International Economic Law Clinic

NEW GENERATION IIAS: A NEGOTIATORS' HANDBOOK

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Submitted by

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LIST OF ABBREVIATIONS

ADR	Alternative Disputes Resolution
ASEAN	Association of Southeast Asian Nations
APEC	Asia-Pacific Economic Cooperation
BLEU	Belgium-Luxembourg Economic Union
BIT	Bilateral Investment Treaty
CAFTA	Dominican Republic–Central America Free Trade Agreement
CARIFORUM	Caribbean Forum
CFIA	Cooperation and Facilitation Investment Agreement
CEPA	Closer Economic Partnership Arrangement
CIL	Customary International Law
COMESA	Common Market for Eastern & Southern Africa
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific
CRCICA	Cairo Regional Center for International Commercial Arbitration
CSR	Corporate Social Responsibility
DoB	Denial of Benefits
ECT	Energy Charter Treaty
EPA	Economic Partnership Agreement
ETEA	Economic and Trade Expansion Agreement
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FIA	Framework Investment Agreement
FPS	Full Protection and Security
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
HRs	Human Rights
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IIA	International Investment Agreement
IISD	International Institute for Sustainable Development
ILC	International Law Commission
ILO	International Labour Organisation
IPA	Investment Protection Agreement
IPRs	Intellectual Property Rights
ISDS	Investor-State Dispute Settlement
KLRCA	Kuala Lumpur Regional Centre for Arbitration
LLC	Limited Liability Company

MERCOSUR	Mercado Común del Sur
MFN	Most Favored Nation
NAFTA	North American Free Trade Agreement
NT	National Treatment
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of the Petroleum Exporting Countries
PACER	Pacific Agreement on Closer Economic Relations
PCA	Permanent Court of Arbitration
SADC	Southern African Development Community
SDT	Special and Differential Treatment
TIFA	Trade and Investment Framework Agreement
TRIPS	Trade-Related Aspects to Intellectual Property Rights
TTIP	Transatlantic Trade and Investment Partnership
UAE	United Arab Emirates
UN	United Nations
UNASUR	United of South American Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
US	United States
USMCA	United States-Mexico-Canada Agreement
VCLT	Vienna Convention on the Law of Treaties
WIF	World Investment Forum
WTO	World Trade Organization

INTRODUCTION

This Negotiators' Handbook aims at supporting government representatives during the process of negotiating new generation IIAs.

It is structured on a provision-by-provision basis, by reference to the standard provisions usually contained in investment agreements.

The commentary of each provision includes a chart containing the most relevant information: recent trends in treaty making, recommended approaches by UNCTAD and other relevant authorities, and practices that should be avoided.

Subsequently, a detailed explanation is provided on the basis of emergent treaty practice, case law and best practices in order to back up the negotiators with valuable arguments to support and defend the proposed elements that could be included in a future agreement. Furthermore, clauses that may have negative consequences for the Contracting States are pointed out. The Handbook provides for a justification for why certain practices should be avoided.

The main purpose of this Handbook is to back up negotiators with practical and powerful arguments and suggest solid and viable alternative approaches to face potential objections during negotiations.

PREAMBLE

The Preamble outlines the motives and objectives of IIAs so as to ensure a better understanding of "their proper perspective." [1] Though not operative in nature, preambles are relevant for interpreting the treaty provisions.[2]

States utilize preambles to convey their respective underlying investment philosophy which may include, *inter alia*, sustainable development, right to regulate, protection of HRs and the environment.

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[1] Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff 1995) 20.
[2]UNCTAD, 'International Investment Agreements: Flexibility for Development' (2000) available at <https://unctad.org/en/Docs/psiteiitd18.en.pdf> accessed 16 October 2018.
[3] *Mr Patrick Mitchel v The Democratic Republic of Congo*, ICSID Case No ARB/99/7, Decision on the Application for Annulment of the Award (1 November 2006) para 32.
[4] *Romak SA (Switzerland) v The Republic of Uzbekistan*, UNCITRAL, PCA Case No AA280, Award (26 November 2009) para 206 and para 242.
[5] *Philip Morris v Oriental Republic of Uruguay*, ICSID Case No ARB/10/7, Award (8 July 2016).

DETAILED EXPLANATION

OBJECTIVES AND AIM

A Preamble drafted with "sufficient precision" will help in understanding the operative provisions of the IIA.[6] The VCLT recognizes the role of the Preamble in interpretation. Article 32(2) of the VCLT states that the "context for the purpose of interpretation of a treaty shall compromise [inter alia] its Preamble and annexes [...]."

Arbitral tribunals frequently refer to the Preamble of a treaty to interpret certain provisions of the IIA.[7] For example, in *Mitchel v Congo,*[8] the *ad hoc* annulment committee relied on the Preamble of the BIT in order to "justify the reinstatement of the criterion of contribution to economic development" in the definition of an investment.[9] Similarly, in *Romak v Uzbekistan,* the arbitral tribunal relied on the Preamble of the BIT to conclude that a sale transaction fell outside the scope of the BIT.[10]

RIGHT TO REGULATE

States can utilize the Preamble to reflect that the objective of the IIA is not, solely, confined to investment promotion, but rather promotes other public policy interests.[11] Reference to other policy objectives of the State is not alien to the recent trend in IIAs. States have adopted a practice of encompassing cultural, environmental and HRs aspects in the Preambles of their investment agreements.[12]

As shown in a statistical study prepared by UNCTAD, the majority of BITs (56% to be specific) signed between the years 2011 and 2016 referred to "the protection of health and safety, labour rights, environmental or sustainable development."[13] For example, the Preamble of US Model BIT (2012) states that:

> *Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights.*

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[6] Makane Mbengue, 'Preamble' *Max Planck Encyclopedia of Public International Law* (2006).
[7] Christopher Schreuer, 'Diversity and Harmonization of Treaty Interpretation in Investment Arbitration' (2006) 3(2) Transnational Dispute Management.
[8] *Mr Patrick Mitchell v Democratic Republic of the Congo*, ICSID Case No ARB/99/7, Decision on the Application for Annulment of the Award (1 November 2006) para 32.
[9] Walid Ben Hamida, 'Two Nebulous ICSID Features: The Notion of Investment and the Scope of Annulment Control' (2007) 24(3) Journal of International Arbitration 287, 294.
[10] *Romak SA (Switzerland) v The Republic of Uzbekistan*, UNCITRAL, PCA Case No AA280, Award (26 November 2009) para 242.
[11] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 29.
[12] See UNCTAD 'Mapping of IIA Content' <http://investmentpolicyhub.unctad.org/IIA/mappedContent#iiaInnerMenu> accessed 16 October 2018.
[13] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 70.

Certain IIAs plainly reserve the right of a State to regulate, most notably, the Preamble of Canada – EU CETA (2016) states that:

> *The provisions of this Agreement preserve the right of the Parties to regulate within their territories and the Parties' flexibility to achieve legitimate policy objectives, such as public health, safety, environment, public morals and the promotion and protection of cultural diversity.*

Reserving the right to regulate can be addressed by briefly referring to non-economic objectives of the Contracting Parties in the Preamble.[14] Another approach would be to make explicit reference to the "well recognized" international instruments in each respective field:[15]

- Universal Declaration of Human Rights (1948);
- UN International Covenant on Civil and Political Rights (1966);
- ILO Declaration on Fundamental Principles and Rights at Work (1998);
- UN Convention Against Corruption (2003);
- Rio Declaration on Environment and Development (1992).

Among the IIAs that refer expressly to certain instruments:

- Austria – Nigeria BIT (2013); which makes reference to the UN Convention against Corruption (2003);
- EU – Korea FTA (2011); which makes reference to the UN Charter (1945) and the Universal Declaration of Human Rights (1948).

It should be noted that reference to the right to regulate is of relevant importance but will remain of no significant value if not linked with substantive rights and obligations. The right to regulate is substantively addressed in MFN, FET, indirect expropriation, as well as in carve-out provisions.[16]

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[14] For example, the Preamble of the Switzerland – Tunisia BIT (2012).
[15] Patrick Dumberry and Gabrielle Dumas Aubin, 'How to Incorporate Human Rights Obligations in Bilateral Investment Treaties?' (2013) Investment Treaty News available at https://www.iisd.org/itn/2013/03/22/how-to-incorporate-human-rights-obligations-in-bilateral-investment-treaties/.
[16] UNCTAD, *Reforming International Investment Governance* (United Nations 2015) 135.

ASYMMETRIC DEVELOPMENT

Though a creature of international trade, asymmetrical development and SDT has started its migration to international investment.[17] It is a concept that was developed during the late 1950s and the early 1960s in the context of trade law in order to provide greater flexibility for developing countries in trade commitments.[18] The rationale behind it is that treaty parties at different stages of development should not be bound by the same obligations. As a conclusion, developing countries should be allowed to continue their developing process whilst abiding by their obligations.

Asymmetric development is recognized by UNCTAD as a feature that could be reflected in preambles of IIAs.[19] Examples of treaties following such approach are:

- The Preamble of the ASEAN Comprehensive Investment Agreement (2009) which states:

> *Recognizing the different levels of development […] which require some flexibility including special and differential treatment […];*

- The Preamble of Mauritius – US TIFA (2006) which states that:

> *Considering that it would be in their mutual interest to establish a bilateral mechanism between the Parties for encouraging the liberalization of trade and investment between them, whilst taking into account the asymmetry in their economies;*

- The Preamble of the SADC Model BIT Template (2012) which states that:

> *Reaffirming the right of the State Parties to regulate and to introduce new measures relating to investments in their territories in order to meet national policy objectives, and—taking into account any asymmetries with respect to the measures in place—the particular need of developing countries to exercise this right.*

The commentary of the SADC Model BIT Template (2012), explains that the reference to asymmetrical development in the provision aims to recognize such "asymmetries as part of this mix of international investment law policy building, which overlaps with Mode 3 of the GATS."[20]

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[17] Riham Marii, 'Special and Differential Treatment in International Investment Agreements' (2016) Investment Treaty News available at https://www.iisd.org/itn/2016/12/12/special-and-differential-treatment-in-international-investment-agreements-riham-marii/.
[18] Over 145 provisions in WTO agreements contain an expression of SDT See, Hunter Nottage, 'Trade and Competition in the WTO: 'Pondering the Applicability of Special and Differential Treatment' (2003) 6 Journal of International Economic Law 23, 28.
[19] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 12.
[20] SADC Commentary *ad* Preamble.

