

# Overview of Presentation

- Introduction to International Investment Policy and Law
- Defining the Scope of Application in IIAs
- Investment Protection in IIAs
  - Relative Standards of Treatment: National and Most-Favoured (MFN) Treatment
  - Absolute Standards of Protection: Fair and Equitable Treatment, Expropriation, Transfer of Funds
- Dispute Settlement in IIAs
  - State-to-State Dispute Settlement
  - Investor-State Dispute Settlement (Arbitration)

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- Introduction to International Investment Policy and Law
- Defining the Scope of Application in IIAs *Today*
- Investment Protection in IIAs
  - Relative Standards of Treatment: National and Most-Favoured (MFN) Treatment
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# Introduction to International Investment Policy and Law

# What is Foreign Investment?

- Definition Foreign **Direct** Investment (**FDI**)
  - Establishment or acquisition of an interest in a business in a foreign state - **resulting in lasting influence or control of the management of a business**
  - “**Greenfield**” or acquisition
  - Distinguished from “**portfolio**” investment
    - **Typically long term commitment**
      - Substantial “sunk costs” – not recoverable if investment terminated
      - Return over long period of time
      - Long term relationship with host state
      - Subject to significant commercial and political risks
  - International investment law addresses these risks
    - Especially political risk
    - Through investor protection and investor-state arbitration

# Portfolio Investment

- Investment that is not FDI
- No lasting interest in management or control
  - Less than 10 % of voting equity
- More easily sold compared to FDI
  - More liquid and volatile
  - Less need for IIA protection against political risk
- Comes from more diverse sources than FDI
  - *e.g.*, investment via minority interest in equity instruments (stocks) or debt (bonds) of an enterprise

# Business Rationales for FDI

- Natural resource-seeking FDI
  - Invest to acquire and export host country resources
- Market-seeking FDI
  - Invest to access host country market
- Efficiency-seeking FDI
  - Invest to allocate part of global business to a particular country to take advantage of locational benefits
- Strategic asset-seeking FDI
  - Invest to acquire specific (created) assets like brand name, technology or specialized skills

# Natural Resource-seeking FDI

- Provides complementary assets
  - Technology, management and organizational competence
- Provides access to foreign markets
- May (or may not)
  - lead to local spillover effects
    - *e.g.*, secondary processing activities

# Market-seeking FDI

- Provides complementary assets
  - Technology, management and organizational competence
- Fosters backward supply linkages and development of specialized labor markets
- Raises
  - standards of product quality
  - domestic consumers' expectations of indigenous competitors
- Stimulates local entrepreneurship and domestic rivalry



# Efficiency-seeking FDI

- Investment in host state is part of global allocation of production process
- Investor seeks
  - Lower labour or other costs
  - Regulatory structure
  - Access to capital, inputs, raw materials, skills
- Facilitated by
  - Reduction in costs of transportation
  - Improvements in and reduction of costs of communication
  - Reduction in tariffs and non-tariff barriers for goods and services

# Efficiency-seeking FDI

- Export oriented
  - Net generator of foreign exchange
- Significant political gains
  - Expansion and diversification of exports
  - Transfer of technology
- Improves international division of labor and cross-border networking
  - Fosters backward supply linkages and development of specialized labor markets
  - Provides access to foreign markets and/or sources of supply
- Aids structural adjustment

## Strategic asset-seeking FDI

- Provides new finance, capital and complementary assets
- Provides access to foreign markets
- Improves international division of labor and cross-border networking
  - Strategic assets in host state are incorporated in global business

# FDI flows in Pakistan

- Profile of FDI currently flowing into Pakistan
  - By source of capital
  - Sector of destination
  - Impact on development

# Kind of FDI Currently Flowing into Pakistan

**Table 4.4a : FDI Inflows in Pakistan-Source wise (million US dollar)**

	2006-07	2007-08	2008-09	2009-10	2010-11
USA	913.1	1,309.3	869.9	468.3	238.9
UK	860.1	460.2	263.4	294.6	208.1
U.A.E	661.5	589.2	178.1	242.7	284.2
Japan	64.4	131.2	74.3	26.8	3.2
Hong Kong	32.6	339.8	156.1	9.9	125.6
Switzerland	174.7	169.3	227.3	170.6	47.2
Saudi Arabia	103.5	46.2	-92.3	-133.8	6.5
Germany	78.9	69.6	76.9	53.0	21.2
Korea (South)	1.5	1.2	2.3	2.3	7.7
Norway	25.1	274.9	101.1	0.4	-48.0
China	712.0	13.7	-101.4	-3.6	47.4
Others	1,512.2	2,005.2	1,964.2	1,019.6	631.6
Total including Pvt. Proceeds	5,139.6	5,409.8	3,719.9	2,150.8	1,573.6
Privatization Proceeds	266.4	133.2	0.0	0.0	0.0
FDI Excluding Pvt. Proceeds	4,873.2	5,276.6	3,719.9	2,150.8	1,573.6

Source: SBP

# Kind of FDI Currently Flowing into Pakistan

**Table 4.4b : FDI Inflows in Pakistan-Sector wise (million Rupees)**

	2006-07	2007-08	2008-09	2009-10	2010-11
Oil & Gas	545.1	634.8	775.0	740.6	512.2
Financial Business	930.3	1,864.9	707.4	163.0	246.9
Textiles	59.4	30.1	36.9	27.8	25.0
Trade	172.1	175.9	166.6	117.0	53.0
Construction	157.1	89.0	93.4	101.6	60.8
Power	193.4	70.3	130.6	-120.6	155.8
Chemical	46.1	79.3	74.3	112.1	30.5
Transport	30.2	74.2	93.2	132.0	104.6
Communication (IT&Telecom)	1898.7	1,626.8	879.1	291.0	-34.1
Others	1,107.2	764.5	763.4	586.3	418.9
Total including Pvt. Proceeds	5,139.6	5,409.8	3,719.9	2,150.8	1,573.6
Privatization Proceeds	266.4	133.2	0.0	0.0	0.0
FDI Excluding Pvt. Proceeds	4,873.2	5,276.6	3,719.9	2,150.8	1,573.6

