT arbitration proceedings.[89] The present article argues that new provisions should be incorporated in BITs to impose direct human rights and other non-investment obligations upon corporations. There is indeed a need for a greater degree of balance in BITs between the legitimate interests of investors and host countries.

At the moment, the prospect of a new generation of BITs, balancing the rights and obligations of corporations, is uncertain. There does not seem to be any clear political will amongst countries for such developments. Ultimately, all countries, both developed and developing, would have a great interest in pursuing these changes in future treaties. In my view, emerging markets (which appear as host countries in

87. Helene Bubrowski, "Counterclaims," in: A. De Mestral & C. Lévesque (eds.), *Improving International Investment Agreements*, Routledge, 2013, p. 16 (of the paper version on file with author); Schreuer, Ibid., p. 743.

88. One drafting possibility could be the following clause: "A host state may initiate a counterclaim before any tribunal established pursuant to this Agreement for damages resulting from an alleged breach of the Agreement." The clause is adapted from art. 18(E) of the *IISD Model International Agreement on Investment for Sustainable Development*, op.cit. note 83.

89. Dumberry & Dumas-Aubin, op.cit. note 7, p. 349-372.

most cases) will increasingly realize that the proposed changes are to their benefit insofar as it would provide them with additional tools in defending claims by foreign investors.

Objection to the proposed changes may come from capital-exporting countries (often Western markets). Thus, when signing a BIT, their goal is, after all, to provide extensive legal protection to their national investors conducting business abroad. They may be reluctant at first to adopt any BIT provisions that would also impose human rights obligations upon their own nationals. However, different segments of civil society will increasingly put pressure on governments to take effective measures to control the activities of corporations abroad. One simple way for capital-exporting markets to respond to these grievances would be to adopt BITs imposing human rights obligations upon corporations. The inclusion of specific reference to corporate social responsibility in a number of new BITs is a first step in this direction. It is noteworthy that, in the context of the recent negotiation of Canada's Free Trade Agreements with Peru, Colombia and Panama, references to corporate social responsibility were in fact pushed by Canada.[90] In my view, countries will eventually and inevitably be pushed toward including human rights obligations within their BITs, as a result of the unremitting concerns about the legitimacy of the current generation BITs.

90. Canada-Peru FTA (2009), art. 810; Canada-Colombia FTA (2008), art. 816; Free Trade Agreement between Canada and the Republic of Panama, signed on 14 May 2010. In doctrine: Jarrod Hepburn & Vuyelwa Kuuya, "Corporate Social Responsibility and Investment Treaties" in Marie-Claire Cordonier Segger, Markus W. Gehring & Andrew Newcombe eds., *Sustainable Development in World Investment Law* (The Netherlands: Kluwer Law International, 2011), p. 607; Jean-Michel Marcoux, "La recherche d'un équilibre – Évolution des protections et des obligations des sociétés minières canadiennes dans les Amériques," 24(1) *Revue québécoise de droit international* (2011).

ISDS, Extractive Industries and the Case of Pacific Rim vs El Salvador

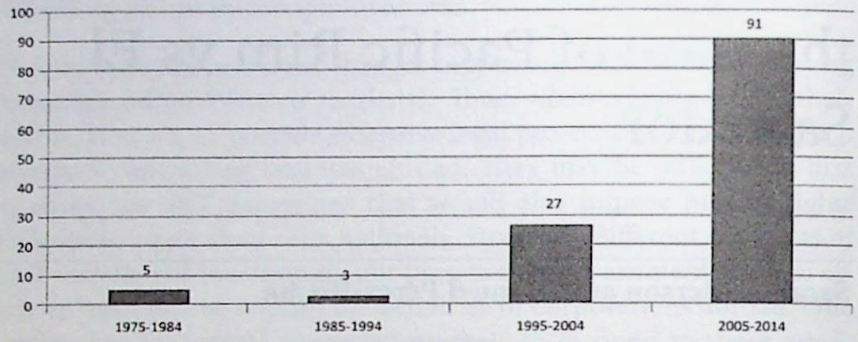
Sarah Anderson and Manuel Pérez-Rocha

British-owned Churchill Mining is suing Indonesia for US$1 billion over the revocation of coal mining permits on the island of Borneo. Canadian-based Bear Creek Mining is suing Peru for canceling a silver mine project after six people lost their lives in protests against the plan. Pacific Rim-Oceana Gold is suing El Salvador for more than $300 million for not being allowed to operate a potentially environmentally harmful gold mining project.

These are just a few examples of how transnational corporations are increasingly using international investment agreements as weapons in disputes with governments over valuable natural resources.

At just one of the several international arbitration tribunals that handle such 'investor-state' cases (the only tribunal that publishes a list of cases), private investors filed 91 claims related to oil, mining, and gas disputes in the past decade. These cases, filed with the World Bank-affiliated International Centre for the Settlement of Investment Disputes (ICSID), number more than three times the cases registered in the previous decade and well more than double the number in the three prior decades combined.

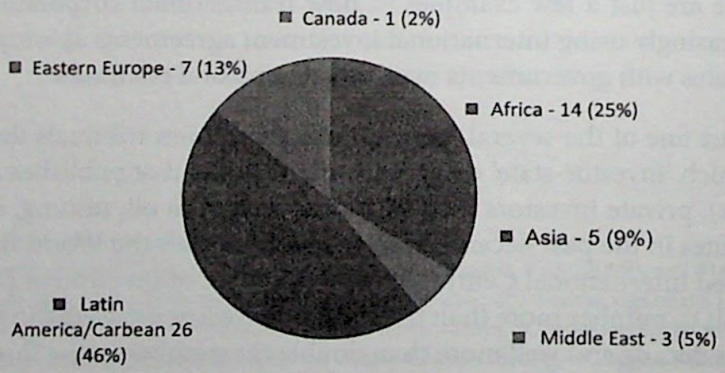
Figure 1 : Oil, mining, and gas cases registered at ICSID



Source: www.worldbank.org/ICSID

The trend of using investor-state lawsuits as a means of prevailing in resource rights fights is most evident in Latin America. As of 4 March 2015, there were a total of 197 pending ICSID cases. Of these, 56 (28%) are related to oil, mining, or gas.[1] Countries of the Latin America and Caribbean region are the target of 26 (46%) of the pending extractives cases.[2] Venezuela faces the largest number – eight – followed by Argentina, with seven.

Figure 2 : Regional Breakdown of Oil, Mining, and Gas Investor-State Cases (pending at ICSID as of March 1, 2015)



Source: www.worldbank.org/ICSID

1. Data based on ICSID cases.
2. Analysis of ICSID data by Institute for Policy Studies.

The growth in Latin America's investor-state cases has coincided with major political shifts in the region. As the price of extractives has increased, a mining rush in Latin America exacerbated tensions with local communities that have long demanded a fairer share of the benefits of their natural resources and have also opposed environmentally destructive practices.[3] Indigenous groups and local populations throughout the region have risen up to protect their rights to lands and water sources against the destructive forces of transnational mining corporations.[4] Political leaders who have responded to these demands have had to face the prospect of provoking expensive investor lawsuits.

Extractives cases illustrate some of the most controversial elements of the corporate investment regime

1. The 'chilling effect'

As it is well-known, the investor-state dispute settlement (ISDS) system allows private foreign investors to bypass domestic courts and sue governments directly in international tribunals. While the tribunals cannot force a government to repeal national laws and regulations, the threat of massive damages awards can put a 'chilling effect' on responsible policy-making. Below are some examples:

- In 2010, the Inter-American Commission on Human Rights advised the Guatemalan government to close the notorious Marlin Mine because of harmful effects on the surrounding region and its indigenous population. After briefly agreeing to suspend operations, the Guatemalan government reopened the mine a short time later. In internal documents obtained through a Freedom of Information Act request, the Guatemalan government cited potential investment arbitration as a reason to avoid suspending the mine, writing that closing the project could provoke the mine's owners

3. Kelly Hearn, "South America's Mining Wars Heat Up," Alternet, 28 June 2005. Available at http://www.alternet.org/environment/22307.
4. Michael Voss, "Ecuador tribes vow to fight oil threat," BBC News, 3 March 2005. Available at http://news.bbc.co.uk/2/hi/americas/4308537.stm.