It should be noted, however, that such provision shall be of no effect if it is not coupled with operative provisions, as pointed out by the APEC – UNCTAD Negotiators Handbook.[21]

UNCTAD also suggests that negotiators may consider adding SDT or asymmetric development elements to the treaty provisions, which makes agreements more sustainable-development-friendly. In this regard, UNCTAD proposes that lower levels of obligations for developing countries could be achieved through:

(i) Development-focused exceptions from obligations/commitments;
(ii) Best endeavor commitments for developing countries;
(iii) Asymmetrically phased implementation timetables with longer time frames for developing countries.[22]

To sum up, apart from the preamble, the notion of SDT can be added in different provisions. By a way of illustration, several treaties concluded from the 1980's onwards include differently worded SDT provisions that could serve as basis. Inspiration for alternative approaches can be drawn from:

- Protocol to the China – Japan BIT (1988)

> *'It shall not be deemed 'treatment less favorable' for either Contracting Party to accord discriminatory treatment, in accordance with its applicable laws and regulations, to nationals and companies of the other Contracting Party, in case it is really necessary for the reason of public order, national security or sound development of national economy.'*[23]

- The Unified Agreement for the Investment of Arab Capital in Arab States (1980) allows States to accord preferential privileges to some investors or projects that aim at fostering the development of the national economy, regional integration and transfer of technology.[24]

- The Protocol on Finance and Investment of SADC (2006) includes a wider notion of SDT by allowing preferential treatment for some investments and investors in order to achieve national development objectives:[25]

> *ARTICLE 7: GENERAL EXCEPTIONS*
>
> *1. Notwithstanding the provisions of Article 6, State Parties may in accordance with their respective domestic legislation grant preferential*

[21] ibid.
[22] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 82.
[23] Protocol to the Agreement Between Japan and the People's Republic of China Concerning the Encouragement and Reciprocal Protection of Investment (1 August 1988) para 3.
[24] Unified Agreement for the Investment of Arab Capital in the Arab States (26 November 1980) Article 16.
[25] Protocol on Finance and Investment (18 August 2006) Annex 1 (Cooperation on Investment), Article 7 and 20.

treatment to qualifying investments and investors in order to achieve national development objectives.

ARTICLE 20: CONDITIONS FAVOURING LEAST DEVELOPED COUNTRIES

1. State Parties shall establish conditions favouring the participation of least-developed countries of SADC in the economic integration process, based on the principles of non-reciprocity and mutual benefit.

2. For the purpose of ensuring that least-developed countries of SADC receive effective preferential treatment, State Parties shall investigate the establishment of market openings as well as the setting up of programmes and other specific forms of cooperation including in relation to derogations in respect of investment incentives.

- COMESA Investment Agreement (2007), Article 14(3) reads as follows:[26]

  For greater certainty, Member States understand that different Member States have different forms of administrative, legislative and judicial systems and that Member States at different levels of development may not achieve the same standards at the same time. Paragraphs 1 and 2 of this Article do not establish a single international standard in this context.

- The Draft Pan-African Investment Code (2016), in addition to reservation schedules and measures carved out of national treatment and MFN, provides for development-oriented performance requirements; preferential treatment to qualifying investments and investors, commensurate with national development objectives; and interim periods.[27]

- Colombia Model BIT (2017), General Provision on National Treatment and Most-Favoured Nation Treatment reads as follows:

  2. The provisions of this Section referred to as National Treatment and Most Favoured Nation Treatment are not intended to protect Covered Investors and Investments from any Measure that results in differential treatment.

[26] Investment Agreement for the COMESA Common Investment Area (23 May 2007).
[27] Draft Pan-African Investment Code (26 March 2016) Article 10, Article 17.

OBJECTIVE PROVISION

It is very rare that State include a standalone Objective clause in an IIA given that structurally, the most common place to address the object and purpose of a treaty is the Preamble.[28]

Nevertheless, States are free to adopt the form and structural division of their treaties.[29]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Inclusion of a standalone Objective clause. • A succinct and elaborative Preamble would generally suffice.	
RELEVANT AUTHORITIES	***PRACTICES TO BE AVOIDED***
• SADC Model BIT Template (2012), Article 1 • ASEAN Comprehensive Investment Agreement (2009), Article 1	• Including an Objective clause that narrows the Preamble.

DETAILED EXPLANATION

Though unorthodox, few investment treaties do have a standalone Objective article. Examples of this type of clause have been identified both in the ASEAN Comprehensive Investment Agreement (2009) and the SADC Model BIT Template (2012). Unlike the detailed clause of the ASEAN Agreement (2009), the SADC Model BIT Template (2012) adopts a brief one paragraph Objective clause. Article 1 states the following:

> *The main objective of this Agreement is to encourage and increase investments [between investors of one State Party into the territory of the other State Party] that support the sustainable development of each Party, and in particular the Host State where an investment is to be located.*

The purpose of the Objective article as purported by the SADC Commentary, is to further clarify the objectives of the IIA beyond the Preamble:[30]

> *[…] highlight, in a succinct manner within the substantive text, the treaty's main goal. This gives added weight to the objective as an interpretational guide, beyond which is normally attributed to the preamble.*

[28] Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press 2015) 142.
[29] Federal Department of Foreign Affairs Directorate of International Law, 'Practice Guide to International Treaties' (Swiss Federation 2015).
[30] SADC Commentary *ad* Preamble.

The rationale of inserting such a clause, as depicted by SADC, is justifiable if the objective clause, indeed, adds further to those items highlighted in the Preamble.

If the Objective clause does not add anything new to the Preamble, it is highly possible that it would be deemed redundant. Nevertheless, if the parties wish to further expand to items mentioned in the Preamble, they may consider negotiating a more detailed standalone Objective clause.

Moreover, maintaining an under inclusive Objective article, narrower in drafting than the Preamble, may imply that in interpreting the object and purpose of the IIA, tribunals should seek guidance from the narrow Objective article and not from the more elaborate Preamble. This can be drawn by analogy from the awards of NAFTA tribunals that had to analyze "the phenomenon of the parallel existence of several objects and purposes" provisions to reach a conclusion that specific objective provisions are considered *sui generis* and have priority in application.[31]

[31] Malgosia Fitzmaurice and Panos Merkouris, 'Canons Of Treaty Interpretation: Selected Case Studies From The World Trade Organization And The North American Free Trade Agreement' in Malgosia Fitzmaurice, Olufemi Elias and Panos Merkouris (eds), *Treaty Interpretation and the Vienna Convention on the Law of Treaties: 30 Years on* (Brill Nijhoff 2010) 221.

SCOPE OF APPLICATION

The Scope of Application clause highlights in one place the scattered provisions addressing the criteria required to gain access to the privileges under the treaty. Items provided in the Scope of Application may include, *inter alia*, the definition of investment, investor, temporal scope and territorial scope of the treaty.

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Salini v Jordan[33]</td></tr>
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India Model BIT (2015), Article 2(1)
India – Thailand BIT (2002), Article 2</td></tr>
<tr><td>Excluding certain sectors</td><td>Malaysia – Sweden BIT (1979), Article 1(1)(e)(i)
Indonesia – UK (1976), Article 2(1)
Gruslin v Malaysia[34]</td></tr>
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[32] *SGS Société Générale de Surveillance SA v Republic of Philippines*, ICSID Case No ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction (20 January 2004) paras 165-168.
[33] *Salini Costruttori SpA and Italstrade SpA v The Hashemite Kingdom of Jordan*, ICSID Case No ARB/02/13, Decision on Jurisdiction (9 November 2004) para 177.
[34] *Philippe Gruslin v Malaysia*, ICSID Case No ARB/99/3, Award (27 November 2000) para 25.5. See also, Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press 2015) 196.

- Accepting retroactive application without excluding from application any existing non-conforming measures maintained within the territory or any continuation of any non-conforming measures.[35]

DETAILED EXPLANATION

Traditionally, investment agreements have not included an independent Scope of Application clause. The matters encompassed in it were, and still remain to be, addressed in several provisions of a treaty, including definitions of *investment, investor and territory.*[36] Recently, numerous treaties include a Scope of Application clause which aims "to clarify the different dimensions in one clause."[37] This provision does not, however, intend to substitute the substantive criteria evident in other sections of the IIA.

There is no need to identify all the key aspects in the Scope of Application clause. To the contrary, the common practice is to utilize this clause to highlight one main criterion.[38] Some treaties, instead, opt to emphasize on several criteria, for example:

a. Temporal scope;
b. Admission of investment;
c. Exclusion of certain sectors; and
d. Exclusion of measures made by local governments and subdivisions.

It is worth noting that parties may opt to explicitly exclude, from the sphere of the treaty, pre-establishment and development expenditures. Though it is generally settled that pre-establishment expenditures are not protected investments under IIAs, claimants may attempt to argue to the contrary. The landmark precedent on this matter is *Mihaly v Sri Lanka.*[39] In this case, the tribunal held that "the Claimant has not succeeded in furnishing any evidence of treaty interpretation or practice of States […] to the effect that pre-investment and development expenditures in the circumstances of the present case could automatically be admitted as "investment".[40]

TEMPORAL SCOPE

Non-retroactivity of treaty provisions is the default rule provided by Article 28 of the VCLT, which states that "unless a different intention appears from the treaty or is

[35] See Canada – Czech Republic BIT (2009), Article 4(1)(a)(i).
[36] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (United Nations 2007) 5.
[37] ibid.
[38] ibid.
[39] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 62.
[40] *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/00/2, Award (15 March 2002) para 61.

otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party." Arbitral tribunals have upheld in several awards that, save explicit language to the contrary, a treaty will not have retroactive effect on disputes arising prior to the treaty's entry into force. [41]

It is a common trend to emphasize on the temporal application of the IIA in the Scope of Application article.[42] Usually the clause grants protection to investments whenever established while stating that the treaty is not applicable to disputes arising before its entry into force.[43] Other investment agreements limit the scope to investments made after the treaty comes into force.[44] An example of the latter is Article 12 of the Egypt – Cyprus BIT (1998) which states that:

> *This Agreement shall apply to all investments made by investors of either Contracting Party in the territory of the other Contracting Party after its entry into force.*

It is worth noting that capital importing countries usually oppose extending treaty privileges to pre-existing investments. In support of their position on this issue, importing States tend to advocate the following:

i. There is little purpose in granting additional protection to investments already made in the Host State.[45]
ii. Governments would not have approved the pre-treaty investments if they would have known that an investment treaty could later expand the investor's privileges.[46]

Certain treaties include existing investments, while excluding previous non-conforming measures. This, for example, is the stance adopted in the Canada – Czech Republic BIT (2009) which provides in Article 4(1) that the protection of investment does not apply to any existing non-conforming measures maintained within the territory of a contracting party and the continuation of prompt renewal of any such non-conforming measure.