Source: SBP

# Impact of FDI on Economy of Pakistan

- Despite the fact that FDI brings technological innovations, enhanced human resources, administrative improvements, trained labor force and management skills –
  - studies revealed for Pakistan a negative impact on Economic Growth
- Various studies had attributed it to
  - Unfavorable government policies
  - Technological gap
  - Un-qualified human capital
  - Lack of R & D
  - Above all lack of **ABSORPTION CAPACITY**

# Current Investment Portfolio of Pakistan

- **Total Investment** declined from 13.1 percent of GDP to 12.5 percent of GDP in 2011-12 as compared to last year
- **Fixed Investment** declined from 11.5 percent of GDP to 10.9 percent of GDP in 2011-12 as compared to last year
- **Private Investment** declined from 8.6 percent of GDP to 7.9 percent of GDP in 2011-12 as compared to last year
- However **Public Investment** increased from 2.9 percent of GDP to 3.1 percent of GDP in 2011-12 as compared to last year



# The Different Levels of International Investment Regulation

- National laws
- Bilateral and regional level:
  - Bilateral Investment Treaties (BITs)
  - Investment Chapters in Preferential Trade Agreements (PTAs)
- Multilateral rules applicable to investment

# Potential benefits from inward FDI

- Provides external financing
- Transfer of hard technology
- Transfer of “soft technology”
  - knowledge, management skills, organizational methods
- Promotes exports
- Employment creation
- Promote local skills development through training
- Improve quality of local good and services
- Introduce new goods and services
- Competitive spur to local economy
- Contribute to local enterprise development
  - via spill-overs and directly
- Provide access to international markets

# FDI – National Regulation

- Host states often combine openness with incentives to attract FDI
  - Free zones – imports and exports permitted without duty
  - Subsidies and other financial incentives
  - Foreign investment guarantees – *e.g.*'s

Often  
In  
Contract  
Between  
Investor and  
Host State

- Stabilization of law
- Limits on taxes or tax relief
- Convertibility of local currency
- Repatriation of profits, proceeds of sale

May amount  
to  
customized  
legal regime  
for the  
investor

# FDI - National Regulation

- FDI subject to intrusive regulation in many countries and some regulation in all countries
  - National security and defence
  - Concerns about sovereignty
  - Limited use of local inputs and high remittances
    - Balance of payments concerns
  - Protection of local industries
    - Risk of crowding out
  - Control over natural resources
  - Protection of local culture

# FDI - National Regulation

- FDI subject to intrusive regulation in many countries and some regulation in all countries (ii)
  - Negative spill-overs
    - Environment, human rights, labour rights and indigenous people's rights
  - Limited transfer of technology
  - Employment loss
  - Anticompetitive practices (abuse of dominant position)

# FDI – National Regulation

- National regulation takes many forms
    - to ensure that benefits received and costs minimized
    - Limits on ownership, closed sectors (and priority sectors)
    - Approval requirements (e.g. *Investment Canada Act*)
    - Requirements as to form (e.g. joint venture)
    - Local content and/or employment requirements
    - Trade balancing
    - Export performance
    - Product mandating
    - Technology transfer
    - Restrictions on
      - land ownership
      - repatriation of investment
      - conversion of currency
- } “Performance Requirements”

# FDI - International Rules

- International investment law addresses **access** for foreign investment and **risk** to investment
  - Especially political risk
  - By protecting
    - investors from some host state actions through investor protection standards and
    - giving access to investor-state arbitration where host state breaches protection obligation
  - Are alternatives
    - insurance and contractual commitments
- No comprehensive multilateral agreement
  - Dropped from WTO Doha round agenda in 2004
  - Result: International rules are fragmentary

# FDI - International Rules

- International rules are fragmentary
  - Customary international law
  - WTO TRIMs Agreement
  - WTO GATS commitments on commercial presence

Sometimes called international investment agreements (IIAs)

- FTAs and Bilateral Investment Treaties (*BITs*) provide more comprehensive rules
- Other international agreements have rules relating to investment too, including double taxation agreements (*DTTs*)
- International Convention on the Settlement of Investment Disputes (*ICSID*)
  - Dispute resolution process only



# TRIMs Agreement

- BASIC ELEMENTS

- Prohibition on TRIMs inconsistent with GATT obligations relating to **national treatment** of goods (Art. III)
- Illustrative list of prohibited TRIMs
  - local content requirements (*FIRA* case against Canada)
  - trade balancing requirements
  - foreign exchange balancing
  - restrictions on exports

“**Performance Requirements**”

# WTO's General Agreement on Trade in Services (GATS)

- All services are subject to GATS - including services delivered through a **commercial presence**
  - *i.e.* some forms of investment
  - Such as a legal person (*e.g.* a subsidiary) that supplies services in one WTO Member and that is owned or controlled by natural or legal persons of another WTO Member
- Some obligations apply to **all services** that are subject to the agreement
  - *E.g.* Most Favoured Nation (MFN)
    - Subject to MFN exemption list
- Other obligations apply only to **services sectors listed** by each WTO Member in **National Schedule** (positive list)
  - *E.g.* National treatment and market access

# International investment treaty obligations have expanded dramatically

- Strands in the “spaghetti bowl”
  - More than 5,900 treaties worldwide dealing with investment issues
    - An increase of 40% in the past decade
      - led by Asian countries
    - More than 2,800 **bilateral investment treaties** (*BITs*) involving 179 countries
      - Annual *rate* of growth peaked in 2001
      - 33 new *BITs* in 2011
    - More than 300 bilateral and regional preferential trade and investment agreements (*PTIAs*)
      - 14 new other *IAs* in 2011
      - *PTIAs* doubled between 2003 and 2008
      - Investment content varies – some like *BITs*, some softer economic cooperation commitments

# Pakistan's Investment Commitments

- As a WTO Member
  - No general commitments regarding investment
  - TRIMs and GATS obligations
- Pakistan – Malaysia Closer Economic Partnership Agreement 2007
  - Most investment obligations do not apply to delivery of service through a commercial presence (Art. 93.7(a))
- Pakistan – China Free Trade Agreement 2006
- BITS with 45 countries