"to invocate the clauses of the free trade agreement to have access to international arbitration and subsequent claim of damages to the state."[5]

- In 2014, Newmont Mining Corporation sued Indonesia over plans to ban unprocessed mineral exports. The ban was part of a new mining law aimed at ensuring that the Indonesian people would reap more benefits from the country's natural resources. One month later, Newmont withdrew its case after successfully pressuring the Indonesian government to give the mining company special exemptions from the new mining law, allowing them to continue exporting unprocessed minerals while paying a 7.5% export duty.[6]

2. Restrictions on 'indirect' expropriation

Whereas expropriation in the past applied to physical taking of property, current rules also protect investors from 'indirect' expropriation, interpreted to mean regulations and other government actions that significantly reduce the value of a foreign investment. Hence, corporations can sue over environmental, health, and other public interest laws developed through a democratic process. For example, the energy firm Lone Pine Resources filed a lawsuit against Canada in 2012 over the provincial government of Quebec's moratorium against fracking for shale gas. Fracking, which involves injecting liquids deep into the ground, has been contentious because of concerns over potential harmful effects on the environment and on drinking water. Several European countries and the state of New York have banned the practice. Lone Pine, which had invested in permits to mine for oil and gas in Quebec, alleges that this temporary moratorium constituted a breach

5. Manuel Pérez-Rocha and Julia Paley, "What Free Trade has done to Central America," Foreign Policy in Focus, 21 November 2014. Available at http://fpif.org/free-trade-done-central-america/.
6. Van de Pas Hilde and Damanik Riza, "The case of Newmont Mining vs Indonesia," Transnational Institute, 12 November 2014. Available at http://www.tni.org/briefing/netherlands-indonesia-bit-rolls-back-implementation-new-indonesian-mining-law.

of the North American Free Trade Agreement's provisions on indirect expropriation.[7] It is reportedly seeking $250 million in compensation in this pending United Nations Commission on International Trade Law (UNCITRAL) case.[8]

3. Vaguely defined 'minimum standard of treatment'

Under a typical trade or investment agreement, governments are obligated to provide foreign investors a 'minimum standard of treatment,' including 'fair and equitable treatment.' These terms are so vague that arbitrators have interpreted them in wildly different ways. Not surprisingly, foreign investors more often allege violations of these protections than any others.[9]

A flexible interpretation of 'fair and equitable treatment' was a key factor in the case that resulted in the largest ICSID award in history. This was the *Occidental Petroleum vs Ecuador* case. In October 2012, Ecuador was ordered to pay a staggering $1.7 billion plus interest to the US-based oil giant.

Occidental had been active in the country for decades and environmental and indigenous organizations had accused the company of numerous human rights abuses and widespread environmental devastation. Indigenous groups had long demanded the cancellation of the Occidental contract.[10] In 2006, the government did just that, on the basis of Occidental violating the terms of their contract by improperly

7. See http://www.italaw.com/sites/default/files/case-documents/italaw1596.pdf.
8. See http://www.theglobeandmail.com/globe-investor/us-firm-to-launch-nafta-challenge-to-quebec-fracking-ban/article5337929/.
9. Porterfield Mathew, "A Distinction without a Difference? The Interpretation of Fair and Equitable Treatment under Customary International Law by Investment Tribunals," *Investment Treaty News*, 22 March 2013. Available at http://www.iisd.org/itn/2013/03/22/a-distinction-without-a-difference-the-interpretation-of-fair-and-equitable-treatment-under-customary-international-law-by-investment-tribunals/.
10. "Ecuador Breaks with Washington over Occidental Petroleum," Council on Hemispheric Affairs, Press Release, 19 May 2006, available at www.coha.org/2006/05/19/ecuador-breaks-with-washington-over-occidental-petroleum/; and "*Ecuador: resistencia popular en contra de laspetroleras*," available at www.voltairenet.org/article127827.html.

transferring a share of Ecuadorian production to a Canadian company.[11] Occidental immediately retaliated by filing the ICSID claim.

When the ICSID tribunal ruled in favor of Occidental six years later, the ruling raised eyebrows not just for the eye-popping size of the award but also the substance of the decision. Despite admitting that Occidental could have reasonably expected to lose their contract after selling off part of their concession without government approval, the tribunal argued that Ecuador still breached their obligation to provide fair and equitable treatment because they could have treated Occidental in a less severe manner.[12]

4. National Treatment and Most Favored Nation Treatment

Governments must treat foreign investors and their investments at least as favorably as domestic investors and those from any third country. While this is touted as a basic principle of fairness, it strips the power of governments to pursue national development strategies used in the past by nearly every successful economy. Moreover, a regulatory action that applies to all corporations but has a disproportionate impact on a foreign investor could be targeted as a national treatment violation. Some governments have negotiated exceptions for certain sensitive sectors, such as national oil reserves, so that the investor protections in trade and investment treaties do not apply to those sectors. One typical example used to be Mexico, but with the recent opening of the oil sector to foreign investment, it could be sued by an oil company if the government interferes with an investment. Indeed, with these types of carve-outs, governments run the risk of provoking investor lawsuits if they pursue policies to build up domestic production capacity or incubate local innovation by offering incentives that favor local companies. The US is particularly adamant about including this rule in free trade

11. "Ecuador's Government Annuls Occidental Contract," *Global Insight*, available at www.globalinsight.com/SDA/SDADetail5898.htm.
12. "US$1.76 billion dollar award levied against Ecuador in dispute with Occidental; tribunal split over damages," available at http://www.iisd.org/itn/2013/01/14/awards-and-decisions-10/.

agreements, seeking to curb the 'exclusive rights' that it considers state-owned enterprises have in particular emerging economies.[13]

Other elements of typical investment agreements have less direct, but still serious impacts on extractives policies. For example, most agreements restrict government's authority to use capital controls to prevent or mitigate financial crises. In December 2012, even the International Monetary Fund adopted an official policy endorsing the regulation of cross-border finance in some circumstances.[14] And yet thousands of investment and trade treaties still restrict the use of these policy tools. While these policies are not directly related to resource extraction, countries mired in financial crisis face additional pressure to exploit resources recklessly.

In addition, most agreements require governments to surrender the authority to impose 'performance requirements' on foreign investors, such as requiring them to use a certain percentage of local inputs in production, transfer technology, and other conditions used in the past as responsible economic development tools. This is particularly problematic for governments attempting to avoid the 'resource curse' that so many countries rich in non-renewable resources face. Without the ability to ensure that extractive industries create good local jobs by requiring them to give a share of their business to domestic suppliers and train personnel to use advanced technologies, the potential benefits for the broader economy are limited.[15]

13. "Competition Policy and State-Owned Enterprises," available at https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-chapter-chapter-negotiating-7.
14. International Monetary Fund (2013), *The Liberalization and Management of Capital Flows – An Institutional View*. Available at http://www.imf.org/external/pubs/ft/survey/so/2012/POL120312A.htm
15. Zarsky Lyuba and Stanley Leonardo, *Searching for Gold in the Highlands of Guatemala: Economic Benefits and Environmental Risks of the Marlin Mine*, GDAE at Tufts University, September 2011. Available at http://ase.tufts.edu/gdae/policy_research/marlinminereport.html.

Pacific Rim vs El Salvador

In 2004, the Canadian mining company Pacific Rim applied for a permit for a gold mining project in El Salvador's northern region of Cabañas. Local communities were concerned about the environmental and public health effects of the project. In particular, they feared it could contaminate the Lempa River, an essential source of drinking water for over half of El Salvador's population.

The National Roundtable against Metallic Mining in El Salvador (*Mesa Nacional Frente a la Mineria Metálica*) brought together a wide range of social, faith-based, and community groups to demand that the government should not approve the project.[16]

The government maintains that Pacific Rim neither fulfilled the environmental impact assessment required for obtaining an exploitation permit, nor succeeded in acquiring the lands from the local population to develop such a project.[17] In light of the public pressure, two successive presidents issued moratoriums on all mining projects.

In 2009, Pacific Rim retaliated by filing an investor-state lawsuit at ICSID.[18] The company argued that El Salvador violated four of the investor protections provided in the Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), including National Treatment, Most Favored Nation Treatment, Minimum Standard of Treatment, and Expropriation (which covers indirect expropriation).[19] The company also argued that El Salvador had breached similar protections in a national Foreign Investment Law enacted in 1999, as part of a World

16. Robin Broad and John Cavanagh, "Like Water for Gold in El Salvador," *The Nation*, 1-8 August 2011. Available at http://www.thenation.com/article/162009/water-gold-el-salvador.
17. International Allies against Metallic Mining in El Salvador, "Debunking 8 Falsehoods by Pacific Rim and Oceana Gold in El Salvador." Available at http://www.ips-dc.org/debunking_eight_falsehoods_by_pacific_rim_mining/.
18. See http://www.italaw.com/sites/default/files/case-documents/ita0591_0.pdf.
19. See http://www.italaw.com/sites/default/files/case-documents/ita0591_0.pdf.