Certain States may wish to exclude also investments made prior to the treaty. This can be done explicitly by adding language that reads "this Agreement shall apply to

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[41] *Mondev International LTD v United States of America*, ICSID Case No ARB(AF)/99/2, Award (11 October 2002) para 68; *SGS Société Générale de Surveillance SA v Republic of Philippines*, ICSID Case No ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction (20 January 2004) paras 165-168.
[42] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (United Nations 2007) 6.
[43] See for example, Australia – Uruguay BIT (2001), Article 2(1) which states that "This Agreement shall apply to investment whenever made but shall not apply to disputes which have arisen prior to the entry into force of this Agreement."
[44] Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press 2015) 192.
[45] ibid193.
[46] ibid.

investment, which are made after its entry into force." An example of a treaty that has such language is Article 11 of the China – Djibouti BIT (2003).

A compromise position would be to cover pre-established investments on the condition of excluding pre-existing non-conforming measures. This was done in Article 4(1) of the Canada – Czech Republic BIT (2009) which states that the protections under the Agreement do not apply to:

> *Any existing nonconforming measures maintained within the territory of a Contracting Party […] The continuation or prompt renewal of any nonconforming measure referred to [above].*

ADMISSION

Some States have emphasized the issue of admission in their Scope of Application clause.[47] As an example, Article 2 of the India – Thailand BIT (2002) states the following:

> *The benefit of this Agreement shall apply to all investments made by investors of one Contracting Party in the territory of the other Contracting Party, which have been admitted in accordance with the laws and regulations and, where applicable, specifically approved in writing by the competent authorities concerned of the other Contracting Party, whether made before or after coming into force of this Agreement.*

EXCLUSION OF CERTAIN SECTORS

Some States provide coverage under the agreement exclusively to certain approved projects for the purpose of encouraging the contribution to specific underdeveloped sectors of the concerned country.[48] This is the approach of, for example, Article 1(1)(e) of the Sweden – Malaysia BIT (1979), which has limited the definition of investment to projects classified by the appropriate Ministry in Malaysia. This language has been successfully tested in arbitration where the tribunal held that investments which are not on the approved list fall outside the scope of treaty.[49]

ATTRIBUTION LIMITED TO THE CENTRAL GOVERNMENT

Contracting Parties may aim to exclude attributing acts or omissions of subnational actors to the central government.[50] However, the inclusion of such a provision runs counter the norms of State responsibility under CIL. Article 4 of the ILC Draft Articles

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[47] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (United Nations 2007) 6.
[48] Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press 2015) 193.
[49] *Philippe Gruslin v Malaysia*, ICSID Case No ARB/99/3, Award (27 November 2000) para 25.5.
[50] Anthony Vanduzer, Penelope Simons and Graham Mayeda, *Integrating Sustainable, Development into International Investment Agreements: A Guide for Developing Country Negotiators* (Commonwealth Secretariat 2013) 99.

on the Responsibility of States for International Wrongful Acts states that "the conduct of any State organ shall be considered an act of that State under international law […] whatever its character as an organ of the central Government or of a territorial unit of the State." Moreover, Article 5 of the ILC Draft Articles further provides that the conduct of a non-State actor which is "empowered by the law of that State to exercise elements of the government authority shall be considered an act of the State."

Applications of Articles 4 and 5 of ILC Draft Articles in the context of investment arbitration are numerous.[51] For example, in *MCI v Ecuador,* the tribunal found the actions of a public sector agency attributable to the State.[52] In another example, the tribunal, in *Vivendi v Argentina,* held that the internal constitutional structure of a country will not alter the State's international obligations, and found that the actions of a political subdivision of a federal State are attributable to the central government.[53]

The customary nature of the rules of attribution does not prohibit States to agree otherwise in treaty.[54] However, the proposing party needs to take into account that it will likely be hard to persuade a counterparty to act contrary to already established CIL. Though not conventional, excluding the conduct of State organs can be evident in few IIAs. For example, Article 2(1) of the India Model BIT (2015) excludes from its scope any measure taken by an "urban local body, municipal corporation or village level government or an enterprise owned by" any of them.

There are other examples that limit certain aspects of the treaty to the central government. For example, Article 1 of the US Model BIT (2012) limits the definition of investment agreements entered by the US to those entered by "an authority at the central level of Government." Nevertheless, this example is an outlier in the field of international investment law. Traditionally, IIAs follows the general rules under CIL which, by definition encompasses all State organs. For example, the China – ASEAN FIA (2009), defines "measure" under Article 1 as:

> *Any measure by a Party, whether in the form of a law, regulation, rule, procedure, decision, administrative action or any other form, taken by: (i) central, regional or local governments and authorities; and (ii) non-governmental bodies in the exercise of powers delegate by central, regional or local governments or authorities.*

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[51] James Crawford, 'Investment Arbitration and the ILC Articles on State Responsibility' (2010) 25 ICSID Review 127, 134.
[52] *MCI Power Group LC and New Turbine, INC v Republic of Ecuador*, ICSID Case No ARB/03/6, Award (31 July 2007) paras 45-68.
[53] *Compania de Aguas del Aconquija, SA & Compagnie Generale des Eaux v Republic of Argentina*, ICSID Case No ARB/97/3, Award (21 November 2000) para 53.
[54] The Institute of International Law, 'Resolution on Problems Arising from a Succession of Codification Convention on a Particular Subject' (1 September 1995) Conclusion 11.

DEFINITION OF INVESTMENT

Several approaches exist for defining "investment." The main two categories are asset-based and enterprise-based definitions. This handbook will address a closed-list asset-based definition of investment and does not intend to encompass the whole notion of investment.

<table>
<tr><th colspan="2">RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES</th></tr>
<tr><td colspan="2">• Narrow definition of investment.
• Inclusion of criteria for the term investment and list of explicit exceptions.
• Adoption of exclusive list of assets.</td></tr>
<tr><th colspan="2">RELEVANT AUTHORITIES</th></tr>
<tr><td>Closed List Approach</td><td>• UNCTAD, Policy Options for IIA Reform: Treaty Examples and Data (2015)
• Slovak Republic – Iran BIT (2016), Article 1(2)
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<tr><td>Exclusion of specific type of assets</td><td>• UNCTAD, Policy Options for IIA Reform: Treaty Examples and Data (2015)
• Morocco – Nigeria BIT (2016), Article 1(3)
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<tr><th colspan="2">PRACTICES TO BE AVOIDED</th></tr>
<tr><td colspan="2">• Adopting a broad asset-based definition of investment.
• Omitting of the criteria for the definition of investment, especially in non-exhaustive listing of assets.</td></tr>
</table>

[55] *Fedax NV v The Republic of Venezuela*, ICSID Case No ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction (11 July 1997) para 43.
[56] *Phoenix Action, LTD v The Czech Republic*, ICSID Case No ARB/06/5, Award (15 April 2009) para 85.
[57] *Salini Construttori SpA and Italstrade SpA v Kingdom of Morocco*, ICSID Case No ARB/00/4, Decision on Jurisdiction (31 July 2001) para 52.

- Accepting anything lower than the *Phoenix* criteria.

DETAILED EXPLANATION

CLOSED-LIST APPROACH

A closed-list approach is able to define assets through an ample but still finite list.[58] Such a list may include:

i. An enterprise or a subsidiary of an enterprise:

Recent IIAs adopting a closed-list use the term "enterprise" and not "company."[59] For the purpose of avoiding any unintended inclusion or exclusion of certain juridical persons, it is advisable to define the terms. This is, indeed, a common practice in most closed-list definitions. To give an example, Article 1(1) of the China – Mexico BIT (2008) defines an "enterprise" to mean:

> *Any entity constituted or organized under the applicable law, whether or not for profit, and whether privately owned or governmentally owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association;*

ii. Shares, stocks or other forms of equity participation in an enterprise:

This is a relatively a classic inclusion to the list. This type of wording is adopted in Article 1 of both the US Model BIT (2002) and the Bahrain – Mexico BIT (2012). Similarly, Article 1 of Canada Model BIT (2004) lists under the term investment "an equity security of an enterprise."

iii. Contractual rights:

Including contractual rights may be problematic. The language may suggest that, save for explicit exceptions, any contract may be categorized as an investment.[60] The Host State risk extending the protection of the treaty to transactions that were not intended to be a protected investment due to a broad definition of "contractual rights."[61]

If contracts to exploit natural resources are required explicitly by one of the Parties, a restrictive "contractual rights" inclusion is preferable. Article 1(1)(f) of the Germany

[58] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (United Nations 2007) 7.
[59] A survey of the most recent closed list BITs shows to that effect: Slovak Republic – Iran BIT (2016), Mexico – United Arab Emirates BIT (2016), Morocco – Nigeria BIT (2016), Canada – Honduras FTA (2013).
[60] UNCTAD, *Scope and Definition: A sequel* (United Nations 2011) 9.
[61] ibid 10.

Model BIT (2008), for example, limits contracts to business concessions under public law, including concessions to search for, extract and exploit natural resources.

Alternatively, limiting protection to *in rem* rights protected under domestic law might be an option.[62] Article 1 of the US – Rwanda BIT (2012) defines the term "investment" in relevant part as "licenses, authorizations, permits, and similar instruments that do not have the characteristics of an investment are those that do not create any rights protected under domestic law." It further provides that, "for greater certainty, the foregoing is without prejudice to whether any asset associated with the license, authorization, permit, or similar instrument has the characteristics of an investment."[63]

iv. Property rights and assets:

It might be preferable to qualify the language to exclude assets of non-business purpose.[64] Article 1(1)(j) of the Canada – China FIPA (2014) qualifies property rights as those "acquired in the expectation or used for the purpose of economic benefit or other business purpose." An identical provision is evident in Article 1139 of NAFTA.

Arbitral tribunals may confuse property rights (*in rem*) with contractual rights. Indeed, tribunals in the past considered a lease agreement to constitute a property right.[65] Therefore, it would be advisable to add the terms "real" or "*in rem*" to further qualify the definition of property rights.

The Contracting Parties may wish to include other rights such as liens and mortgages. Should that be the case, the language of Article 1(1)(a) of the Germany Model BIT (2008) might be consulted, which reads as follows: "[…] as well as any other rights in rem, such as mortgages, liens and pledges."