# International investment treaty arbitrations have expanded more dramatically

- As of December 31, 2011
  - 450 *known* **treaty-based** arbitrations
    - 46 new claims in 2011
      - More than 60% of all cases commenced in since 2004
    - Claims have been against 89 countries
      - 55 developing countries, 18 developed countries and 16 transition economies
      - Over 90% by **developed** country investors against **developing** countries
      - **3 claims against Pakistan**
    - 220 cases concluded – 26 in 2011
      - 40% in favour of host country
      - 30% decisions in favour of investor
      - 30% settled

# Defining the Scope of Application in IIAs

# Defining the Scope of Application in IIAs

- Scope of application of treaty determines scope of obligations
- Issues:
  - What is a protected **investment**?
    - Does treaty only apply to investments admitted in **accordance with host state law**?
  - Who is a protected **investor**?
  - When do the treaty obligations **begin**?
    - After the treaty comes into force
    - Often for **investments in place** and new investments
  - When do the treaty obligations **end**?
    - On termination of treaty – Often obligations continue to apply in relation to investments made while the treaty was in force for a period of time (e.g. 10 years, US Model BIT)

# Scope of Treaty

Treaty obligations only apply to “**investments**” of “**investors**” as defined in the treaty

- Key threshold questions are **who is an investor** and **what is an investment?**
  - What kinds of investments will benefit from treaty obligations?
    - And potentially give rise to investor-state arbitration claims
  - What kinds of investments will treaty commitments attract?



# Investments

- Classical economic concept of investment of FDI
  - Transfer of funds or commitment of substantial assets
  - Long term project – more than one year
  - Expectation of profit
  - Participation of person transferring funds in management of investment
  - Assumption of business risk
  - Contribution to host state development
- Broader definitions are included in most investment treaties
  - Open – “every kind of asset, including...”
  - Closed – only investment if fits in discrete category
  - May or may not be any requirement that investment have characteristics of classical concept
    - Required in Art. 88 Pakistan – Malaysia Closer Economic Partnership (2007)

# Investments

- Issues regarding definition of *investment (i)*
  - Should investment be required to contribute to development?
  - Should “portfolio investment” be included or only “direct investment”?
    - Need for protection?
    - Risk of multiple claims
    - Definition challenges
  - Should bonds and other claims issued by state be included?

# Investments

- Issues regarding definition of *investment* (ii)
  - Should intellectual property be included?
  - Already subject to WTO TRIPS agreement requirements and other international obligations
    - Poses implementation challenges for many developing countries
  - Why add investment agreement protection?
    - Secures (but does not impose) rights
    - Important for investors
    - But exposes a state's intellectual property measures to treaty obligations and investor-state dispute settlement

# Investments

- Issues regarding definition of *investment* (iii)
  - How should intellectual property be included?
  - Should stand alone intellectual property rights be protected?
    - *E.g. patent or copyright in a song*
  - Or only if related to another form of investment?
  - Should certain kinds of intellectual property be excluded?
    - *E.g. traditional knowledge*
  - Inclusion supplemented by appropriate specific exceptions
    - Compulsory licencing of patent not expropriation
    - Derogations from national treatment and MFN that are permitted by TRIPS are not breaches

# Investments

- Issues regarding definition of *investment (iv)*
  - Assets used for non-business purposes
    - *E.g.* real estate not acquired in the expectation of profit or for other business purpose
  - Financial transactions
    - Short term debt instruments
    - Claims to money that arise solely from commercial contracts for the sale of goods and services

# Legality of Investment

- Often treaty applies only to investments **admitted** “in accordance with law”
- Legality requirement may be in definition of investment or **scope provision**
- **Host state retains control of admission**
- Does this mean that investments that violate national law in any way are not protected by the treaty?
  - Does not disqualify every investment in relation to which is some minor irregularity
  - Some degree of seriousness required
    - *E.g.* false information supplied to get investment approved, investment contract obtained by bribery
  - Does not mean that national law definitions of investment define what investments are covered by the treaty
    - Investment is as defined in the treaty

# Investors

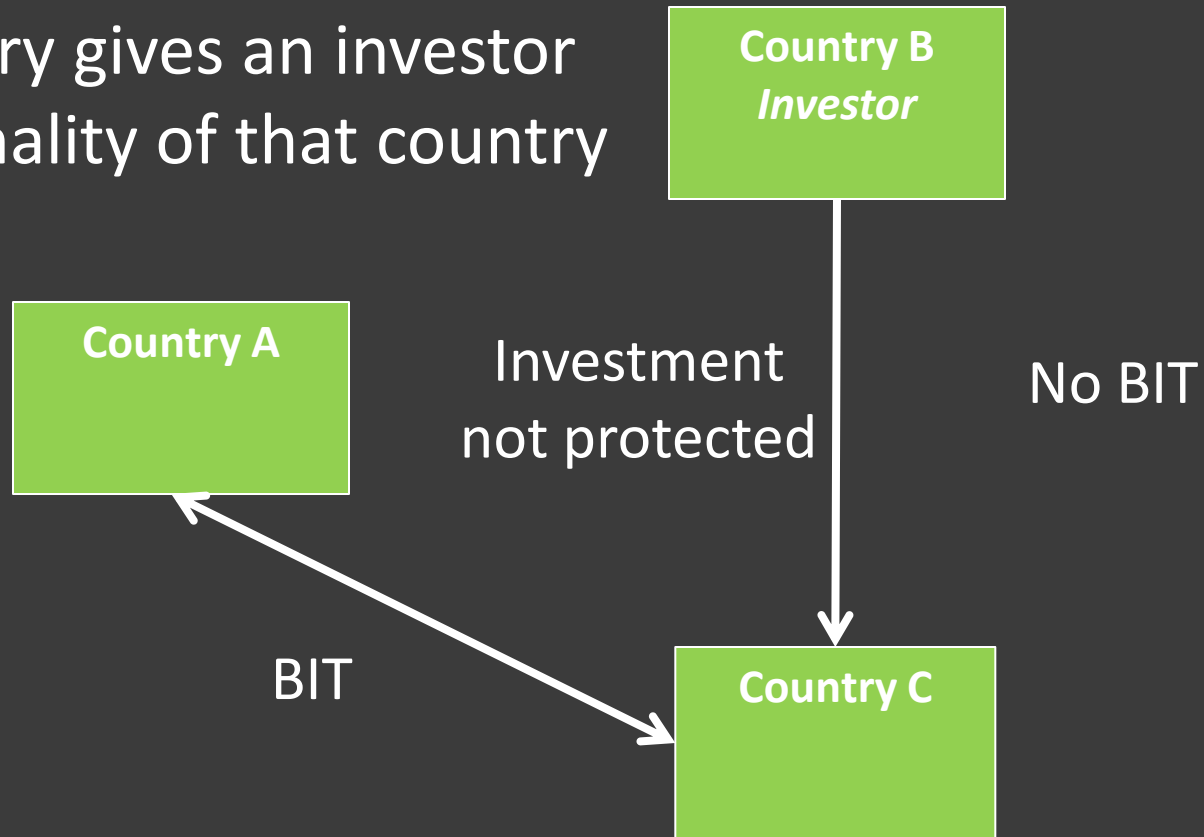
- Investor must be related to State Party to treaty **other than the one complained against** (the *host state*) to benefit from the investor protection obligations on the host state
- **Individuals**
  - Typically must be nationals
  - Nationality determined by law of state whose nationality is claimed to the extent not addressed in treaty
    - Dual nationality may be permitted by state law
    - Treaty may address
      - *E.g.* dual national has nationality of country with which has closest connection
    - Residency in state typically not required