Bank-designed structural adjustment package that offered loans in return for free market-oriented policy reforms.[20]

It is hard to figure how Pacific Rim's 'National Treatment' and 'Most Favored Nation' treatment claims could hold up. There are no domestic Salvadorian mining companies. So how could Pacific Rim have been given less favorable treatment?

Even more outrageous was the fact that Pacific Rim filed the case under the DR-CAFTA – despite the fact the company is headquartered in Canada. The company had created a subsidiary in the US for this purpose, but there is a 'denial of benefit' provision in trade and investment treaties that requires subsidiaries to have 'substantial business activities' in the host country in order to enjoy the benefits of that country's agreement, and to prevent 'treaty shopping.'[21]

In June 2012, the ICSID tribunal dismissed Pacific Rim's claims related to alleged violations of the DR-CAFTA, deciding that Pacific Rim, be-

20. According to Broad and Cavanagh, "Research suggests that El Salvador's investment law was revised in 1999 in connection with World Bank structural adjustment lending. Two studies are particularly useful in linking that domestic law with the World Bank's structural adjustment requirements: Maria Eugenia Ochoa, Oscar Dada Hutt and Mario Montecinos, "El Impacto De Los Programas De Ajuste Estructural Y Estabilizacion Economica En El Salvador" ["The Impact Of Structural Adjustment Programs and Economic Stabilization in El Salvador"], Structural Adjustment Participatory Review International Network (SAPRIN), December 2000 (see especially chapter 1, pp.12-14); and Francis Montserrat Sanchez Garcia, Nancy Reyes Yolanda Nunez, and Mabel Denisse Velásquez Leiva, "Evaluación De Políticas De Inserción Laboral Y Su Impacto En Los Jóvenes" ["Evaluating Labor Market Integration Policy and Its Impact on Youth"], "José Simeón Cañas" Universidad Centroamericana, UCA, Graduation Work Prepared for the Faculty of Economics and Social Sciences, September 2010 (see especially pp. 5-8)." Robin Broad and John Cavanagh, *Gold for Export?... or Water & Food for Life? The Case of Gold Mining in El Salvador.* Available at http://www.iss.nl/fileadmin/ASSETS/iss/Research_and_projects/Research_networks/ICAS/11_Broad__Cavanagh_2013.pdf.

21. Behlman Jordan, "Out on a Rim: Pacific Rim's Venture into CAFTA's Denial of Benefits Clause," *Inter-American Law Review*, Volume 45(2). Available at http://inter-american-law-review.law.miami.edu/wp-content/uploads/2014/05/IAL201.pdf.

ing a Canadian-based company and not having substantial business activities in the US, did not have standing under the treaty.[22] However, the tribunal accepted jurisdiction over claims related to violations of El Salvador's Foreign Investment Law.[23] The company, which was acquired by Australian-Canadian firm Oceana Gold in 2013, is demanding $301 million in compensation.[24] That is close to 2% of the country's Gross Domestic Product (GDP).

The world is watching the outcome of *Pacific Rim vs El Salvador*. In September 2014, when the ICSID tribunal began the merits phase of the case, activists delivered a letter in support of the Salvadorian people to the President of the World Bank on behalf of more than 300 organizations around the world.[25] Sadly, even if Pacific Rim's claim fails, El Salvador will still lose out. The suit has cost the government almost $13 million to date in legal fees, which amounts to nearly its entire environment and natural resources spending in 2013. In reality governments never win under ISDS. They can only defend themselves at high costs.[26]

On the positive side, it seems clear that the boom in extractives-related investor-state cases was a key factor in what today is a strong backlash against the corporate investment regime. Bolivia, Ecuador and Venezuela, all of which have been sued extensively by extractives corporations, have withdrawn from the ICSID convention (in 2007, 2009, and 2012 respectively). This has been followed by several countries revising their investment treaty models, denouncing their bilateral investment treaties (e.g., Indonesia and South Africa), and strong parliamentary opposition to the inclusion of ISDS in the massive free

22. Achtenberg Emily, *Pacific Rim Ruling Threatens El Salvador's National Sovereignty*, NACLA, 2012. Available at https://nacla.org/blog/2012/6/8/pacific-rim-ruling-threatens-el-salvador%E2%80%99s-national-sovereignty.
23. Pac Rim Cayman LLC vs Republic of El Salvador (ICSID Case No. ARB/09/12).
24. See http://www.italaw.com/sites/default/files/case-documents/italaw3040.pdf.
25. Open Letter to the President of the World Bank in Defense of El Salvador. Available at http://www.stopesmining.org/j25/index.php?option=com_content&view=category&layout=blog&id=92&Itemid=519.
26. Perez-Rocha Manuel, "When Corporations Sue Governments," *New York Times*, 3 December 2014. Available at http://www.nytimes.com/2014/12/04/opinion/when-corporations-sue-governments.html?_r=0.

trade agreements currently under negotiation, the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP).

Civil society and legal experts have also been developing detailed alternatives to the ISDS system. The literature is ample, but a recent document from the Working Group on Investment of the Americas synthesizes proposals from a wide variety of sources in three broad areas: (i) proposals to achieve the preeminence of human rights over investor rights and to establish the obligations of transnational corporations with regard to the observance of human and environmental rights; (ii) proposals for alternative dispute settlement solutions; and (iii) proposals to abolish the privileges of foreign investors and to guarantee states the space to be able to implement public policy and special and differentiated treatment, guaranteeing that the principle of equality supports national priorities.[27]

27. Working Group on Investment of the Americas, "A Call for the Building of an Alternative Legal Framework to the International Investment Treaties," available at http://justinvestment.org/wp-content/uploads/2014/05/A-Call-for-the-Building-of-an-Alternative-Legal-Framework-to-the-International-Investment-Treaties-May-2014.pdf.

Profiting from Injustice: Tracing the Rise of Investment Arbitration Industry

Pia Eberhardt and Cecilia Olivet

The debt crisis in Greece grabbed the attention of the world in 2011. With an enormous budget deficit, violent protests and public spending cuts that devastated the lives of ordinary people, the country appeared to be on the brink of collapse. Without massive restructuring to reduce the debt, Greece's survival was under threat.

Several international law firms were also watching Greece – but their concern was not to save its people from social disaster or to prevent economic collapse in Europe. On the contrary, in the midst of the debt crisis, lawyers saw an opportunity to tout for business, urging multinational corporations to pursue investment arbitration to defend their profits in Greece.

The German law firm Luther, for example, told its clients that, where states were unwilling to pay up, it was possible to sue on the basis of international investment treaties. Luther suggested that "Greece's grubby

Note: This paper is largely based on the report, *Profiting from Injustice. How lawyers, arbitrators and financiers are fuelling an investment arbitration boom*, published by Corporate Europe Observatory and Transnational Institute in 2012. (Available at http://corporateeurope.org/sites/default/files/publications/profiting-from-injustice.pdf).

financial behaviour" provided a solid basis for seeking compensation for disgruntled investors; compensation that would ultimately be paid by Greek taxpayers.[1]

Analysing one of the pending disputes against Argentina in an October 2011 client briefing paper, US-based law firm K&L Gates wrote that investment treaty arbitration could "recover damages for investment losses from nations defaulting on their sovereign debts." It continued: "Given the current financial crises worldwide, this should provide hope for investors who have suffered losses at the hands of sovereign restructuring of their debt instruments." The firm identified Greece as a country where investors should check which investment treaties "may protect their investment."[2]

In March 2012, after long negotiations between the European Union (EU) and the banks, funds, and insurers that were owed money by Greece, most creditors accepted an easing of repayment terms. However, soon afterwards, several law firms announced that they would seek millions in damages on behalf of lenders refusing to accept the debt swap. In May 2013, the first investor lawsuit challenging the debt swap was filed against Greece, while more claims are looming.[3]

Investment lawyers fuel the arbitration goldrush

The Greek debt crisis case stands out as just one example in a highly lucrative investment arbitration business. As the number of international investment disputes against states has exploded over the past

1. Luther (2011), Rechtsschutz bei Staatsbankrott, 16 August. (Available at http://www.luther-lawfirm.com/uploads/tx_fwluther/Prozessfuehrung_Schiedverfahren_Q3-2011.pdf). Translation: Pia Eberhardt.
2. Konrad, Sabine and Richman, Lisa (2011), Investment Treaty Protection for State Defaults on Sovereign Bonds, K&L Gates Arbitration World, 10-11 December 2011. (Available at http://www.klgates.com/files/Publication/f8204a97-6d40-4f34-a4ea-094ff384d616/Presentation/PublicationAttachment/d10ea79c-ec9a-4293-8bbf-31a4458db0be/ArbWorld_Dec_2011.pdf).
3. Transnational Institute and Corporate Europe Observatory (2014), Profiting from Crisis: How corporations and lawyers are scavenging profits from Europe's crisis countries, Chapter 3. (Available at http://corporateeurope.org/sites/default/files/profiting-from-crisis_0.pdf).

two decades, legal arbitration has become a money-making machine in its own right. As arbitration lawyer Nicolas Ulmer from the Swiss law firm Budin & Partners explained: "Arbitration institutions vie for their market share of disputes, legislatures pass arbitration-friendly measures to attract this business, various conferences and workshops are held year round, a class of essentially full-time arbitrators has developed and a highly specialised 'international arbitration bar' pursues large cases avidly. A veritable 'arbitration industry' has arisen."[4]

Box 1: Investment arbitration is big business for big law[5]

- Legal costs for investor-state disputes average over US$8 million, exceeding $30 million in some cases.
- Insiders estimate that more than 80% of the legal costs end up in the pockets of the parties' lawyers, the counsel.
- The tabs racked up by elite law firms can be $1,000 per hour, per lawyer – with whole teams handling cases.
- The lawyers who sit on the tribunals that ultimately decide the cases, the arbitrators, also earn handsome fees: at the most frequently used tribunal for investor-state claims, International Centre for Settlement of Investment Disputes (ICSID), arbitrators make $3,000 a day.