CHARACTERISTICS OF INVESTMENTS

An IIA could provide the characteristics of investments covered under the treaty, which may include:

i. Commitment of capital or resources:

The definition of "investment" under Article 8(1) of Canada – EU CETA (2016) includes "commitment of capital and other resources." Likewise, Article 1(1)(4) of the India Model BIT (2015) and the Article 1 of the US Model BIT (2012) include an

[62] Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press 2009) 175.
[63] ibid.
[64] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (United Nations 2007) 11.
[65] Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press 2009) 177.

identical language. The reference to commitment of capital or resource is generic and finds its origin in the arbitral award of *Fedax v Venezuela*.[66]

Article 1(1)(4) of the India Model BIT includes in the definition of the investment an: "enterprise constituted, organized and operated in good faith by an investor in accordance with the law of the Party in whose territory the investment is made."

ii. The investment has been admitted pursuant to the laws and/or policies of the Host State:

The inclusion of this characteristic is intended to reserve the right to admit and/or regulate investments according to the policy objectives of the State. The language of the ASEAN Comprehensive Investment Agreement (2009), Article 4(a) which refers to national policies may be of relevance. It reads:

> *[…] an investment in its territory of an investor of any other Member State in existence as of the date of entry into force of this Agreement or established, acquired or expanded thereafter, and has been admitted according to its laws, regulations, and national policies, and where applicable, specifically approved in writing […]*

It should be noted that attempts by respondent States to rely on the claimant's failure to comply with the admission procedures to dismiss the claim have failed in the past.[67] Even when the IIA mentioned specifically that the investment should be accepted by the Host State, such attempts have failed. In *Desert Line v Yemen*, the respondent in its objections to jurisdiction argued that the investment had never been accepted, and that an investment certificate had not been issued by the authorities. The tribunal held that the requirement should correspond to a material objective rather than a mere formalism.[68]

iii. Inherent characteristics of an investment

Currently, there is a general trend to better define the term "investment" so as to entail specific characteristics.[69] For example, Article 1 (a) of the Japan – Oman BIT (2015) states that:

> *[…] the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk […].*[70]

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[66] *Fedax NV v The Republic of Venezuela*, ICSID Case No ARB/96/3, Decision of the Tribunal on Objections to Jurisdiction (11 July 1997) para 43.
[67] Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (Oxford University Press 2017) 242.
[68] ibid.
[69] UNCTAD, *Policy Options for IIA Reform: Treaty Examples and Data* (2015).
[70] See also Article 1 of the Morocco – Nigeria BIT (2016) and Article 1 of the US Model BIT (2012).

Another example is Article 2(II)(10) of the SADC Model BIT Template (2012) which states:

> *In order to qualify as an investment under this Agreement, an asset must have the characteristic of an investment, such as the substantial commitment of capital or other resources, the expectation of gain or profit, the assumption of risk, and significance for the Host's State's development.*

As shown from the above two examples, treaty practice has converged on most characteristics, notably, the commitment of capital, the expectation of profit and the assumption of risk. Other IIAs add, certain duration and establishing lasting economic relations. Instead, the introduction of sustainable development remains a debatable issue. An example of a treaty provision that requires sustainable development as one of the characteristics of an investment is Article 1(1) of the Egypt – Mauritius BIT (2014), which says:

> *"Investment" means every kind of asset that has the characteristics of an investment, such as the commitment of capital or other resources, the expectation of gain or profit, the assumption of risk, the contribution to sustainable development, and established or acquired by an investor of one Contracting Party in the territory of the other Contracting Party in accordance with the laws and regulations of the latter Contracting Party […].*[71]

Several tests for the definition of "investment" exist. The most widely adopted in treaty practices, yet criticized, is the *Salini* test[72] which requires (1) contribution of money or assets, (2) a certain duration, (3) risk, and (4) contribution to the economic development of the Host State. The fourth condition of the test has been subject to great debate. Treaties have also adopted a variation of the *Salini* test.[73]

For example, a different test was set out in *Phoenix v Czech Republic*, requiring commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk.[74] The *Phoenix* text is reflected in the Chapeau of the investment definition adopted in Article (1) of the US Model (2012).

It is advisable to exclude non-investment considerations in the definition of investment, such as, for example, the protection of HRs and the environment given that these are subjective criteria, which would be better addressed under the DoB clause or an Investor Obligations clause.

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[71] See also Article 1(2)(1) of the India Model BIT (2015).
[72] *Salini Construttori SpA and Italstrade SpA v Kingdom of Morocco*, ICSID Case No ARB/00/4, Decision on Jurisdiction (31 July 2001) para 52.
[73] Julian Mortenson, 'The Meaning of "Investment": ICSID's *Travaux* and the Domain of International Investment Law' (2010) 51 Harvard International Law Journal 257, 274.
[74] *Phoenix Action, LTD v The Czech Republic*, ICSID Case No ARB/06/5, Award (15 April 2009) para 85.

The definition of "investment" may include other characteristics, such as requiring: (i) *lasting economic development* for obtaining a lasting interest by a resident entity in the territory and excluding application of the treaty to portfolio ownerships;[75] (ii) *significant contribution to the Host State,* aiming to bring the *Salini* requirement into the treaty framework.[76] If the former is intended, then it is preferable to use the language adopted in, for example, Article 1(1) of the Nigeria – Turkey BIT (2011) which requires the asset to be "acquired for the purpose of establishing lasting economic relations in the territory of a Contracting Party […]." If the latter is intended, the language in Article 1(2)(1) of the India Model BIT (2015) is advisable, which provides that investments should be of "significance for the development of the Party in whose territory the investment is made […]."

It should be noted that requiring the contribution to the development of the economy of the Host State will most likely be challenged by counterparties. It is likely that the counterparty will argue that proving "contribution" to the economy of the State will "compel a tribunal to make a highly subjective and possibly invidious distinction between investments that make a significant contribution to the Host State's economy and those that do not."[77]

A less ambitious approach is to adopt the *Phoenix* test, as for example, Article 1 of the US Model BIT (2012). This test only requires contribution, duration and risk. As stated by the arbitral tribunal in *Phoenix*, contribution of an international investment to the economy of the Host State is inherently presumed by an investment that has the three above stated elements.[78]

iv. Territorial requirement:

The conventional territorial link language can be found, for example, in Article 8(1) of Canada – EU CETA (2016), which defines covered investment as follows:

> *Covered investment means, with respect to a Party, an investment:*
> *(a) in its territory;*
> *(b) made in accordance with the applicable law at the time the investment is made;*
> *(c) directly or indirectly owned or controlled by an investor of the other Party; and*
> *(d) existing on the date of entry into force of this Agreement, or made or acquired thereafter […].*

[75] UNCTAD, *Scope and Definition* (United Nations 1999) 27.
[76] *Salini Construttori SpA and Italstrade SpA v Kingdom of Morocco*, ICSID Case No ARB/00/4, Decision on Jurisdiction (31 July 2001) para 52.
[77] Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press 2009) 201.
[78] *Phoenix Action, LTD v The Czech Republic*, ICSID Case No ARB/06/5, Award (15 April 2009) para 85.

A higher threshold for the territorial requirement, albeit less conventional, is adopted, for instance, in Article 1(2)(d) of the Iran – Slovak Republic BIT (2016), which requires for specific kinds of investments to have significant presence in the territory. The same Article excludes from the definition of "significant physical presence", "sales offices without other operational facilities, post office box-based businesses, internet-based business or other types of business with no or limited physical presence in the Host State." More generally, the same BIT in Article 1(2)(e) requires under the definition of investment that "the investor performs via its investment substantial business activities in the Host State […]."

CARVE-OUTS

According to UNCTAD, 48% of all treaties signed between 2012 and 2014 expressly exclude specific types of assets.[79] Negative definitions of investment can be found in both IIAs that adopt a broad asset-based definition and those that adopt an exhaustive list of assets.[80] However, including both closed-list and a negative definition of investment is the exception.[81] This approach is evident, for example, in the Morocco – Nigeria BIT (2016), Article 1(3); the Kuwait – Mexico BIT (2013), Article 1(4); and the Canadian Model FIPA (2004), Article 1.

Excluded assets from the definition of investment may include:

i. *Portfolio management*:

The typical reason behind the exclusion of portfolio management from the definition of investment is that "the risk involved in some portfolio investments for the investor would not be as high as that involved in a direct investment, since the former investment could normally be pulled out of a Host State more easily than the latter."[82] Furthermore, such an exclusion may preclude minority shareholders claims.[83]

It is advisable that IIAs qualify or define the term "portfolio." Some agreements do indeed qualify the definition of "portfolio" by a certain percentage of control.[84] For example, the Tanzania – Turkey BIT (2011) reads in Article 1:

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[79] UNCTAD, *Policy Options for IIA Reform: Treaty Examples and Data* (2015).
[80] OECD, *International Investment Law: Understanding Concepts and Tracking Innovations* (OECD Publishing 2008) 50 available at <http://www.oecd-ilibrary.org/finance-and-investment/international-investment-law-understanding-concepts-and-tracking-innovations/definition-of-investor-and-investment-in-international-investment-agreements_9789264042032-2-en> accessed 13 October 2018.
[81] From surveying the database of UNCTAD (investmentpolicyhub.unctad.org), only 14 treaties include an exhaustive list and carveouts. To name several examples, such combination is evident in Morocco – Nigeria BIT (2016), Iran – Slovakia BIT (2016), Mexico – United Arab Emirates BIT (2016), Canada – Honduras FTA (2013).
[82] UNCTAD, *Scope and Definition: A sequel* (United Nations 2011) 10.
[83] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 18.
[84] ibid.

> *Provided that such investments are not in the nature of acquisition of shares or voting power amounting to, or representing of less than ten (10) percent of a company through stock exchanges which shall not be covered by this Agreement.*

Other IIAs, such as Article 2(III) of the SADC Model BIT Template (2012), define portfolio investment as:

> *Investment that constitutes less than 10 per cent of the shares of the company or otherwise does not give the portfolio investor the possibility to exercise effective management or influence on the management of the investment.*

ii. Intellectual Property Rights:

It is preferable to positively include a qualified definition of IPRs in a positive list, rather than negatively exclude certain types of IPRs. Indeed, having a negative exclusion of certain types of IPRs without having a general positive rule may be used to argue that the Contracting Parties did not intend their list to be exhaustive. This naturally follows from the idea that a positive list is supposed to be exhaustive. The Contracting Parties may consider adopting a positive definition and then narrow it down by either qualifications or specific exclusions in a negative list.

Qualifying IPRs can be done in several ways. Some treaties narrow down the protection of IPRs by limiting recognition to those recognized by both States.[85] For example, Article 1(a)(iv) of the Benin – Ghana BIT (2001) qualifies IPRs as those recognized "by the national laws of both Contracting Parties." Others limit IPRs to those defined in international agreements. For example, Article 3(1)(3) of the Brazil CFIA (2015) limits IPRs to those recognized in the TRIPS Agreement. In another example, Article 1(1) of the Morocco – Serbia BIT (2013) limits recognition of IPRs to those "recognised by the World Intellectual Property Organisation including copyrights, patents, trademarks, trade names, industrial designs, technical processes and other similar rights."

iii. Loans:

Similar to the remark made concerning IPRs, it is preferable to include a positive definition of loans than excluding certain types in a negative list. This is, once again, because the positive list is supposed to be exhaustive. For example, Article 1(2) of the Iran – Slovakia BIT (2016) positively includes as investment, "bonds, debentures and other forms of debt instruments in an enterprise" then it excluded certain kinds of debt instruments including "a loan to or debt security issued by a financial institution […]."