# Investor

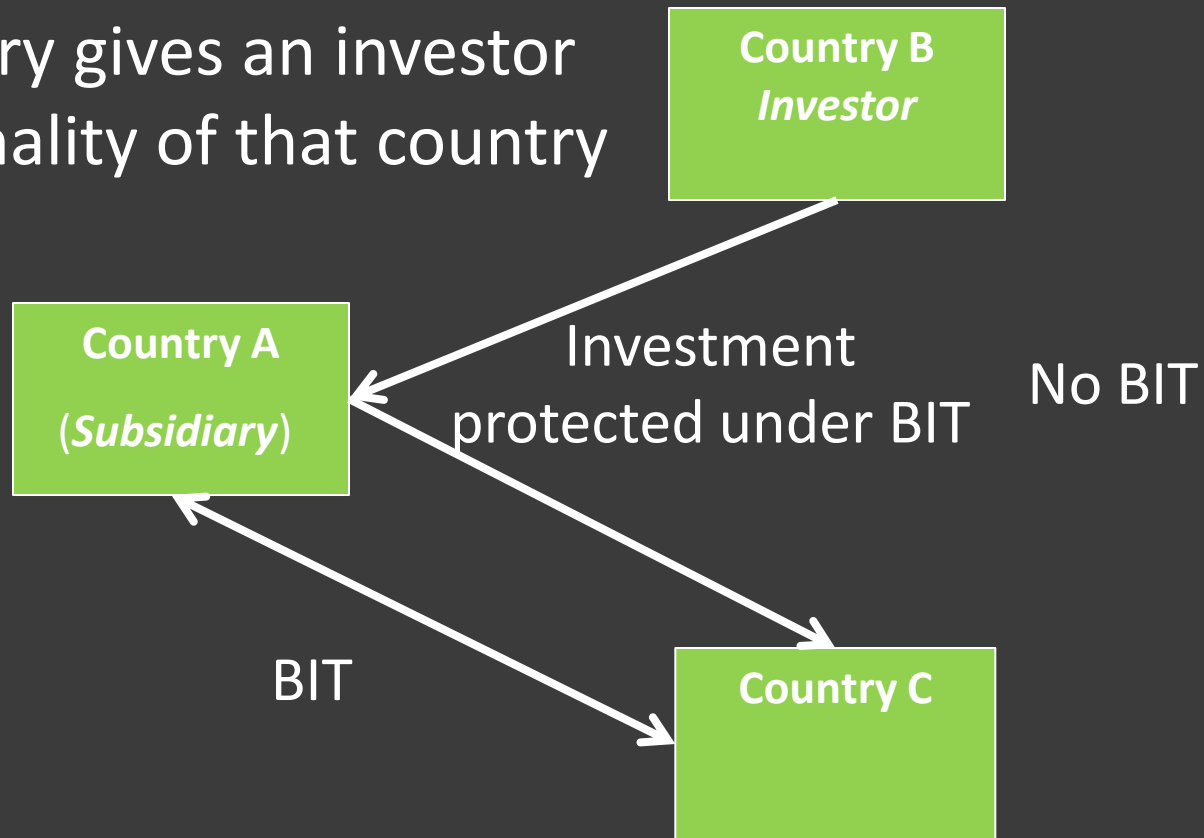
- Legal or juridical persons (*e.g.* corporations)
  - IIAs typically only require that **a legal person be incorporated or organized under laws of a Party to have that Party's nationality**
    - Simple for foreigner to meet and so qualify for treaty protections
    - Easy to determine whether qualify
    - Potentially results in very broad protection
      - Must make investment to qualify for protection
      - How desirable depends on domestic policy
  - Requirement only for incorporation or organization in a state alone raises possibility of **treaty shopping** – or planning opportunity