In this 'new Eldorado,' lawyers have multiple roles – and wield enormous power. As counsel, they represent the parties in the multi-million-dollar disputes. But they also sit as arbitrators, deciding the cases. They advise governments on the drafting of investment treaties, which

4. Nicolas Ulmer (2010), *The Cost conundrum*, Arbitration International 26:2, p.224.
5. Corporate Europe Observatory and Transnational Institute (2012), *Profiting from Injustice*, p.15.

form the legal basis of the disputes. They advise companies on how to structure investments to get access to the most investor-friendly arbitration routes – for example, by channelling an investment through a subsidiary in a country with many international investment treaties. And they have mounted fierce lobbying campaigns to counter attempts by governments to reduce their legal exposure to predatory corporate legal action, by reforming investment treaties.[6]

Turning international investment arbitration into a lucrative business has provided a great incentive for smart lawyers to sustain and expand the system in order to maximise profits. Keeping corporate clients constantly informed about the opportunities for litigation is the bread and butter of an investment arbitration lawyer (see Box 2). Not every company follows their advice, but the marketing of some law firms is nevertheless a driving force behind the recent boom in international investment arbitration. As Nathalie Bernasconi-Osterwalder from the International Institute on Sustainable Development (IISD) has put it: "Lawyers live on disputes. They create monsters like the current investment arbitration regime and hype it to produce work for themselves as lawyers and arbitrators. I truly believe that the investment arbitration system wouldn't exist the way it does today if it wasn't for the lawyers."[7]

Box 2: How arbitration law firms advertise investment arbitration in the corporate world

Profiting from economic crises: In an October 2011 newsletter for its corporate clients, lawyers at the US-based law firm Milbank outlined the "potential for claims" against economic crisis-related measures that "do significant damage to international investors." They wrote, "Debt re-payment defaults are an obvious threat. [...] Less obvious threats include the impairment

Contd. on next page...

6. Ibid.
7. Interview with Nathalie Bernasconi-Osterwalder, lawyer at the International Institute for International Development, 15 June 2012.

of investments as the direct consequence of austerity measures, significant exchange rate interference by a state, as well as increased taxation."[8]

Challenging access to medicines policies: When India allowed a generic drug producer to sell a cheaper version of a patented cancer drug in 2012, US law firm White & Case pointed out to the corporate world that patent-holding drug multinationals "may be able to seek relief under applicable bilateral investment treaties."[9]

Making money from humanitarian crises: In the midst of the 2011 civil war in Libya, UK-based law firm Freshfields suggested corporations could use investment treaties to sue the Libyan state with investors claiming financial compensation for the country's failure to comply with promises "regarding physical security and safety of installations, personnel etc."[10]

Securing profits in the mining sector: In 2013, when Kenya considered new charges in the mining sector to ensure its people benefit from its mineral resources, law firms such as US-based King & Spalding advised mining companies to "bring

8. Nolan, Michael D. and Sourgens, Frédéric (2011), The US and EU Dept Crises in International Law – A Preliminary Review, October, *Wall Street Lawyer*, 15:10, p1. (Available at http://www.milbank.com/images/content/6/5/6568/10-2011-Nolan-Sourgens-Wall-Street-Lawyer.pdf).
9. White & Case (2012), Client Alert. Indian Patent Office Grants Compulsory License for Bayer's Nexavar: Implications for Multinational Drug Companies, March, p.9. (Available at http://www.whitecase.com/files/Publication/f1e2ff33-cc55-40d6-938c-bc77146b782b/Presentation/PublicationAttachment/0d511714-843f-4641-b961-cea6117bc185/alerts-Indian-Patent-Office-Grants-Compulsory-License.pdf).
10. Freshfields (2011), Investments in Libya, March, p.2. (Available at http://m.freshfields.com/uploadedFiles/SiteWide/Knowledge/Investments%20in%20Libya%20%2810.03.2011%29.pdf).

Contd. on next page...

compensation claims against Kenya before international investment arbitration tribunals" and that they should structure their investment accordingly "to ensure that they can rely on bilateral investment treaties entered into by Kenya."[11]

Using lawsuit threats as a bargaining chip: Arbitration lawyers also encourage their clients to use the threat of investment disputes as a way to scare governments into submission. According to German law firm Luther: "A settlement, which you should always aim for, is easier to reach under the shadow of a looming investment treaty claim."[12]

The many conflicting interests of the investment arbitrators

The lawyers who decide investor-state disputes, the arbitrators, have a particularly powerful role, which one of them has nicely summarised: "When I wake up at night and think about arbitration, it never ceases to amaze me that sovereign states have agreed to investment arbitration at all [...] Three private individuals are entrusted with the power to review, without any restriction or appeal procedure, all actions of the government, all decisions of the courts, and all laws and regulations emanating from parliament."[13]

Yet investment arbitrators are hardly neutral guardians who stand above the law. In fact, they are crucial actors in the arbitration industry, with a financial interest in the existence of investment arbitration. Arbitrators, to a far greater degree than judges, have a financial and

11. King & Spalding (2013), Client Alert. Recent Developments: Kenya – What Legal Options are Available to Mining Companies, August, p2. (Available at http://www.kslaw.com/imageserver/KSPublic/library/publication/ca082013.pdf).
12. Germany Trade & Invest (2011), Hilfe, ich werde enteignet! Abkommen schützen Auslandsinvestitionen, p9; Translation: Pia Eberhardt.
13. Perry, Sebastian (2012), Stockholm: Arbitrator and counsel: the double-hat syndrome, Global Arbitration Review 7(2), 15 March 2012. (Available at http://globalarbitrationreview.com/journal/article/30399/stockholm-arbitrator-counsel-double-hat-syndrome/).

professional stake in the system. They earn handsome rewards for their services. Unlike judges, there is no flat salary and no cap on financial remuneration.

Arbitrators' fees can range from $375 to $700 per hour depending on where the arbitration takes place. How much an arbitrator earns per case will depend on the case's length and complexity. The presiding arbitrator in the case between oil giants Chevron and Texaco v. Ecuador, received $939,000. In another case, the presiding arbitrator billed for 719 hours at an hourly rate of $660 plus VAT.[14]

To put it simply, if a doctor is sponsored by a pharmaceutical company, we might question whether the medicine prescribed is the best for our health; if a public servant receives money from a lobbyist, we might question whether the policies they promote are in the public interest. In the same vein, if an arbitrator's main source of income and career opportunities depend on the decision of companies to sue, we should question how impartial their decisions may be.