[85] 'Intellectual Property Provisions in International Investment Arrangements' (2007) 1 IIA Monitor 8, 4.

Another approach would be to qualify the definition of debt instruments in a positive list. There are several means to qualify the debt instruments that fall outside the scope of the definition. Criteria for debt may include a certain maturity period and the lending of an affiliated enterprise within the territory. Moreover, a general exclusion to any debt provided to State owned entities may be included. The definition of debt instruments in the Canada Model FIPA (2004), Article 1 is quite elaborate, and provides a suitable benchmark that could be adopted:

> *[…] a debt security of an enterprise*
>
> *where the enterprise is an affiliate of the investor, or*
>
> *where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise;*
>
> *(IV) a loan to an enterprise*
>
> *where the enterprise is an affiliate of the investor, or*
>
> *where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise;*
>
> *(V) notwithstanding subparagraph (III) and (IV) above, a loan to or debt security issued by a financial institution is an investment only where the loan or debt security is treated as regulatory capital by the Party in whose territory the financial institution is located, and*
>
> *a loan granted by or debt security owned by a financial institution, other than a loan to or debt security of a financial institution referred to in (i), is not an investment; for greater certainty:*
>
> *a loan to, or debt security issued by, a Party or a state enterprise thereof is not an investment; and*
>
> *a loan granted by or debt security owned by a cross-border financial service provider, other than a loan to or debt security issued by a financial institution, is an investment if such loan or debt security meets the criteria for investments set out elsewhere in this Article […].*

iv. *<u>Orders and Judgments</u>:*

Excluding judgments from the definition of investment is a conventional approach. For example, Article 1(a) of the Japan – Uruguay BIT (2017) and Article 1 of the US – Rwanda BIT (2008) exclude from the definition of "investment" orders or judgments.

For greater certainty, it is advisable to exclude also "arbitral awards" from the definition of investment, such an exclusion is evident in Article 1 of the Netherlands Model BIT (Draft, 2018).

v. *<u>Goodwill and Market Share</u>:*

Some IIAs exclude from the definition of "investment" goodwill and market shares. For example, Article 1(1)(4) of the India Model BIT (2015) excludes from the scope of

the definition "goodwill, brand value, market share or similar intangible rights." Similarly, Article 1(2) of the Iran – Slovakia Model BIT (2016) excludes "goodwill and market share."

However, other agreements have taken the opposite position, and explicitly include goodwill in the definition of "investment." To name few examples, goodwill was included in the UAE – Russia BIT (2010), Switzerland – Egypt BIT (2010), Colombia – UK BIT (2010), and ASEAN – China FIA (2009).

vi. *Claims to payment:*

Exclusion of claims to money from commercial contracts is conventional in treaty practice. For example, a footnote to Article 1 of the US Model BIT (2012) excludes from the definition of investment, "claims to payment that are immediately due and result from the sale of goods or services." Similarly, Article 1(a) of the Colombia – Japan BIT (2011) states that "each Contracting Party recognizes that some claims to money that are immediately due and result solely from export and import contracts for the sale of goods or services […] do not have the characteristics of an investment."

DEFINITION OF INVESTOR

"The foreignness of an investor is determined by the investor's nationality."[86]

The general rule is that nationality of a natural person is defined by the local laws of the State in question. For juridical persons, other criteria apply and the most common one is the place of incorporation or seat of business. Nevertheless, parties are free to agree on different criteria.

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• For natural persons, nationality determined by the national legislation of the Contracting Party. • For juridical persons, nationality determined by place of incorporation, place of business, control or a mixture of those elements.	
RELEVANT AUTHORITIES	***PRACTICES TO BE AVOIDED***
• Norway Model BIT (2015), Article 2(1) • Switzerland – Tunisia BIT (2012), Article 1(2)(b) • Colombia Model BIT (2007), Article 1(1) • *Micula v Romania*[87] • *Yaung Chi Oo v Myanmar*[88]	• Limiting the definition of legal entities based solely on the place of incorporation.

DETAILED EXPLANATION

NATURAL PERSON

The general practice is that the nationality of the investor is based on national law.[89] However, States are free to agree in their treaties "whether any additional standards must be applied to the determination of nationality."[90]

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[86] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 44.
[87] *Ioan Micula and others v Romania*, ICSID Case No ARB/05/20, Decision on Jurisdiction and Admissibility (24 September 2008) para 98.
[88] *Yaung Chi Oo Trading PTE LTD v Government of the Union of Myanmar*, ICSID Case No ARB/01/1, Award (31 March 2003) paras 49-52.
[89] UNCTAD, *Scope and Definition: A sequel* (United Nations 2011) 13.
[90] *Ioan Micula and others v Romania*, ICSID Case No ARB/05/20, Decision on Jurisdiction and Admissibility (24 September 2008) para 98. In this case, the tribunal rejected the genuine link theory for individuals with a single nationality and asserted that a respondent State cannot argue that there are no sufficient ties if an investor has only one nationality.

Introducing the effective nationality test is unlikely to be acceptable by States because it is not aligned with CIL as codified in Article 4 of the ILC Draft Articles on Diplomatic Protection. Moreover, it is worth noting that "tribunals have generally been unimpressed by arguments concerning the effectiveness of a nationality."[91]

Nonetheless, the effective nationality test may be relevant in the case of dual nationals.[92] For example, Article 1 of the Canada – Burkina Faso BIT (2015) adopts the test of effectiveness as follows: "a natural person who is a dual citizen of Canada and of Burkina Faso shall be deemed to be exclusively a national of the Party of his or her dominant and effective nationality."

The exclusion of those who have the nationality of both Contracting Parties is generally incorporated in IIAs and recognized in case law. This rule is in fact set out in the ICSID Convention, particularly, Article 52(2)(a). To name another example, Article 1 of the Canada Model FIPA (2004) excludes from the definition of "investor" nationals who hold both the nationality of Canada and the one of the other Contracting Party.

Some IIAs require actual residency in the Home State.[93] For example, Article 1(c) of the Germany – Israel BIT (1976) requires, in respect of Israeli nationals, actual residency in the State of Israel.

In conclusion, States may consider that the nationality of an investor may be determined by the relevant national laws, while the nationality of dual citizens may be determined pursuant to the effective nationality test. This approach is adopted in Article 1 of the US – Uruguay BIT (2005) which states that:

> *Investor of a Party means […], a national […] of a Party, […]; provided, however, that a natural person who is a dual national shall be deemed exclusively a citizen of the State of his or her dominant and effective citizenship.*

JURIDICAL PERSON

Nationality for juridical persons may include different criteria such as: (i) incorporation, (ii) effective seat, and (iii) ultimate control by a national of the Home State. As stated by the tribunal in *Autopista v Venezuela*,[94] the place of incorporation, seat of central administration and effective seat are the most commonly used criteria for determining the nationality of legal entities.[95]

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[91] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 46.
[92] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 25.
[93] UNCTAD, *Scope and Definition: A sequel* (United Nations 2011) 74.
[94] *Autopista Concesionada De Venezuela v Venezuela*, ICSID Case No ARB/00/5, Decision on Jurisdiction (27 September 2001) para 105.
[95] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 47.

Many IIAs do combine incorporation with seat.[96] Instead, other agreements require a genuine economic link.[97] For example, Article 2 of the Norway Model BIT (2015) states:

> *Any entity established in accordance with, and recognised as a legal person by the law of a Party, and engaged in substantive business operations in the territory of that Party, irrespective of whether their liabilities are limited and whether or not their activities are directed at profit that seeks to make, is making or has made an investment in the other Party.*

A three-prong test has been adopted in Article 1(1) of the Colombia Model BIT (2017), which defines legal entities to mean: companies, corporations, commercial associations and other organizations, (1) constituted or otherwise organized according to the law of the contracting party and (2) have their seat, (3) as well as substantial business activities in the territory of the same contracting party. A similar provision is found in Article 1(2) of the Egypt – Switzerland BIT (2010) which states:

> *Companies, corporations, business associations and other organisations, which are constituted or otherwise duly organised under the law of that Contracting Party and have their statutory seat, together with real economic activities, in the territory of the same Contracting Party;*

It is worth noting that tribunals have considered valid the effective management requirement in the definition of investor.[98] In *Yaung Chi Oo v Myanmar* [99] the tribunal held that it:

> *has no doubt that, in the case of companies, the 1987 ASEAN Agreement requires both local incorporation and effective management; there is no justification for ignoring either requirement [… this additional requirement] was primarily included in the 1987 ASEAN Agreement to avoid what has been referred to as "protection shopping" i.e. the adoption of a local corporate form without any real economic connection in order to bring a foreign entity or investment within the scope of treaty protection.*

Some IIAs accept control as an alternative to actual ownership. For example, Article 1(1)(5) of the India Model BIT (2015) defines an "enterprise" to mean a legal entity: "directly or indirectly owned or controlled by a natural person." Article 2 of the SADC Model BIT Template (2012), likewise, defines an "enterprise" as a juridical person that "is effectively owned or controlled by a natural or juridical person."

A requirement of control exists in several treaties as part of a DoB clause, allowing the State to refuse the benefits of the agreement if there is no substantial business activity

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[96] ibid 49.
[97] Pia Acconci, 'Determining the Internationally Relevant Link between a State and a Corporate Investor: Recent Trends Concerning the Application of the Genuine Link Test' (2004) 5 Journal of World Investment & Trade 139.
[98] *Yaung Chi OO Trading PTE LTD, v Government of the Union of Myanmar,* ICSID Case No ARB/01/1, Award (31 March 2003) paras 49-52.
[99] ibid.

in the territory, or the "country of ultimate control does not have normal economic relations with the Host country."[100] Therefore, in case Contracting Parties insist on a broad definition of "investor", they may consider including a clearly detailed DoB clause to preserve the State's right of preventing unfair treaty shopping practices.[101]

Proposing a qualified definition of "investor" is a legitimate proposal, since broad definitions in IIAs are considered "an open door to abusive practices."[102] An example of such abusive behavior are those investment claims brought by intermediaries with no real connection with the State of incorporation.[103] Indeed, "tribunals have allowed intermediate corporations direct access to arbitration whenever faced with a treaty definition of an "investor" limited to the incorporation under the laws of one of the parties to the BIT."[104] As an illustrative example, the tribunal in *Aguas del Tunari v Bolivia* held that:[105]

> *It is not uncommon in practice, and – absent a particular limitation – not illegal to locate one's operations in a jurisdiction perceived to provide beneficial regulatory and legal environment in terms, for example, of taxation or the substantive law of the jurisdiction, including the availability of a BIT.*