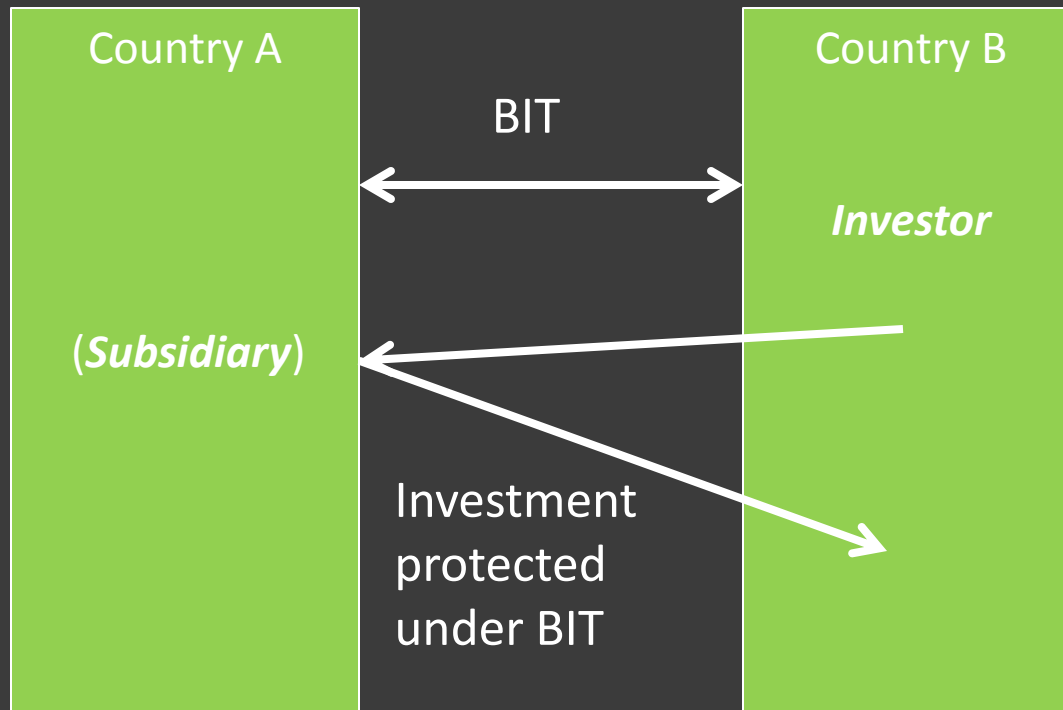
Treaty shopping issues  
where simple incorporation  
in a country gives an investor  
the nationality of that country



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Trade and Investment  
Module 6  
DAY 2

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# Investor

- Issue: How to avoid **treaty shopping** by investors?
  - Require **ultimate owners** who control investment to be nationals of home state Party (rare)
    - *E.g.* Germany – Antigua and Barbuda BIT
  - Require legal person to have **substantial business activities**, seat, head office or some other significant connection in home state Party (common but vague)
  - **An alternative - Denial of benefits provision**
    - Instead of incorporating in treaty definition, allow host state to deny benefits of treaty if these criteria are not met by a **particular investor**
    - May not be able to use after claim made unless expressly permitted

## Other Scope Limitations

- Exclude sectors, policy areas or measures listed in reservations (**negative list**)
  - List it or lose it – means must conduct survey of existing domestic rules and list to be able to maintain if inconsistent with treaty obligations
  - Transparent
    - For the benefit of investors
    - Provides agenda for future negotiation on liberalization
- Include only policy areas or sectors listed (**positive list**)
  - May have reservations to limit scope of obligations
  - Any restrictions in other sectors permitted
  - Not transparent

## Other Scope Limitations

- General exceptions for sectors or policy areas
  - *E.g.* security, health, environmental protection
- Geographical scope
- Commencement and termination
  - Application to pre-existing investments
  - Application to new measures only
  - Term and termination procedures
  - Survival of obligations for some specified period after termination for investments in place at time of termination

# Admission and Establishment

- Two Basic Treaty Models
  1. Treaty standards apply only after **unilateral decision by state to admit in accordance with its laws**
    - No obligation regarding admission
    - Most common
  2. Treaty includes commitment to admit
    - Often limited commitment
      - Sectors excluded (**negative list**) or sectors included (**positive list**)
      - Exclusions reflect domestic policy
        - » e.g. sectors exclude based on national security
      - Admissions procedures
        - » e.g. *Investment Canada Act* review
    - Canada, US, Japan model agreements
      - May be express commitment or
      - Done through national treatment and MFN provisions



# Admission and Establishment

## Art. 1102 of NAFTA National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the **establishment, acquisition, expansion**, management, conduct, operation, and sale or other disposition of investments.

**Example of a “Right of Establishment”**

# Admission and Establishment

- Another approach - GATS
- Positive list for
  - National treatment plus
  - Prohibition on specified market access restrictions
    - *E.g.*'s limitations on
      - foreign capital
      - form of investment (such as joint venture)
      - total value of services operations
  - **Subject to limitations written in National Schedule of Commitments for each Member**
- Other alternatives
  - Best efforts to allow establishment
  - Commit to grant right to establishment at future date or based on future negotiations

# Standards of Investor Protection

Relative Standards

Absolute Standards

# National Treatment

Treatment **no less favourable** than treatment of investors **of host state**

– Includes both *de jure* and *de facto* discrimination

- Advantages

- Protects investors against discrimination
  - level playing field

- Disadvantages

- Reduces possibility of favouring domestic firms

- But most agreements contain some **exceptions and reservations** expressly permitting discrimination in some circumstances

- *E.g.* domestic subsidies to local businesses, government procurement

- Can also limit by using *positive list*

# National Treatment

E.g. US Model BIT

“Each Party shall accord to **investors** of another Party **treatment no less favorable** than that it accords, **in like circumstances**, to its **own investors** with respect to the **establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition** of investments.”