Out of the hundreds of lawyers who serve as investment arbitrators, only 15 have decided 55% of cases (247 cases in total) that are known to have taken place by the end of 2011. They have also handled most of the biggest cases in terms of amounts demanded by the corporations and have been repeatedly ranked as top arbitrators by well-known surveys.[15] One arbitrator has described this group of elite arbitrators as "not just the mafia but a smaller, inner mafia."[16]

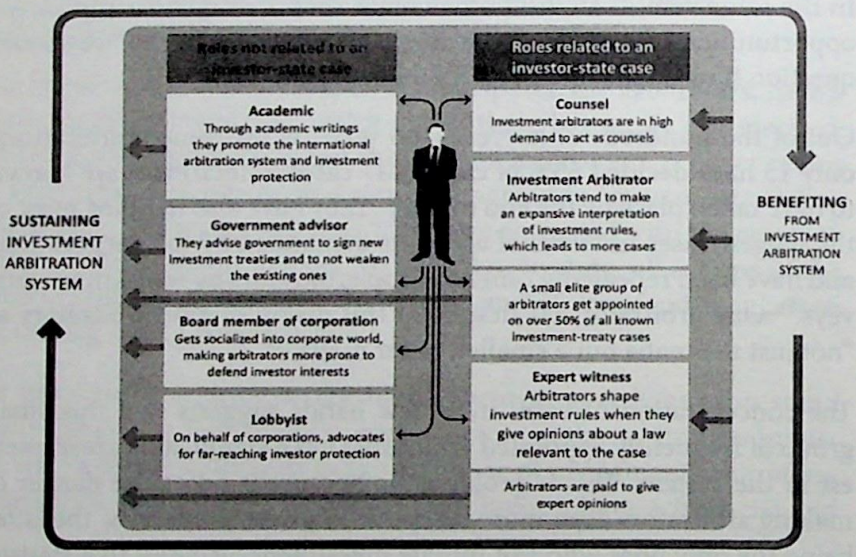
The concentration of cases in so few hands suggests that this small group of frequently appointed arbitrators has a significant career interest in the system. This is problematic because it poses the danger of making arbitrators even more receptive to investor interests, the latter being the only ones who can initiate investment disputes. In a statistical study based on 140 investment-treaty cases, Canadian Professor

14. Corporate Europe Observatory and Transnational Institute (2012), op.cit., p.35.
15. Ibid.
16. Kapeliuk, Daphna (2010), The Repeat Appointment Factor – Exploring Decision Patterns of Elite Investment Arbitrators, *Cornell Law Review* 96(47), p.77. (Available at http://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=3185&context=clr).

Gus Van Harten indeed found evidence that arbitrators tend to adopt an expansive (claimant-friendly) interpretation of various clauses in investment treaties, such as the concept of investment.[17]

And concerns not only arise from the financial benefits arbitrators gain. Arbitrators frequently combine their role with several other hats: working on the side as lawyers for the parties in investment disputes, academics, policy advisers or as media commentators. With these various roles, this small group of investment lawyers can influence the direction of the investment arbitration system in such a way that they can continue benefiting from it.[18]

Figure 1: How investment arbitrators' multiple roles interact with the investment arbitration system



17. Van Harten, Gus (2012), Pro-Investor or Pro-State Bias in Investment – Treaty Arbitration? Forthcoming Study Gives Cause for Concern, *Investment Treaty News*, April 2012. (Available at http://www.iisd.org/itn/2012/04/13/pro-investor-or-pro-state-bias-in-investment-treaty-arbitration-forthcoming-study-gives-cause-for-concern/).
18. Corporate Europe Observatory and Transnational Institute (2012), op.cit., chapter 4.

Speculating with injustice

As the number of international investment disputes has increased, so the stakes in them as well as legal costs have exploded over the past two decades and another breed of financiers has recently entered investment arbitration: third-party funders. They help fund investor-state disputes in exchange for a share in any granted award or settlement. Little is known about the industry, but occasional reports suggest that litigation finance shops such as Juridica (UK), Burford (US) and Omni Bridgeway (NL) are becoming an established part of international investment arbitration. Banks, hedge funds and insurance companies also invest in international disputes. Brokers and electronic marketplaces where claimants can shop for potential funders and funders can shop for claims are emerging.

The financialisation of investment arbitration has even extended to proposals to sell on packages of lawsuits to third parties, in the vein of the disastrous credit default swaps behind the global financial crisis. This is likely to further fuel the boom in arbitrations, as well as increasing costs for cash-strapped governments, and raising concerns of potential conflicts of interest because of a dense web of personal relationships that link financiers to arbitrators, lawyers and investors.

Caution: vested interests

The international investment arbitration system was justified and put in place by Western governments with the argument that a fair and neutral dispute settlement system was needed to protect their corporations' investments from perceived bias and corruption within national courts. Investment arbitrators were to be the guardians and guarantors of this regime.

However, rather than acting as fair and neutral intermediaries, it has become clear that the arbitration industry has a vested interest in perpetuating an investment regime that prioritises the rights of investors at the expense of democratically elected national governments and sovereign states. They have built a multimillion-dollar, self-serving industry that is dominated by a narrow exclusive elite of law firms and

lawyers whose interconnectedness and multiple financial interests raise serious concerns about their commitment to delivering fair and independent judgements. As a result, the arbitration industry shares responsibility for an international investment regime that is neither fair nor independent, but deeply flawed and biased towards business.

Unsurprisingly, the arbitration industry stands to profit most from an expansion of the investment regime. This is particularly relevant in the context of a number of mega-agreements currently under negotiation by the EU and the US administration: the EU-China and US-China agreements, the Trans-Pacific Partnership Agreement (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). These treaties alone would expand investment arbitrators' rules from around 15-20% of global investment flows that are covered by existing agreements to over 80%.[19] Hence investment lawyers' active lobbying for investment arbitration in these agreements.[20]

Meaningful change to address even the most egregious injustices of the international investment regime will not come from the arbitration industry. On the contrary, those fighting for change will have to continue to confront the anti-reform counter-offensive by law firms, arbitrators and funders, including taking steps to oust their vested interests in the system.

19. Van Harten, Gus (2015), *A Report on the Flawed Proposals for Investor-State Dispute Settlement (ISDS) in TTIP and CETA*, p.12-13. (Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2595189),
20. See, for instance, Corporate Europe Observatory, Friends of the Earth Europe and Transnational Institute (2015), *Lawyers subverting the public interest. Lobby group EFILA's stake in investment arbitration*. (Available at http://corporateeurope.org/sites/default/files/efila_report-web.pdf.)

State-State Dispute Settlement in Investment Treaties

Nathalie Bernasconi-Osterwalder

Background

Investor-state arbitration has boomed over the past decade: the number of recorded cases rose from 51 in 2000 (UNCTAD, 2014) to 608 by the end of 2014 (UNCTAD, 2015). Alongside the increase in arbitrated disputes has been growing concern from some states about the nature of arbitration claims by foreign investors against host states. These have included challenges to legitimate environmental and other public welfare and financial policy measures. The high costs of arbitration and the actual or perceived lack of openness, independence and predictability have also led several countries to rethink the scope of their investment treaty obligations as well as the arbitration mechanisms incorporated in their investment treaties.

State-state dispute settlement predates investor-state arbitration, and was the norm in the early friendship, commerce and navigation (FCN) treaties and some early investment treaties.[1] It was not until 1969, with the Chad-Italy bilateral investment treaty (BIT), that the first investor-

1. See, for instance, Yackee, J. W. (2008). See also Roberts (2014, p. 3).

state dispute settlement clause was included in an investment treaty. And it was not until 1990 that a tribunal asserted its jurisdiction under such a clause.[2] Today, most investment treaties include both state-state and investor-state dispute settlement mechanisms.

As the number of investor-state arbitration cases has grown exponentially, state-state arbitration has taken a backstage role – to our knowledge only four such cases have occurred under investment treaties. One case was a diplomatic protection claim initiated by Italy against Cuba on behalf of Italian investors. Another claim was brought by Mexico against the US, and related to alleged treaty violations by the respondent state. This claim was not brought on behalf of any specific investors, and therefore had a declaratory character. In the two remaining cases, host states filed claims in response to investor-state disputes that they were facing at the time, seeking an interpretation of treaty provisions by the tribunal (*Peru v. Chile* and *Ecuador v. United States*).