There are several proposals limiting the grant of protection under the IIAs to intermediaries. One of them, consists in requiring that an investment should be made directly in the Host State.[106] Another approach is to require that the entity has substantial business activity in the territory of the Home State, as adopted by Article 1 of the Netherlands Model BIT (Draft, 2018). More importantly, the Netherlands Model BIT also provides guidance on the meaning of the term substantive business activities so as to include:

> *a. the undertaking's registered office and/or administration is established in that Contracting Party;*
> *b. undertaking's headquarters and/or management is established in that Contracting Party;*
> *c. the number of employees and their qualifications based in that Contracting Party;*
> *d. the turnover generated in that Contracting Party; and*
> *e. an office, production facility and/or research laboratory is established in that Contracting Party;*
>
> *These indications should be assessed in each specific case, taking into account the total number of employees and turnover of the undertaking*

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[100] UNCTAD, *Scope and Definition: A sequel* (United Nations 2011) 93.
[101] See also, analysis of: Denial of Benefits.
[102] Suzy H Nikièma, 'Definition of Investor" (2012) IISD Best Practices Series, 7.
[103] Ibid 14.
[104] Martin Valasek and Patrick Dumberry, 'Developments in the Legal Standing of Shareholders and Holding Corporations in Investor-State Disputes' (2011) 26 ICSID Review 34, 55.
[105] *Aguas del Tunari, SA v Republic of Bolivia*, ICSID Case No ARB/02/3, Decision on Respondent's Objection to Jurisdiction (21 October 2005) para 330.
[106] Martin Valasek and Patrick Dumberry, 'Developments in the Legal Standing of Shareholders and Holding Corporations in Investor-State Disputes' (2011) 26 ICSID Review 34, 74.

concerned, and take account of the nature and maturity of the activities carried out by the undertaking in the Contracting Party in which it is established.

ADMISSION

The Admission clause provides the Host State with a degree of control over the conditions by which an investment is privileged with the rights (and obligations) under the agreement.[107]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Requiring approval in writing.	
RELEVANT AUTHORITIES	***PRACTICES TO BE AVOIDED***
• Iran – Japan BIT (2016), Article 3 • ASEAN Comprehensive Investment Agreement (2009), Article 4 • Mexico – China BIT (2008), Article 2 • *Inceysa Vallisoletana v El Salvador*[108]	• Including a generic admission clause that may confuse actual admission with the requirement to abide by the laws of the Host State.

DETAILED EXPLANATION

Tribunals have read conventional Admission clauses to connote legality rather than mere admission. Attempts by States to broaden the matters encompassed by this phrase failed.[109]

Even in cases where the investment was not accepted by the Host State and the clause specifically provided for such acceptance, some tribunals accepted jurisdiction. In *Desert Line v Yemen*, the respondent State's challenged the jurisdiction of the tribunal by asserting that the investment was never formally accepted, and the investment certificate was not issued.[110] The tribunal held that "the requirement should correspond to a material object rather than a mere formalism."[111]

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[107] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 92.
[108] *Inceysa Vallisoletana SL v Republic of El Salvador*, ICSID Case No ARB/03/26, Award (2 August 2006) para 190.
[109] Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (Oxford University Press 2017) 241.
[110] *Desert Line Projects LLC v The Republic of Yemen*, ICSID Case No ARB/05/17, Award (6 February 2008) para 95.
[111] Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (Oxford University Press 2017) 241.

Seldom do tribunals dismiss claims based on an Admission clause. In one of these rare occasions, *Inceysa v El Salvador*, the tribunal held that "it is valid and common for States to limit the protection of the agreement to investments made in accordance with the laws of the Host State […]. The will of the parties to the BIT was to exclude from the Scope of Application and protection of the Agreement, disputes originating from investments which were made in accordance with the laws of the Host State."[112]

To avoid arguments that the Admission clause simply aims to require compliance with local laws, it is advisable to use a more detailed language. For example, Article 4 of the ASEAN Comprehensive Investment Agreement (2009) provides that "an investment has been admitted according to its laws, regulations, and national policies, and where applicable, specifically approved in writing by the competent authority of a member State."

A variance on the above language has been adopted in most of the Iran BITs. For example, Article 3 of the Iran – Japan BIT (2016) states that:

> *This Agreement shall apply to investments approved by the competent authority of the Host State, if so required by its laws and regulations.*

Similarly, paragraph 2 of Article 1 of the Singapore – Switzerland BIT (1978) reads:

> *Only an investment so admitted and, to the extent that written approval is required, specifically approved in writing by that other Contracting Party as an admitted investment, shall enjoy the benefits and protection of this Agreement.*

[112] *Inceysa Vallisoletana SL v Republic of El Salvador*, ICSID Case No ARB/03/26, Award (2 August 2006) para 190.

NON-DISCRIMINATORY TREATMENT

The non-discriminatory treatment in the investment regime is ensured by two standards: MFN and NT. These clauses prevent nationality-based distinctions among investors, thereby creating a degree of competitive equality.

MFN prevents the Host State from treating foreign investors of one nationality better than foreign investors of other nationality, whereas NT prevents the Host State from treating its own investors better.[113]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Within the framework of national legislation. • "Similar/like circumstances" with criteria. • Carve-outs. • Non-inclusion of MFN. • Limiting MFN.	
RELEVANT AUTHORITIES	
Within the framework of national legislation	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • APEC and UNCTAD Handbook (2012) • Colombia – Israel FTA (2013), Article 10 • Morocco – Viet Nam BIT (2012), Article 3(3) • China – Russian Federation BIT (2006), Article 3(2) • India – Indonesia BIT (1999), Article 4(3)
"Similar/like circumstances" with criteria	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • Draft Pan-African Investment Code (2016), Article 9(3) • India Model BIT (2015), Article 4(1)

[113] Jonathan Bonnitcha, Lauge N Skovgaard Poulsen and Michael Waibel, *The Political Economy of the Investment Treaty Regime* (Oxford University Press 2015) 95.

	• ASEAN – India Investment Agreement (2014), Article 3(4) • COMESA Investment Agreement (2007), Article 17(2) • *Feldman v Mexico*[114] • *Occidental v Ecuador*[115]
Carve-outs	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • Colombia – United Arab Emirates (2017), Article 5(1)
Non-inclusion of MFN	• EU – Singapore IPA (2018) • China – Hong Kong CEPA (2017) • India Model BIT (2015) • SADC Model BIT Template (2012) • Australia – New Zealand FTA (2009) • Jordan – Singapore BIT (2004)
Limiting MFN	• Brazil – Peru ETEA (2016), Article 2.6(5) • Canada – EU CETA (2016), Article 8.7 • Brazil's CFIA (2015), Article 6 • IISD Model International Agreement for Sustainable Development • *Ickale v Turkmenistan*[116] • *Parkerings v Lithuania*[117]

[114] *Marvin Roy Feldman Karpa v United Mexican States*, ICSID Case No ARB(AF)/99/1, Award (6 December 2002) para 171.
[115] *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN3467, Final Award (1 July 2004) para 173.
[116] *İçkale İnşaat Limited Şirketi v Turkmenistan*, ICSID Case No ARB/10/24, Award (8 March 2016) paras 328–332.
[117] *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case No ARB/05/8, Award (11 September 2007) paras 362-380; 390-392; 371.

PRACTICES TO BE AVOIDED

- Omitting the clause, since it is generally considered as conducive to good governance.
- Including the wording "similar circumstances" without setting out the relevant criteria.
- Including a broadly drafted MFN clause which allows a retroactive application.

DETAILED ANALYSIS

WITHIN THE FRAMEWORK OF NATIONAL LEGISLATION

UNCTAD recommends as a policy option that those countries that are reluctant to rescind the right to discriminate in favour of domestic investors should make the NT obligation "subject to their domestic laws and regulations."

Whilst this approach gives full flexibility to grant preferential treatment to domestic investors as long as this is in accordance with the country's legislation, it should be noted that such a significant limitation may be perceived as a disincentive to foreign investors.[118] Nevertheless, there are some treaties that follow this UNCTAD's recommendation:

- Morocco – Viet Nam BIT (2012), Article 3(3)[119]

  The national treatment, as provided in paragraph (1) and (2) above, shall be accorded in accordance with the applicable laws and regulations of the host Contracting Party and in accordance with the provisions on the Most Favoured Nation treatment provided for in this Agreement. The linking of national treatment to the applicable laws and regulations of the host Contracting Party preserves the right of the host Contracting Party to apply, a treatment to investors of the other Contracting Party and their investments different than that which applies to its own investors and their investments and in accordance with the provisions on the Most Favoured Nation treatment provided for in this Agreement. In this way each Contracting Party may maintain any economic sector or activity as reserved for its own investors within the framework of its development policy.

- China – Russian Federation BIT (2006), Article 3(2)

  Without prejudice to its laws and regulations, each Contracting Party shall accord to investments and activities connected in connection with such investments by investors of the other Contracting Party treatment not less

[118] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 96. See also, APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 40.
[119] Not entered into force.

favourable than that accorded to the investments and activity activities connected with such investments by its own investors.

- India – Indonesia BIT (1999), Article 4(3)[120]

  Each Contracting Parry shall, subject to its laws and regulations, accord to investment of investors of the other Contracting Party treatment no less favourable than that which is accorded to investments of its investors.

"SIMILAR/LIKE CIRCUMSTANCES" WITH CRITERIA

According to UNCTAD, when the provision states that the NT obligation requires a comparison of investors or investments that are in "like circumstances," it safeguards to some extent the State's right to regulate. However, this wording raises questions about the specific criteria for comparison. Therefore, it is necessary to set out the relevant criteria.[121]

The idea behind listing the criteria for comparison in "like circumstances" is to avoid a very broad interpretation. Tribunals have been inconsistent in this regard, an illustration of this lack of consistency is provided by:

- *Feldman v Mexico,*[122] where the tribunal interpreted that "like circumstances" so as to refer to the same business, which in the case was the exporting of cigarettes.
- *Occidental v Ecuador*,[123] where the tribunal adopted a broad interpretation of "like circumstances" referred to local producers in general, thereby considering investments made in different economic sectors that were not in a competitive relationship.

The practice followed by many treaties. For instance:

- Draft Pan-African Investment Code (2016), Article 9(3)

  3. The concept of "in like circumstances" requires an overall examination, on a case-by-case basis, of all the circumstances of an investment, including, among others:
  (a) Its effects on third persons and the local community;
  (b) Its effects on the local, regional or national environment, the health of the populations, or on the global commons;
  (c) The sector in which the investor is active;
  (d) The aim of the measure in question;
  (e) The regulatory process generally applied in relation to a measure in question;

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[120] Terminated treaty.
[121] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 95.
[122] *Marvin Roy Feldman Karpa v United Mexican States*, ICSID Case No ARB(AF)/99/1, Award (6 December 2002) para 171.
[123] *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN3467, Final Award (1 July 2004) para 173.