# National Treatment

- *Issue: what is the comparator to foreign investor?*
- Some IIAs require that foreign investor must be “**in like circumstances**” to national investors for there to be breach
  - “in like circumstances”
    - Makes clear that many factors relevant to choosing comparator
      - Broader concept than same economic sector
      - Businesses in same economic sector may not be “in like circumstances”
        - » *E.g. Bayindir v. Pakistan*
    - Not in “like circumstances” for purposes of a particular measure if different treatment justified by legitimate public purpose and the measure bears reasonable relation to that purpose

# National Treatment

- Example of significance of not “in like circumstances” qualification
  - A state enacts a measure to protect the environment by limiting use of a particular polluting industrial technology
  - The measure affects foreign investors who are the only users of that technology but not domestic businesses in the same sector that do not use the polluting technology
  - The foreign investors are not “in like circumstances” with the domestic businesses for the purposes of the achievement of environmental protection and the measure is not a breach of national treatment
  - Expressed another way,
    - discrimination is based on who is a polluter not nationality

# National Treatment and Sub-federal Governments

- Some states may want to limit the scope of national treatment as it applies to sub-federal levels of government

Art. 1102 (3) of NAFTA

- [National treatment] means, with respect to a **regional level of government**, treatment no less favorable than the treatment accorded, in like circumstances, by that regional level of government **to natural persons resident in and enterprises constituted under the laws of other regional levels of government of the Party of which it forms a part**, and to their respective investments.
- A regional level of government only obliged to give foreign investor treatment that it gives to national investor from outside the region.



# National Treatment

- Relevance of discriminatory intent
  - In most cases, not relevant – too hard to show
    - the fact of less favourable treatment enough  
(*Bayindir v. Pakistan*)
- Relevance of WTO jurisprudence on national treatment and especially “like products”
  - Early cases seemed to suggest WTO cases are a useful guide though do not apply directly  
But rejected in later cases
    - Parties aware of WTO language but chose not to use

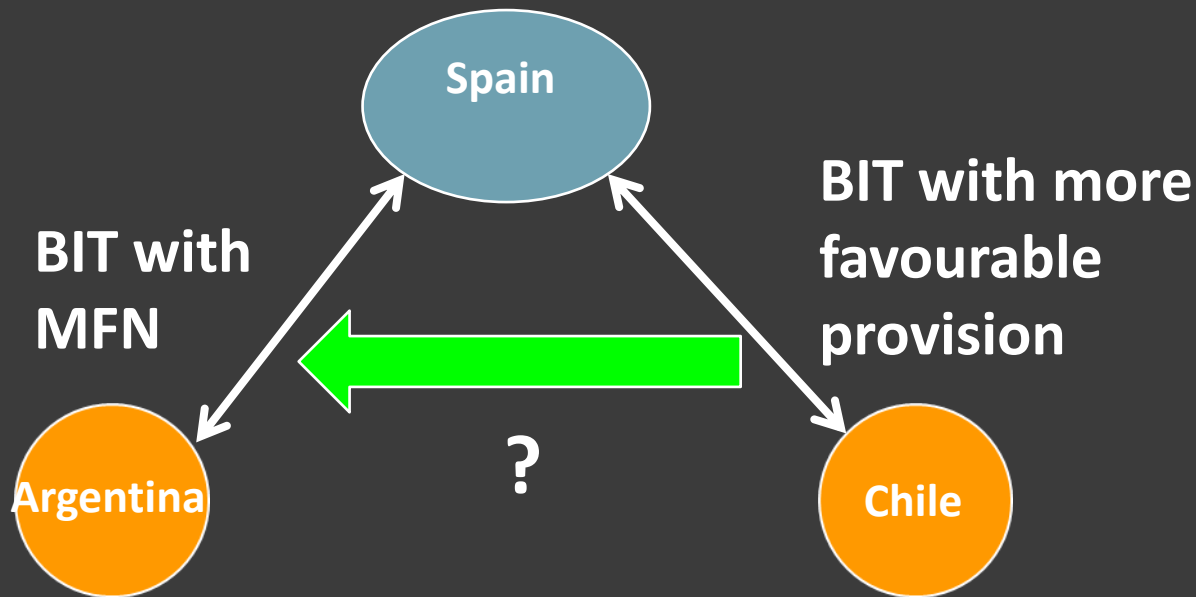
# Most Favoured Nation (MFN) Treatment

- *Almost* universally found in international trade and investment treaties
- Issues:
  - Some of **same issues as national treatment**
    - What is comparator group?
      - foreign investors from other states “in like circumstances”
    - What is differential treatment?
    - Less significant from policy point of view
      - Discrimination between foreign investors less common
      - Except in **preferential trade and investment agreements**

# Most Favoured Nation (MFN) Treatment

- Issues (ii)
- To what extent is MFN meant to alter arrangements specifically agreed **in a treaty between two states** by importing standards from **another treaty** between **state complained against and third state**?
  - Depends on treaty language

# MFN Applied to Other Treaty Provisions



To what extent does MFN in BIT with **Argentina** permit **Argentine investor** to **use more favourable provision** in BIT with **Chile** in claim against Spain?

# Most Favoured Nation (MFN) Treatment

- Importation from other treaties
  - Other treaties have been used to inform **interpretation of substantive standards** for investor protection in some cases
  - **Importation of standards** permitted
    - *E.g. Bayindir v. Pakistan*
    - Treaty objective of creating conditions favourable to investment invoked in support
  - Less consistency in arbitration decisions related to incorporation of **dispute settlement provisions** in other treaties (*Maffezini*)

# Most Favoured Nation Treatment (MFN)

- Can threaten stability and coherence of obligations
  - Issues to be considered in future negotiations
    - Will **new treaty obligations** be incorporated in **old treaties** by MFN provisions in those old treaties?
    - How could incorporation of **old treaty provisions** into **new treaties** be avoided in drafting of MFN provisions in **new treaties**?
- Can be addressed by
  - Exceptions and state specific reservations
  - Limiting application to certain activities
    - “management, conduct, operation, expansion and sale or other disposition of investments” in host state (“Establishment , acquisition or expansion,” only if pre-establishment rights created)

# Most Favoured Nation (MFN) Treatment

## ANNEX III to Canada's Model FIPA

### Exceptions from Most-Favoured-Nation Treatment

1. Article 4 shall not apply to treatment accorded under **all bilateral or multilateral international agreements** in force or signed **prior** to the date of entry into force of this Agreement.
2. Article 4 shall not apply to treatment by a Party pursuant to any existing or **future** bilateral or multilateral agreement:
  - (a) establishing, strengthening or expanding a **free trade area or customs union**;
  - (b) relating to:
    - (i) **aviation**;
    - (ii) **fisheries**;
    - (iii) **maritime matters, including salvage**.
3. For greater certainty, Article 4 shall not apply to any **current** or **future foreign aid programme** to promote economic development, whether under a bilateral agreement, or pursuant to a multilateral arrangement or agreement, such as the OECD Agreement on Export Credits.