Despite their rarity, state-state dispute settlement options are gaining renewed attention from both states and academics as an alternative, given the numerous concerns associated with investor-state arbitration.[3] State-state mechanisms are also becoming more relevant due to the trend towards fully-fledged investment chapters in free trade agreements (FTAs) and comprehensive economic partnership agreements (EPAs). These agreements typically include elaborate state-state dispute settlement provisions to resolve a wide range of disputes. While some countries continue to sign treaties with investor-state dispute

2. *Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award, 27 June 1990.
3. See, for instance, Potestà (2013); Roberts (2014); Orecki (2013); Seifi (2004); Trevino (2013).

settlement provision, others have decided not to include it, opting instead for state-state dispute settlement only.[4]

The use of state-state dispute settlement in treaty-based investment disputes is viewed in different ways. While some experts consider that the state-state mechanism offers possibilities for states to "re-engage with the investment treaty system" (Roberts, 2014, p.2), others caution that interstate arbitration may "re-politicize" investment disputes (Roberts, 2014, p.4).[5] The latter view appears to contradict the view that state-state adjudication at the International Court of Justice (ICJ), under the framework of the World Trade Organization (WTO) or in other fora, has helped keep disputes outside of the political realm.[6] Accordingly, depoliticization may not be a distinct feature of investor-state arbitration, but rather of international adjudication more generally. Nevertheless, all disputes may become politicized to some extent, including investor-state arbitration. For instance, some home states have put pressure on host state governments behind the scenes before or during ongoing investor-state disputes. Some home states have also intervened at the enforcement stage. For example, two disputes between US investors and Argentina led the US to cut trade preferences for Argentina to compel the payment of damages awarded by investment tribunals (Palmer, 2012). In sum, rather than being an issue of investor-state versus state-state dispute settlement, a fundamental difference seems to exist between legal settlement of disputes on the

4. Some of the recent investment chapters in comprehensive trade and investment treaties do not contain investor-state arbitration provisions, while providing for state-state dispute settlement clauses, e.g., the Australia-Malaysia FTA (2012), the Japan-Philippines Economic Partnership Agreement (EPA) (2006), the Australia-United States FTA (2004). The same is true for the two Cooperation and Investment Facilitation Agreements signed in 2015 by Brazil with Mozambique (available in Portuguese at http://www.itamaraty.gov.br/index.php?option=com_content&view=article&id=8511&catid=42&Itemid=280&lang=pt-BR) and with Angola (available in Portuguese at http://www.itamaraty.gov.br/index.php?option=com_content&view=article&id=8520:acordo-brasil-angola-de-cooperacao-e-facilitacao-de-investimentos-acfi-luanda-1-de-abril-de-2015&catid=42&lang=pt-BR&Itemid=280).
5. See *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Expert Opinion of Prof. W. Michael Reisman, 24 April 2012, paras. 24-25, 36-37.
6. On international adjudication more generally, see Bilder (2007). On the ICJ, see Daly (1987). On the WTO, see Evans and Shaffer (2010).

one hand and dispute "resolution" by means of political, economic or military power on the other.

State-state investment disputes: issues to consider

The key questions today are the following: as investor-state arbitration is increasingly called into question, should investment dispute settlement be conducted solely on a state-state basis? Or, if both state-state and investor-state arbitration are included in the treaty, what areas should be subject to either mechanism exclusively, and what areas should be subject to both? Finally, if both are included, how should the two mechanisms interrelate?

This paper, based on earlier work,[7] presents recommendations on how state-state dispute settlement could be used as an alternative to investor-state arbitration. Or, if both mechanisms are included, on how to define the relationship between the two and to strengthen the state parties' control over the interpretation of their treaty.

Evaluating the pros and cons of including both investor-state and state-state dispute settlement or including state-state dispute settlement as the sole mechanism

The vast majority of investment treaties provide for both state-state and investor-state dispute settlement, allowing investors to challenge host state laws and other executive, judicial or legislative measures

7. This is an abridged version of a paper by Bernasconi-Osterwalder (2014), which looked in detail at state-state dispute settlement provisions in investment treaties and investment chapters of wider economic agreements, and examined the different mechanisms used to settle investment disputes, including judicial, quasi-judicial, and arbitration procedures. It then looked at the different types of claims that can be brought under the typical state-state clause, which include diplomatic protection claims, interpretive claims and declaratory relief requests. The paper also analyzed how investment treaties, and the few arbitral cases available, deal with the interaction of state-state and investor-state dispute settlement where the treaty provides for both types of dispute settlement. This article summarizes the introduction and policy recommendations of that paper.

pursuant to an open offer to arbitrate. Despite this prevalent approach, states should carefully consider all options, and evaluate the risks and benefits of including investor-state dispute settlement clauses in addition to state-state dispute settlement. Investor-state jurisprudence has demonstrated that investors will cross certain boundaries to sue for compensation that, arguably, home states would not cross, especially with respect to challenging legitimate public policy measures. Accordingly, the issue of whether or not to include investor-state in addition to state-state dispute settlement remains one of the most controversial aspects of negotiations on investment. Beyond the option of not including any provisions on investor-state dispute settlement altogether, another approach is for treaty parties to include a 'placeholder' and postpone negotiations or consultations relating to investor-state arbitration to a later stage – after treaty adoption.[8] This allows parties to wait until reforms have been put in place before submitting to investor-state dispute settlement. In a multiparty context, where some countries wish to include investor-state dispute settlement, and others do not, a further option is to include a provision allowing states to opt out of investor-state dispute settlement.[9]

8. Article 107 (Further Negotiation) of the Japan-Philippines EPA reads: "1. The Parties shall enter into negotiations after the date of entry into force of this Agreement to establish a mechanism for the settlement of an investment dispute between a Party and an investor of the other Party [...]."; Article 11.16 (Consultations on Investor-State Dispute Settlement) of the Australia-United States FTA reads: "1. If a Party considers that there has been a change in circumstances affecting the settlement of disputes on matters within the scope of this Chapter and that, in light of such change, the Parties should consider allowing an investor of a Party to submit to arbitration with the other Party a claim regarding a matter within the scope of this Chapter, the Party may request consultations with the other Party on the subject, including the development of procedures that may be appropriate [...]."
9. A footnote in the 20 January 2015 draft Trans-Pacific Partnership (TPP) investment chapter (leaked on 25 March 2015) stated: "Section B [Investor-State Dispute Settlement, added] does not apply to Australia or an investor of Australia. Notwithstanding any provision of this Agreement, Australia does not consent to the submission of a claim to arbitration under this Section. <<xx note: deletion of footnote is subject to certain conditions>>." See Draft TPP Investment Chapter, retrieved from https://wikileaks.org/tpp-investment/WikiLeaks-TPP-Investment-Chapter.pdf. While the final note seems to suggest that Australia might be willing to accept the application of investor-state arbitration in the TPP under certain conditions, it needs to be noted here that the Australian government has been opposing investor-state dispute settlement over the past few years.

Whatever the approach taken with respect to investor-state dispute settlement, getting the state-state process right should not be neglected. The few state-state cases known to date, together with some lessons learned in the context of investor-state arbitration, give us some indication of what to pay attention to.

Requiring exhaustion of local remedies before initiating state-state litigation and other customary international law requirements

Regardless of whether states decide to include state-state dispute settlement alone or alongside investor-state dispute settlement, it is recommended that they explicitly clarify whether they wish to follow customary international law and require the exhaustion of local remedies before a state-state diplomatic protection claim can be initiated. While not all tribunals will expect the customary international law rule to be spelled out explicitly in the treaty in order to apply, it is safer to preempt the possibility that a tribunal might not apply the implicit customary law standard that requires exhaustion. For example, the Model BIT Template of the Southern Africa Development Community (SADC) unequivocally provides that states could file diplomatic protection claims on behalf of investors on the condition of exhaustion of local remedies prior to international arbitration, unless no reasonably available domestic remedies are in place. States could also clarify if they wish to apply the customary international law rule regarding the investor's nationality.

Thoughtfully designing the state-state dispute settlement mechanism

Also regardless of whether or not investor-state arbitration is included alongside state-state dispute settlement, it is worthwhile for states to consider the various forms of state-state dispute settlement possible. While some older treaties provide for the judicial settlement of state-state disputes at the ICJ, most treaties today involve *ad hoc* arbitration. This should not mean, however, that the ICJ option should be *a priori* ruled out. Rather, it is worth states assessing the benefits of this option, considering its judicial and international nature. Also, although *ad hoc* arbitration is the prevalent form used in investment treaties today, it

is not necessarily the most appropriate for resolving treaty-based investment disputes between state parties. In particular, we have seen in the context of investor-state arbitration that treaty-based investment arbitration based on a commercial *ad hoc* arbitration model can be problematic, raising issues relating to arbitrator impartiality and independence, secrecy of proceedings, lack of predictability and consistency, etc. These issues could arise in a similar fashion in the state-state context, because the pool of arbitrators and the applicable arbitration rules are largely the same as in the investor-state context.

The general expectation is that the dynamics in a purely interstate dispute will be significantly different from the outset, because states are presumably less likely to challenge certain types of regulatory measures, or make certain types of legal arguments that could be brought against them in the future. Even so, it would be useful to consider and weigh the pros and cons of ad hoc third-party adjudication versus a more permanent, judicial or quasi-judicial mechanism.

Clarifying the meaning of "dispute concerning the interpretation or application of the treaty" or allowing for (advisory) opinions

Most treaties provide for state-state dispute settlement about the interpretation or application of the treaty. Jurisprudence shows that this might be interpreted narrowly, especially with respect to the requirement that there be a 'dispute' about the interpretation or application. In *Ecuador v. United States*, the tribunal found the US silence about the interpretation of a treaty provision could not be understood as an opposition, and that therefore there was no dispute, so that it did not have jurisdiction.