(f) Company size, and
(g) Other factors directly relating to the investment or investor in relation to the measure in question.
4. The examination referred to in this Paragraph shall not be limited to or be biased toward any one factor.

- India Model BIT (2015), Article 4(1)

Each Party shall not apply to investor or to investments made by investors of the other Party, measures that accord less favourable treatment than that it accords, in like circumstances,[2] to its own investors or to investments by such investors with respect to the management, conduct, operation, sale or other disposition of investments in its territory.

Footnote: For greater certainty, whether treatment is accorded in "like circumstances" depends on the totality of the circumstances, including whether the relevant treatment distinguishes between investors or investments on the basis of legitimate regulatory objectives. These circumstances include, but are not limited to, (a) the goods or services consumed or produced by the investment; (b) the actual and potential impact of the investment on third persons, the local community, or the environment, (c) whether the investment is public, private, or state-owned or controlled, and (d) the practical challenges of regulating the investment.

CARVE-OUTS

A possibility to limit the scope of the non-discriminatory obligation is to include country-specific reservations in accordance to the States' needs. This is suggested by UNCTAD.[124] For example, countries may wish to carve out:

- Certain policies/measures (subsidies and grants, government procurement, measures regarding government bonds);
- Specific sectors/industries where the Host State wishes to preserve the right to favour domestic investors;
- Certain policy areas;
- Measures related to companies of a specific size.

For treaty practice, see, for example:

- Colombia – United Arab Emirates (2017), Article 5(1)

4. For greater certainty, national treatment at the sub-national level shall not apply to sectors or services that are reserved exclusively to nationals.

- China – Peru FTA (2009), Article 131(3)

3. Notwithstanding paragraphs 1 and 2, the Parties reserve the right to adopt or maintain any measure that accords differential treatment: (a) to socially or economically disadvantaged minorities and ethnic groups14; or

[124] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 96.

> *(b) involving cultural industries related to the production of books, magazines, periodical publications, or printed or electronic newspapers and music scores.*

In any case, when negotiating the treaty text, the omission of the clause should be avoided given that it is considered as conducive to good governance. Moreover, as explained above, negotiators should avoid including the wording "similar/like circumstances" without setting out the relevant criteria for comparison.

NON-INCLUSION OF MFN TREATMENT

Following the *Maffezini v Spain* decision[125], many tribunals have interpreted the MFN clause as allowing the investor to import into the applicable IIA more favourable clauses found in third-party treaties.

As a consequence, treaty practice has evolved in this regard and reacted to this decision in many different ways. A recent trend, and the most radical one, is to avoid including an MFN clause.[126]

When supporting the choice of non-inclusion of an MFN clause, it should be highlighted that the exclusion is not contrary to international law since MFN treatment is not an obligation under CIL. A State is only bound by it if it so commits by treaty.[127]

LIMITING MFN

Those who do not want to take the radical step of omitting the clause could consider an option following the recent trend in case law that limits the MFN provision to "treatment."[128]

In *Ickale v Turkmenistan*, the tribunal made clear that MFN is not about a standard but about treatment. Therefore, the clause does not entail an abstract comparison of standards and clauses but actual treatment. According to the tribunal, the MFN treatment obligation requires a comparison of the factual situation.

The Canada – EU CETA (2016) is a clear example on how to highlight that the MFN clause is only about treatment. Article 8.7 states that:

> *1. Each Party shall accord to an investor of the other Party and to a covered investment, treatment no less favourable than the treatment it accords in like situations, to investors of a third country and to their investments with respect to the establishment, acquisition, expansion, conduct, operation,*

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[125] *Emilio Agustín Maffezini v Spain*, ICSID Case No ARB/97/7, Decision on Jurisdiction (25 January 2000) para 64.
[126] For examples of this approach, please see the relevant chart at the beginning of the section.
[127] Suzy H Nikièma, 'The Most-Favored-Nation Clause in Investment Treaties' (2017) IISD Best Practices Series, 24.
[128] See *İçkale İnşaat Limited Şirketi v Turkmenistan*, ICSID Case No ARB/10/24, Award (8 March 2016) paras 328–332.

management, maintenance, use, enjoyment and sale or disposal of their investments in its territory.

Moreover, there is also a trend in case law that refers to "actual domestic treatment" that could be taken into account when drafting the MFN clause.[129]

Other ways of limiting MFN include clarifying that it only applies to the post-establishment phase and narrowing the scope of the clause during the post-establishment phase. As a way of illustration, any or all of the following limitations could be used:

(i) Exclude all previous or subsequent investment treaties (or both) from the scope of MFN, substantive or procedural rules. Negotiators might consider doing this by starting with the words "for greater certainty" or a similar expression;
(ii) Include the expression "like circumstances" as a comparator and give a list of factors to be taken into account to analyze "like" character;
(iii) Make exceptions for regional integration organizations and double taxation treaties, but also exclude specific measures and sectors that are sensitive for the State.[130]

It is important to note that if the other country wishes, nevertheless, the MFN clause to cover the pre-establishment phase, it would be necessary to apply the above recommendations for the post-establishment phase; and to provide, cumulatively:

(i) Progressive liberalization for selected sectors through a (preferably) positive list;
(ii) A list of all existing non-conforming measures in the liberalized sectors;
(iii) A list of future non-conforming measures in liberalized sectors excluded from the scope of MFN;
(iv) The exclusion of all obligations from the pre-establishment phase from investor-state arbitration to limit the risks associated with the MFN clause.[131]

It is worth mentioning that no State is required to grant pre-establishment rights in their territory to foreign investors in an investment treaty. States can always liberalize sectors of their economies through domestic law.

Lastly, another way of limiting MFN is by providing exceptions. The Brazil's CFIA (2015) provides for a classic MFN clause in Article 6. However, the clause contains

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[129] See *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case No ARB/05/8, Award (11 September 2007) paras 362-380; 390-392; 371.
[130] Suzy H Nikièma, 'The Most-Favored-Nation Clause in Investment Treaties' (2017) IISD Best Practices Series, 25.
[131] ibid.

two main exceptions:

1. The first excludes from the scope the benefits that may be derived from agreements for regional economic integration, free trade areas, customs union or common market;
2. The second exception is the exclusion of the provisions relating to investment dispute settlement.[132]

This wording of the provision was included in the BITs signed in 2015 with Chile, Colombia and Mexico and also the BITs signed in 2018 with Suriname and Ethiopia.

However, the ETEA signed with Peru in 2016, provides an interesting approach that could be considered which includes a broader set of sectorial exceptions. Article 2.6(5) of the Brazil – Peru ETEA (2016) states:

> *The parties reserve their rights to adopt and maintain any future measure that does not comply with this Article:*
>
> *(a) that grants differentiated treatment to countries in accordance with any other international bilateral or multilateral treaty in force, or signed after the entry into force of this Agreement in matters of: aviation; fishing; or maritime matters, including salvage. For increased certainty, maritime matters includes transportation through lakes and rivers;*
>
> *(b) that is related to traditional fishing;*
>
> *(c) that grants preferential treatment to persons from other countries in accordance with any bilateral and multilateral treaties, existing or future, relating to cultural industries, including agreements for audiovisual cooperation;*
>
> *(d) that grants to a person from a third Party the same treatment granted by this party to its national in the audiovisual, editorial or musical sectors;*
>
> *(e) in what regards the enforcement of laws and the provision of social rehabilitation services;*
>
> *(f) in what regards the provision of the following services to the extent that they represent social services established and maintain for public policy reasons: income insurance and maintenance, social security services, social welfare, public education, public capacity building, health.*

In any case, negotiators should always bear in mind that MFN clause plays a key role and poses a further challenge to the strategy of IIAs renegotiation. This is due to the fact that if the MFN clause remains unchanged, investors would still be able to benefit from the rights and privileges found in other IIAs, which the renegotiation sought to eliminate.

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[132] Joaquin P Muniz, Kabir Duggal, and Luis Peretti, 'The New Brazilian BIT on Cooperation and Facilitation of Investments: A New Approach in Times of Change' (2017) 32 ICSID Review 404, 410.

To conclude, if the inclusion of this clause is required, it must be drafted in a way so as to exclude its retroactive application and limit it to successive agreements.[133] As a way of example, the IISD Model (2005) suggests to limit the effects of the MFN clause to "other international agreements relating to investment that enter into force after" the amendment in question.[134]

[133] Federico M Lavopa, Lucas E Barreiros and Victoria Bruno, 'How to Kill a BIT and Not Die Trying: Legal and Political Challenges of Denouncing or Renegotiating Bilateral Investment Treaties' (2013) 16 Journal of International Economic Law 869, 890.

[134] IISD Model International Agreement for Sustainable Development – Negotiators' Handbook (April 2004) 14 available at https://www.iisd.org/library/iisd-model-international-agreement-investment-sustainable-development-negotiators-handbook accessed on 14 November 2018.

FAIR AND EQUITABLE TREATMENT

FET is a highly controversial provision whose interpretation has varied in case law. Its violation has been claimed in almost every investment dispute and it has served as the most frequent basis of treaty breach. Consequently, negotiators should pay special attention when drafting this clause.

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Link to CIL or minimum standard of treatment. • Clarify the standard through a positive or a negative list of FET obligations. • Subject FET standard to the different levels of development. • Clarification that other breaches do not constitute FET violation. • Provide for review of the content of the FET obligation.	
RELEVANT AUTHORITIES	
Link to CIL or minimum standard of treatment	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • USMCA (2018), Article 14.6(2) • CPTPP (2018), Article 9.6(2) • PACER Plus (2017), Article 9(2) • *Occidental v Ecuador*[135] • *CMS v Argentina*[136] • *Deutsche Bank v Sri Lanka*[137] • *Koch Minerals v Venezuela*[138] • *Teinver v Argentina*[139] • *Cervin v Costa Rica*
Clarify the standard through a positive or a negative list of FET obligations	• Australia – Republic of Korea FTA (2014), Article 11.5(2) • COMESA Investment Agreement (2007), Article 14

[135] *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN3467, Final Award (1 July 2004) para 190.
[136] *CMS Gas Transmission Company v Republic of Argentina*, ICSID Case No ARB/01/8, Award (12 May 2005) para 284.
[137] *Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/09/2, Award (31 October 2012) para 419.
[138] *Koch Minerals Sarl and Koch Nitrogen International Sarl v Bolivarian Republic of Venezuela*, ICSID Case No ARB/11/19, Award (30 October 2017) paras 8.42-8.45.
[139] *Teinver SA, Transportes de Cercanías SA and Autobuses Urbanos del Sur SA v Argentine Republic*, ICSID Case No ARB/09/01, Award (21 July 2017) para 666.