# Minimum Standard of Treatment and Fair and Equitable Treatment (FET)

- Most commonly invoked obligation
  - Highest incidence of successful claims
- Different formulations
  - Some limit to customary international law (e.g. NAFTA)
    - If not limited - it represents an **autonomous** standard
    - But the difference in effect is not clear (or agreed)
  - Some treaties combine FET with “full protection and security” and/or general principles of international law
  - Interpretation starts with specific language of treaty



# Minimum Standard of Treatment and FET

- Requires at least
  - States cannot engage in
    - bad faith and arbitrary treatment of investors
    - willful neglect of the interests of investors or
    - clearly unreasonable treatment of investors
  - States must
    - treat investors in accordance with due process
    - be duly diligent in preventing harm to investors
  - States must not deny justice
    - Denial of justice is not just any adverse decision of a court
      - Investor-state challenge is not an appeal
      - *E.g.*'s of denial of justice
        - » Courts refuse to entertain investor's claim
        - » Subject claim to undue delay
        - » Administer justice in seriously deficient way
        - » Clear and malicious misapplication of the law

# *Glamis Gold 2009*

## Minimum standard of treatment in NAFTA

...a violation of the **customary international law** minimum standard of treatment, as codified in Article 1105 of the NAFTA, requires an act that is sufficiently egregious and shocking—a **gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons**—so as to fall below accepted international standards and constitute a breach of Article 1105. Such a breach may be exhibited by a “gross denial of justice or manifest arbitrariness falling below acceptable international standards;” or the **creation** by the State of objective **expectations in order to induce investment and the subsequent repudiation** of those expectations.

Drawing on the *Neer* case of 1927 and interpreting NAFTA 1105

# Minimum Standard of Treatment and FET

- Some cases express a broader view of the standard
- FET requires compliance with the investor's legitimate expectations based on
  - **Compliance with contracts**
    - But most tribunals have held that not all contractual breaches are a breach of FET
      - Was state acting in sovereign capacity?
      - Was there complete repudiation of contract or simple non-performance?
  - **Legal regime at time of investment**
    - State must ensure is transparent, stable and predictable
      - but scope to make changes consistent with degree of freedom considered appropriate for domestic regimes and nature of regime
  - **General expectation** of
    - **Coherence and consistency** in application of law
    - **Procedural propriety and due process**
    - **Good faith** – but bad faith not required
  - **Freedom from discrimination**

# *Example of a broad conception of FET TECMED*

- FET requires state “... to provide to international investments treatment that does not affect the **basic expectations** that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a **consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor**, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. ... The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. ...”

(para. 133) interpreting Spain – Mexico BIT

# Minimum Standard of Treatment and FET

- Issue
  - Not subject to reservations or exceptions in most treaty models
    - Should this obligation be subject to reservations and exceptions?

# Expropriation

- Starting point
  - States have a right to expropriate
- But must be
  - For a public purpose
  - Not arbitrary or discriminatory
  - In accordance with due process of law and
  - Accompanied by compensation
- These requirements generally recognized in customary international law and many national laws
- Protection against expropriation without compensation in IIAs
  - Traditionally most important substantive standard from foreign investors' point of view

# Prohibition on expropriation without compensation

- May be direct or indirect
- Direct expropriation relatively clear
  - State takes investor's property
- What constitutes *indirect expropriation* where state regulation has substantial effect on investor's ability to use property but does not formally transfer property to state?
  - IIA rules must balance
    - a state's right to regulate without having to compensate investors for the resulting costs imposed on them by regulation
    - protecting investors against losing substantial benefit of property

# Prohibition on expropriation without compensation

- What constitutes *indirect expropriation*?
  - Substantial deprivation of ability to use and enjoy benefits from property *as if property taken*
  - What is relevance of objective of government action?
    - Can *bona fide* regulation for a public purpose still be an expropriation if it results in substantial deprivation?
      - Or is the purpose of the government action relevant?
    - Arbitral case law is inconsistent
      - So need to address in treaty



# Canada's FIPA Model Annex B.3(1)

The Parties confirm their shared understanding that:

- a) Indirect expropriation results from a measure or series of measures of a Party that have an effect **equivalent to direct expropriation without formal transfer of title or outright seizure**;
- b) The determination of whether a measure or series of measures of a Party constitute an indirect expropriation requires a **case-by-case, fact-based inquiry that considers**, among other factors:
  - i) the **economic impact** of the measure or series of measures, although the sole fact that a measure or series of measures of a Party has an **adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred**;
  - ii) the extent to which the measure or series of measures **interfere with distinct, reasonable investment-backed expectations**; and
  - iii) the **character** of the measure or series of measures;
- c) **Except in rare circumstances**, such as when a measure or series of measures are so severe in the light of their purpose that they cannot be reasonably viewed as having been adopted and applied in good faith, **non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.**

# Prohibition on expropriation without compensation

- Other issues
  - What is the correct compensation standard?
    - **Prompt, adequate and effective** versus **appropriate compensation**
  - Should this obligation be subject to reservations or exceptions?

# Performance Requirements

- Definition: Obligations imposed by the host state as a condition of (i) admitting an investment or (ii) allowing it to continue to operate
  - Purpose: To obtain benefits of investment
- Performance requirements affecting **trade in goods** prohibited under TRIMs Agreement
  - Contrary to GATT national treatment obligation (Art. III) and prohibition on quotas (Art. IX)
- Some performance requirements affecting **trade in services** **may be** prohibited under GATS Agreement
  - *E.g.* requiring use of host country service providers may be contrary to GATS national treatment (Art. XVII)

# Performance Requirements

## Article 92 - Pakistan-Malaysia Closer Economic Partnership

### Prohibition of Performance Requirements

1. For the purposes of this Chapter, the Parties reaffirm their commitments to the Agreement on Trade-Related Investment Measures in Annex 1A to the WTO Agreement (hereinafter referred to as “**TRIMS**”) and hereby incorporate the provisions of the TRIMS, as may be amended, as part of this Chapter.
2. A Party shall, upon notification by the other Party, promptly convene consultations with the other Party on any matter relating to this Article that affects the other Party’s investors and their investments.