In order to make the use of the state-state process more predictable and avoid such a situation, states could make clear that they understand the definition of 'dispute' broadly to include instances where one state refuses to take position on a matter of interpretation raised by another state party. Another option would be to avoid the term 'dispute' altogether and allow for advisory opinions by third parties.

Clarifying the interrelationship between state-state and investor-state dispute settlement, and their respective roles

If states choose to provide for both state-state and investor-state dispute settlement in their treaties, they should consider clarifying the role of state-state dispute settlement and, possibly, providing for a clearer and more relevant role. Currently, treaties are generally silent as to the relationship, leaving it to tribunals to decide how the two processes interrelate, and whether and how one tribunal might be bound by another. Some treaties have made clarifications with respect to certain types of issues, like in the recent Canada-China agreement with respect to prudential measures, where the two procedures are integrated and coordinated entirely.

If a state wanted to strengthen and clarify the state-state process, several steps could be taken in the text of new agreements, or through the amendment or interpretation of existing agreements. In particular, states could clarify whether and in which situations the state-state decision should be binding for subsequent state-state or investor-state tribunals, or both. States could also clarify how parallel state-state and investor-state cases might be coordinated, for example, if one had to be suspended in certain circumstances.

Conclusion

The state-state dispute settlement option in investment treaties is gaining interest. Several states, such as Brazil and SADC countries, are now identifying state-state dispute settlement as the preferred and only option for treaty-based dispute settlement on investment. Others are taking steps to rein in the scope of application of investor-state dispute settlement (ISDS) or re-introducing the requirement for investors to exhaust local remedies before being able to resort to international arbitration. Finally, still others are strengthening and clarifying the role of state-state dispute settlement *vis-à-vis* ISDS. Whether in conjunction with, or as an alternative to, investor-state dispute settlement mechanisms, well-drafted and thought-through state-state dispute settlement provisions could help countries overcome several of the interpretive and procedural concerns arising from the current investment arbitration regime.

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Democratising International Investment Law: The Case and Channels for Citizen Engagement

Lorenzo Cotula

Introduction

International investment law is at a crossroads. The large number of investment treaties and investor-state arbitrations – as well as rapidly expanding volumes of scholarly writing – have made international investment law one of the most dynamic branches of international law. However, the proliferation of treaties and arbitrations has also turned international investment law into a highly contested field, with some experts and campaigners questioning substantive standards and dispute settlement mechanisms (Bernasconi-Osterwalder et al., 2012; Eberhardt and Olivet, 2012; van Harten, 2007), and commentators talking of a 'legitimacy crisis' or 'backlash' against the investment regime (Franck, 2005; Waibel et al., 2010). There have been vocal calls for reform, and new opportunities are emerging for multilateral dialogue on the 'transformation' of the investment treaty regime.[1]

1. See, for instance, the expert meeting convened by the United Nations Conference on Trade and Development (UNCTAD) on 'Transformation of the International Investment Agreement Regime: the Path Ahead,' Geneva, 25-27 February 2015, http://unctad-worldinvestmentforum.org/followup-events/single-year-expert-meeting/.

There is also uncertainty about the future direction of international investment law. Several states have reclaimed sovereign space and terminated some of their investment treaties. On the other hand, the negotiation of 'mega treaties' and treaty negotiations among large economies could create some of the world's most ambitious investment treaties ever (UNCTAD, 2014). At the same time, several states have sought to 'recalibrate' (Alvarez, 2010) their investment treaties, shifting the balance between multiple policy goals. Yet others have explored entirely novel approaches to the drafting of investment treaties, increasing diversity in the international treaty landscape.

These rapid, far-reaching and partly contrasting evolutions in public debates and policy choices make this a particularly important point in time for shaping the future of international investment law. This paper reviews recent trends in citizen engagement with the making of international investment law. Section I highlights the important political dimensions of investment treaty making and articulates the case for citizen engagement. Section II outlines recent experience with activating multiple channels for citizen engagement. Section III distils some preliminary lessons on means and space for greater citizen engagement with international investment law.

I. The case for citizen engagement

Debates about investment treaties are often framed in technical and legal terms. They are primarily shaped by legal professionals. But choices on whether to conclude investment treaties, and in what form, are eminently political. Investment treaties provide a legal tool for economic policy, and different interest groups can legitimately have different positions on desirable economic policies and acceptable balances between competing policy goals. The political nature of choices in investment treaty making raises questions about how public decisions are made, and more generally about active citizenship – broadly defined here in political, non-legalistic terms as the active participation of citizens in the management of public affairs (Gaventa, 2002).

Many investment treaty negotiations take place with little transparency and limited public participation. Outside jurisdictions where treaties

must be ratified by parliament, members of parliament usually play a minor role in treaty ratification and more generally in the oversight of investment treaty making (Kurtz, 2014). Many investment treaties have been concluded with little public debate about the pros and cons of ratification, particularly in low-income countries.

Other areas of international law have also evolved with limited public participation. However, the extensive involvement of civil society and citizens' groups in the international negotiations shaping international environmental law shows that it is possible to open up international law making so that it is more accessible.

Given the far-reaching implications that investment treaties can have for wide-ranging policy areas, the low level of public oversight creates real challenges of democratic governance and accountability. It undermines the democratic ideal that ties the legitimacy of legal norms to their grounding in democratic deliberation (Kant, 1795/2010; Rousseau, 1762/1963).

Never fully realised, and severely curtailed in countries with authoritarian regimes, this ideal is under further pressure as a result of increased economic interdependence. This has led some democracy theorists to critique political systems where elections are held, opinions are expressed and governments change but important decisions are taken by the executive in the name of economic necessity and outside deliberative democracy (Crouch, 2000; Rancière, 2006; Wolin, 2008; and specifically in relation to investment treaty making, Crouch, 2014).

Some commentators have likened investment treaties to the constitutional safeguards that, in liberal democracies, aim to minimise the risk of a 'tyranny of the majority' – namely, through the affirmation of rights that even majority vote cannot overturn (Montt, 2009; Schneiderman, 2008).[2] Like constitutions, investment treaties are more difficult to change than ordinary national legislation: 'termination clauses' typically prevent unilateral treaty termination for specified periods of time (often 10 or 15 years) and provide that the treaty continues to

2. See also the Separate Opinion of Bryan Schwartz in *S.D. Myers, Inc. v. The Government of Canada*, para. 34.

apply to investments made before termination (often for another 10 or 15 years). Renegotiating treaties with often multiple state parties is more difficult than changing national laws.

However, constitutions – at least in theory – reflect the social contract, and their drafting or modification is – or should be – carried out through mechanisms that "guarantee extraordinarily high levels of democratic consent" (Kurtz, 2014: p. 263). Investment treaty making has not been accompanied by comparable levels of democratic deliberation. And unlike constitutional bills of rights, investment treaties are increasingly complex instruments reflecting legitimately reversible political preferences about economic policy, as the recent rise of investment liberalisation ('pre-establishment') commitments illustrates.

The limited parliamentary oversight of investment treaty making can create uncomfortable situations. In one recent instance that I was personally able to observe, a low-income country government concluded an investment treaty with a major high-income state. The treaty was largely drafted by the high-income state and contains pre-establishment obligations – meaning that, apart from exceptions and reservations, the admission of foreign investment cannot be subjected to restrictions that are not applicable to nationals.

In that particular low-income country, parliament was not involved in the negotiation or ratification of this treaty. At the same time, parliament was discussing a new investment law purporting to restrict foreign investment in sensitive sectors of the economy, in ways that were incompatible with the pre-establishment provisions of the new treaty. Opinion is divided on whether this type of legislation is a sensible policy choice. But the point here is that, with regard to investments from one major capital-exporting state, and potentially other investments depending on the operation of most-favoured-nation clauses, the ratification of the investment treaty in effect placed that legislative process on a collision course with international law.[3]

3. I encountered almost precisely this situation in 2014, in the course of policy support work with government officials and parliamentarians in a low-income country.

In this context, the response to what some perceive as a 'legitimacy crisis' of international investment law cannot be just a technical fix; a reflection on technical options for the recalibration of the investment treaty regime. A full response requires a democratisation of investment treaty making, through rethinking constitutional practices to allow parliament to play a more prominent role in guiding the negotiation or at least approving the ratification of investment treaties; but also through ongoing, day-to-day citizen engagement with the management of public affairs.

And in the context of real-life social processes, vested interests and power imbalances, citizen engagement involves not just the individual citizen of the 1789 French Declaration of the Rights of Man and the Citizen, but the practices of deliberation, participation and contestation by citizens in their collective and organised capacity – as civil society, trade unions, indigenous peoples, social movements and internet-based campaigning groups, for example.