***Putting in IIA means subject to investor-state dispute settlement***

# Canadian Model FIPA

- Certain **performance requirements** prohibited
  - Export performance
  - Domestic content
  - Domestic sourcing
  - Trade balancing
  - Foreign exchange balancing
  - Technology transfer
  - Product mandating
- In connection with “**establishment, acquisition, expansion, management, conduct, operation or sale**” of an investment

Broader than  
WTO TRIMs Agreement

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Broader than  
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# Transfer of Funds

- For investors – a key consideration
  - Transferring funds in and out of host state
    - *E.g.* repatriation of profits, capital, proceeds of sale
- For states – need to be able to monitor and, in some cases, control financial flows
  - *E.g.* risk of capital flight, achievement of other regulatory goals
- Addressed in detailed and specific treaty provisions
  - Many treaties provide that transfer of funds must be permitted – sometimes subject to many exceptions
  - Rarely comes up in investor-state arbitration
  - IMF rules prohibit controls on current transactions
    - But not capital transactions – *i.e.* investment

# Canadian Model FIPA Art. 14

## Transfer of Funds

1. Each Party shall **permit all transfers** relating to a **covered investment** to be made freely, and without delay, **into and out of** its territory. **Such transfers include:**
  - (a) contributions to **capital**;
  - (b) **profits**, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment;
  - (c) **proceeds from the sale of all or any part of the covered investment** or from the partial or complete liquidation of the covered investment;
  - (d) **payments made under a contract** entered into by the investor, or the covered investment, including payments made pursuant to a loan agreement;
  - (e) payments made pursuant to Articles 12 and 13; and
  - (f) payments arising under Section C.
  
2. Each Party shall permit transfers relating to a covered investment to be made in the **convertible currency in which the capital was originally invested**, or in any other convertible currency agreed by the investor and the Party concerned. Unless otherwise agreed by the investor, transfers shall be made **at the market rate of exchange** applicable on the date of transfer.
  
3. Notwithstanding paragraphs 1 and 2, a **Party may prevent a transfer** through the equitable, non-discriminatory and good faith application of its laws relating to:
  - (a) **bankruptcy**, insolvency or the protection of the rights of creditors;
  - (b) **issuing, trading or dealing in securities**;
  - (c) **criminal or penal** offences;
  - (d) **reports** of transfers of currency or other monetary instruments; or
  - (e) ensuring the **satisfaction of judgments** in adjudicatory proceedings.



# Canadian Model FIPA Art. 14

## Transfer of Funds

...

6. Notwithstanding the provisions of paragraphs 1, 2 and 4, and without limiting the applicability of paragraph 5, a Party may prevent or limit transfers by a financial institution to, or for the benefit of, an affiliate of or person related to such institution, through the **equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility of financial institutions.**

# Dispute Settlement

# State-to-State Dispute Settlement

- Most IIAs have process to address disputes between states regarding “**interpretation or application**” of treaty
- Rarely used
- Issues:
  - Scope – all provisions in IIA or exclude some
  - Require
    - Prior consultations
    - Arbitration procedures
      - Typically no transparency

# Investor-state Arbitration

## Meets investor needs

1. Limits investor's exposure to the uncertainties of the host state's laws and regulations
  - Creates a separate legal regime (the IIA legal regime) with limited terms with (generally) known legal effects
2. Limits investor's exposure to the uncertainties, delays and limitations of the host state's judicial system
3. Initiation at investor's discretion
  - Avoids subjecting investor to uncertainties of state-to-state relations

# Advantages of investor-state dispute resolution for states

## Potential advantages for host states:

1. Signals host state commitment to investor and investment regime
  - Helps ensure that promised protection provided
2. Provides incentives to host state to create domestic policies favourable to attracting new and maintaining ongoing foreign investment
  - Can lock-in investment liberalizing reforms to host state's domestic regime

# Disadvantages investor-state dispute resolution for states

## Potential disadvantages for host states:

1. Investor-state arbitration initiated by investors solely to pursue commercial interests (*e.g.*, profit) that might conflict with policy goals of state
2. Not subject to restraining considerations that apply to state to state dispute settlement
3. Exposure to costly international arbitration process and awards
4. “Regulatory chill” associated with risk of claim being brought
5. Investors not accountable

# Disadvantages investor-state dispute resolution for states

## Potential disadvantages for host states (ii):

### 7. Legitimacy and democracy concerns:

- a) Lack of transparency
- b) Lack of access for civil society to dispute resolution mechanisms
- c) Arbitrators do not take into account non-investment-related public policy considerations
- d) Domestic laws and policies subject to interpretation by international arbitrators

### 8. Lack of familiarity of arbitrators with non-investment issues

- *E.g.* indigenous peoples, environment, human rights, domestic law of host state, *etc*

# Investor-state arbitration

- Another key issue:
  - Lack of consistency and predictability of arbitral decisions
    - Debate about seriousness of problem and need to address
- All these concerns have caused many states to reconsider the benefits of investor-state arbitration of IIA commitments in its present form



# Investor-state Process Issue

- Transparency of proceedings and participation of *amicus curiae*
- Traditionally few requirements
  - Not all awards public
  - Now, in some agreements
    - Public disclosure requirements for most documents and all awards
    - Authority to allow *amicus curiae* submissions
    - Canadian model BIT (since 2003)
    - US model BIT (since 2004)
    - New Canadian and US FTA's with investment provisions

## Transparency of Investor-state Process

- Raises costs of arbitration for investor and state
- Increase public attention to investor-state disputes
- Both could
  - discourage investor use of process and, if so
  - impair achievement of investment promotion goal of BITs
- BUT – have become essential to political legitimacy of investor state procedures

**Thank you**