II. Channels for citizen engagement: A fast-evolving arena

Spaces for citizen engagement with international investment law are evolving rapidly, particularly in middle- and high-income countries where citizen groups have so far been active in claiming deliberative space. A few examples illustrate the multiple channels that could allow greater citizen participation in the making of investment law. In some (primarily high-income) polities, parliaments are taking a more active role in investment treaty making. For example, the European Parliament has provided specific guidance on the European Union (EU)'s approach to investment treaty making (European Parliament, 2011) and on the negotiation of individual investment treaties (e.g. European Parliament, 2013).

In the United Kingdom, the House of Lords and the House of Commons carried out inquiries and held debates on the proposed Transatlantic Trade and Investment Partnership (TTIP) – a major trade and investment deal being negotiated between the US and the EU (House of Lords, 2014a; House of Commons, 2015a, 2015b and 2015c). In

2014, controversy on the ratification of an investment treaty between the UK and Colombia, including civil society concerns that the treaty might get in the way of Colombia's land restitution programme (AB-Colombia, 2014), triggered a debate in the House of Lords (2014b), albeit after the treaty was ratified.

There is also some experience with mechanisms for direct democracy and public consultation processes. In 2007, Costa Rica became the first country to hold a referendum on a trade and investment deal – the Central American Free Trade Agreement (CAFTA). The 'yes' vote won by a very narrow margin, and paved the way to Costa Rica's ratification of the deal (Breuer, 2009).

Although public consultations on investment treaties remain rare, they are becoming more common. Examples include the multi-stakeholder consultation processes carried out for the elaboration of the US Model BITs of 2004 and 2012 (ACIEP, 2004 and 2009), and the (carefully circumscribed) online consultation launched by the European Commission on the investment chapter of the proposed TTIP (European Commission, 2015).

Outside formal consultations, public scrutiny of investment treaty making is on the rise. In the Philippines, for example, civil society advocacy on investment treaties has involved campaigning, awareness raising, alliance building and engagement with government (Puruggananan, 2015). Civil society in Malaysia has deployed comparable strategies in connection with the investment chapter of the proposed Trans-Pacific Partnership (Abdul Aziz, 2015).

In Europe, civil society groups filed a request for a 'European citizens' initiative' on two major proposed investment treaties. A European citizens' initiative is an invitation to the European Commission to propose legislation. This type of initiative must be backed by at least one million EU citizens, coming from at least seven member states.[4] The citizens' initiative asked the Commission "to repeal the negotiating man-

4. The legal basis for the European citizens' initiative is provided by Article 11(4) of the Treaty on the European Union, Article 24(1) of the Treaty on the Functioning of the European Union, and Regulation No. 211/2011 of the European Parliament and of the Council of 16 February 2011 on Citizens' Initiatives.

date for the Transatlantic Trade and Investment Partnership (TTIP)" with the US, and "not to conclude the Comprehensive Economic and Trade Agreement (CETA)" with Canada. The European Commission rejected this request in light of the requirements of European legislation (European Commission, 2014a). However, civil society is pushing ahead with the petition as a tool to catalyse awareness raising and citizen engagement.

There has also been greater citizen engagement with investor-state arbitration, leveraging new entries provided by changes in arbitration rules (including revised International Centre for Settlement of Investment Dispute (ICSID) Arbitration Rules and new UN Commission on International Trade Law (UNCITRAL) Transparency Rules) and by new investment treaty clauses providing for greater transparency and public input into arbitration processes. This trend is exemplified by increasing numbers of civil society submissions in investor-state arbitration, including in connection with disputes relating to natural resource investments.[5] Civil society groups have also used 'freedom of information' legislation to obtain access to arbitral awards where these had not been published (see e.g. Hepburn and Balcerzak, 2013).

Despite these developments, opportunities for citizen participation have presented limitations. Even Costa Rica's experience with holding a referendum on CAFTA – so far the clearest application of direct democracy tools to trade and investment treaty making – has not been without critics. Some commentators pointed to the pressures exercised by business groups during the referendum campaign, and to significant asymmetries in the financing of the 'yes' and 'no' campaigns, going so far as arguing that these circumstances "made the referendum appear as a tool for citizen manipulation rather than an instance of informed citizen participation" (Breuer, 2009: p. 464).

In Europe, the online questionnaire for the EU public consultation on the investment chapter of TTIP included seven questions on specific aspects of investor-state arbitration. However, it did not include a question on whether investor-state arbitration clauses should be

5. For instance, *Glamis Gold Ltd. v. United States of America*; *Pac Rim Cayman LLC v. Republic of El Salvador*; *Infinito Gold Limited v. Republic of Costa Rica*.

allowed in the first place (European Commission, 2014b). Yet public concerns about the inclusion of investor-state arbitration were a major factor leading to the consultation. About a third of the nearly 150,000 responses to the consultation answered most of the questions with the same statement: "No comment – I don't think that [investor-state arbitration] should be part of TTIP" (European Commission, 2015: p. 10).

III. Some preliminary lessons

The recent surge in citizen activism on international investment law has seen the pursuit of multiple channels but has also seen real challenges facing citizens seeking to influence policy in this arena. Investment law is an important part of the legal architecture underpinning economic globalisation, because it shapes the terms for the treatment and possibly the admission of foreign investment. Therefore, policy choices can affect major economic interests, and this is bound to affect scope for reform.

Also, promoting informed citizen engagement on complex technical issues raises obvious practical challenges. Opportunities for meaningful citizen influence are particularly constrained in low- and middle-income countries where awareness of international investment law issues tends to remain low, capacity constraints may be particularly hard (as reflected, for example, in lower literacy rates) and political space for genuine dialogue is often limited.

Looking beyond investment law, these experiences highlight the challenges of making democratic participation work in arenas dominated by complex technical issues, major economic interests and significant power imbalances. In many arenas, democratic processes must come to terms with entrenched power relations that undermine the principle of equality – the very foundation of democratic deliberation. So applying democratic tools to international investment law will still leave important questions unanswered.

At the same time, international investment law provides a test case for wider efforts to design systems of democracy that are able to deliver

bottom-up policy making and pursuit of sustainable development.[6] Despite the constraints they face, citizens are increasingly making use of the spaces for deliberation and influence that they do have, aided by increasing public awareness about investment treaties. While it is often too early to assess rigorously what approaches work where, and under what conditions, it is not too early to start distilling some lessons from this growing experience.

Against the backdrop of the often blank statements made about the erosion of state power and the diffuse nature of decision-making in economic globalisation, recent trends confirm the continued centrality of states as the key sites for citizen action (Schneiderman, 2013). Two factors underpin this continued centrality. First, states play a central role in shaping the legal regime for cross-border investment flows. It is states that have the legal authority to do and undo investment treaties, or to recalibrate their content, even though their ability to influence negotiations varies significantly due to imbalances in negotiating power (Schneiderman, 2013).

Second, depending on political systems, states provide the primary spaces for democratic accountability. For these reasons, much recent citizen action has targeted state authorities in relation to their participation in international treaty making. Context does matter, however, particularly given the very diverse degrees of political space that exist in different polities – from democratic countries to authoritarian regimes. Operating in diverse contexts requires different strategies, and thus more fine-grained analyses to inform choices on relevant tools to implement those strategies.

While state frameworks remain very important, international investment law does involve the delegation of considerable authority from states to investor-state arbitral tribunals. These tribunals have the power to review the legality of state conduct based on the standards embodied in investment treaties, and to order payment of compensation if they find that the standards have been breached. In addition,

6. On the link between democracy and sustainable development, see the *Manifesto for Democracy and Sustainability* (http://www.democracyandsustainability.org/manifesto/).

multiple states are grappling with similar challenges, so there is considerable room for lesson sharing and alliance building. As a result, the sites for citizen action transcends the confines of nation states.

The growing experience with civil society submissions to investor-state arbitration illustrates the space for citizen action that these transnational processes can provide, although there is as yet no systematic assessment of the difference that these submissions make to the outcomes of dispute settlement processes. Significantly, emerging experiences with advocacy in national policy processes or international dispute settlement point to the importance of harnessing both law and politics, and of developing local-to-global alliances among groups that have common objectives and different comparative advantages (see e.g. Orellana et al., 2015).

Research can play an important role in facilitating lesson sharing and citizen debate. The combination of sensitive political choices and complex technical issues calls for informed as well as inclusive debate. In turn, this requires rigorous analysis of multiple considerations involved in concluding, renegotiating or terminating investment treaties, and of different options for treaty formulation. As international investment law negotiates the delicate transition it is currently undergoing, there is much scope for new collaborations that harness research and advocacy for greater citizen participation in the making of international investment law.

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