	• Rwanda-United States BIT (2008), Article 5 • Republic of Korea-Peru FTA (2010), Article 9.5 • India-Mexico BIT (2007), Article 5
Clarify the standard through a closed list of FET obligations	• UNCTAD, Fair and Equitable Treatment: A sequel (2012) • Netherlands Model BIT (Draft, 2018), Article 9 • Colombia Model BIT (2017), Fair and Equitable Treatment • Canada – EU CETA (2016), Article 9.10(2)
Subject FET standard to the different levels of development	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • COMESA Investment Agreement (2007), Article 14(2)
Clarification that other breaches do not constitute FET violation	• APEC and UNCTAD Handbook (2012) • CPTPP (2018), Article 9.6(3) • Colombia Model BIT (2017), Fair and Equitable Treatment • PACER Plus (2017), Article 9(3) • Eurasian Economic Union – Viet Nam FTA (2015), Article 8.31(5)
PRACTICES TO BE AVOIDED	
• Including an unqualified promise to treat investors "fairly and equitably." • Omitting the clause.	

LINK TO CIL OR MINIMUM STANDARD OF TREATMENT

A provision linking the content of FET to CIL or minimum standard of treatment sets forth a high threshold to trigger the violation, subsequently diminishing State's exposure to international responsibility.[140]

It is in the context of cases brought under NAFTA where FET is linked to the minimum standard of treatment in international law that tribunals have generally found this link to require a high liability threshold. As a consequence, for a breach to be found, a State's conduct must be "egregious" or "shocking" from an international perspective. In other words, a simple illegality under domestic law is not tantamount to a breach of the obligation.

As a way of illustration, in *SD Myers v Canada*, the tribunal considered that a breach of Article 1105 of NAFTA occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective; that determination must be made in the light of the high measure of deference that international law generally extends to States to regulate within their own borders.[141]

Linking FET to CIL or minimum standard of treatment is useful "as an expression of the gravity of the conduct required for that conduct to be held in violation of the standard."[142]

Tribunals when faced with an FET obligation tied to CIL had generally required the State's conduct to be egregious or outrageous in accordance with the *Neer* case.[143]

CIL is the result of a general and consistent practice of States followed from a sense of legal obligation. Consequently, an investor in a dispute has a heavy burden of proof,

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[140] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 51.

[141] *SD Myers, Inc v Government of Canada*, UNCITRAL, Partial Award (13 November 2000) para 263. See also *Waste Management Inc v Mexico*, ICSID Case No ARB(AF)00/3 (30 April 2004) para 98 referring to *SD Myers v Canada* and quoted in *Mobil Investments Canada Inc & Murphy Oil Corporation v Canada*, ICSID Case No ARB(AF)/07/04, Decision on Liability and on Principles of Quantum (22 May 2012) para 141, and in *Cargill Incorporated v United Mexican States*, ICSID Case No. ARB(AF)/05/2, Award (18 September 2009) para 282.

[142] UNCTAD, *Fair and Equitable Treatment: A sequel* (United Nations 2012) xiv-xv.

[143] *LFH Neer and Pauline Neer* (United States v Mexico) Mexico-United States General Claims Commission (1926): 'Without attempting to announce a precise formula, it is in the opinion of the Commission possible to […] hold (first) that the propriety of governmental acts should be put to the test of international standards, and (second) that **the treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action** so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency. Whether the insufficiency proceeds from deficient execution of an intelligent law or from the fact that the laws of the country do not empower the authorities to measure up to international standards is immaterial."

since in order to prove a breach it would be necessary to collect evidence to demonstrate general State practice and *opinio juris*.[144]

In some cases, tribunals have found that the content of the FET obligation is not different from what is required under CIL. As a way of illustration:

- In *Occidental v Ecuador*,[145] the tribunal found that the treaty standard was not different from that required under international law.

- In *CMS v Argentina*,[146] the tribunal concluded that the treaty standard of FET and its connection with the required stability and predictability of the business environment, founded on solemn legal and contractual commitments, is not different from the international law minimum standard and its evolution under CIL.

- When deciding the case *Deutsche Bank v Sri Lanka*,[147] the tribunal recognized that the actual content of the treaty standard of FET is not materially different from the content of the minimum standard of treatment in CIL.

- In the case *Koch Minerals v Venezuela*,[148] the tribunal concluded that the express qualification "in accordance with the rules and principles of international law" confirms the FET standard as a duty imposed by CIL and precludes an independent or autonomous meaning.

Nevertheless, in other instances, when the provision did not include a reference to CIL or minimum standard of treatment, arbitral tribunals interpreted FET as an autonomous standard entailing broader obligations. For example:

- In *Teinver v Argentina*,[149] the tribunal was of the view that FET is not only the minimum standard of treatment in international law, given that the BIT did not include that term.

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[144] UNCTAD, *Fair and Equitable Treatment: A sequel* (United Nations 2012) 44.
[145] *Occidental Exploration and Production Company v Republic of Ecuador*, LCIA Case No UN3467, Final Award (1 July 2004) para 190.
[146] *CMS Gas Transmission Company v Republic of Argentina*, ICSID Case No. ARB/01/8, Award (12 May 2005) para 284.
[147] *Deutsche Bank AG v Democratic Socialist Republic of Sri Lanka*, ICSID Case No ARB/09/2, Award (31 October 2012) para 419.
[148] *Koch Minerals Sarl and Koch Nitrogen International Sarl v Bolivarian Republic of Venezuela*, ICSID Case No ARB/11/19, Award (30 October 2017) paras 8.42-8.45.
[149] *Teinver SA, Transportes de Cercanías SA and Autobuses Urbanos del Sur SA v Argentine Republic*, ICSID Case No ARB/09/01, Award (21 July 2017) para 666.

- In the absence of a reference to CIL or the minimum standard in the treaty in *Cervin v Costa Rica*,[150] the FET protection contained in the BIT was treated as an autonomous standard by the tribunal.

The inclusion of the wording linking FET to CIL is very relevant. There are numerous examples of treaties following this practice,[151] see for instance:

- CPTPP (2018), Article 9.6(2)

> *For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. […]*

- PACER Plus (2017), Article 9(2)

> *For greater certainty, paragraph 1 prescribes the customary international law6 minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" shall not require treatment in addition to or beyond that which is required by that standard, and shall not create additional substantive rights. […]*

The reference to CIL is advisable since it raises the threshold of State liability. However, the exact scope of minimum standard of treatment and CIL remains vague.[152] For example, some tribunals have stated that the minimum standard of treatment has evolved and now it can be equated to FET. Interestingly, this so-called evolution of the minimum standard of treatment is not sufficiently analyzed.[153] As a consequence, an option for negotiators could be to clarify the Parties' understanding of CIL[154] or by noting, for instance, what are the requirements for finding a breach of the standard. Examples of this approach are found in:

- USMCA (2018), ANNEX 14-A CUSTOMARY INTERNATIONAL LAW

> *The Parties confirm their shared understanding that "customary international law" generally and as specifically referenced in Article 14.6 results from a general and consistent practice of States that they follow from a sense of legal obligation. The customary international law minimum*

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[150] *Cervin Investissements SA and Rhone Investissements SA v Republic of Costa Rica*, ICSID Case No ARB/13/2, Award (7 March 2017) paras 452-3.
[151] See also Colombia – Costa Rica FTA (2013), Article 12.4(2); Canada – United Republic of Tanzania BIT (2013), Article 6; SADC Model BIT Template (2012), Article 5(1); US Model BIT (2012), Article 5(2); CAFTA (2004), Article 10.5(2).
[152] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 51.
[153] See *Cargill, Incorporated v Republic of Poland*, ICSID Case No ARB(AF)/04/2, Award (5 March 2008) para 453, *Siemens AG v Argentine Republic*, ICSID Case No ARB/02/8, Award (6 February 2007) paras 292-300.
[154] See examples above: US Model BIT 2012 and CAFTA.

standard of treatment of aliens refers to all customary international law principles that protect the investments of aliens.

- SADC Model BIT Template (2012), Article 5(2)

  For greater certainty, paragraph 5.1 requires the demonstration of an act or actions by the government that are an outrage, in bad faith, a wilful neglect of duty or an insufficiency so far short of international standards that every reasonable and impartial person would readily recognize its insufficiency.

In any case, even if with the inclusion of an unqualified promise of FET, a country provides maximum protection for investors, this approach should be avoided because it opens the door to an expansive approach to the review of administrative action. It gives the possibility to the tribunal to focus on the needs and perspectives of the investor. Moreover, it will likely provoke an underestimation of the need to balance those claims and the Host State's right to regulate in the public interest.[155]

The omission of the clause should be avoided since even if it would reduce States' exposure to investor claims, it would also reduce the protective value of the agreement.[156] This is because the absence of an FET obligation may be perceived as a signal that the Contracting States are not willing to subject themselves to an internationally enforceable minimum absolute standard of treatment of foreign investors.[157]

CLARIFY THE STANDARD THROUGH A POSITIVE OR A NEGATIVE LIST OF FET OBLIGATIONS

Given that the case law is very heterogenous regarding the interpretation of the standard, the parties can consider providing clarification through a positive or a negative list of FET obligations.

(i) Positive formulation

A positive formulation would specify what the standard includes. For example, including the obligation not to deny justice in criminal, civil or administrative adjudicatory proceedings.

This practice is adopted in Australia – Republic of Korea FTA (2014), Article 11.5(2); COMESA Investment Agreement (2007), Article 14; Rwanda-United States BIT (2008), Article 5; Republic of Korea – Peru FTA (2010), Article 9.5 and India-Mexico BIT (2007), Article 5.

[155] UNCTAD, *Fair and Equitable Treatment: A sequel* (United Nations 2012) 104-5.
[156] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 86.
[157] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 53.

(ii) Negative formulation

Conversely, a negative formulation would explain what the standard does not include. An example would be establishing for instance that the FET standard does not include a stabilization obligation that would prevent the Host State from changing its legislation.

Japan – Mongolia EPA (2015), Article 10.5, Note 1 and Colombia – France BIT (2014), Article 4(1) are examples of this approach.

CLARIFY THE STANDARD THROUGH A CLOSED LIST OF FET OBLIGATIONS

A closed FET list of obligations helps to avoid unanticipated and far-reaching interpretations by tribunals.[158] It provides guidance and even if there is room for the arbitrators' assessment, it is nowhere close to the discretion granted to arbitrators by an unqualified FET standard.

At the same time, the standard formulated in this manner will only find States liable in case of serious misconduct.[159]

The clarification can include obligations not to, for example:

- Deny justice in judicial or administrative proceedings;
- Treat investors in a manifestly arbitrary manner;
- Flagrantly violate due process;
- Engage in manifestly abusive treatment involving continuous, unjustified coercion or harassment;
- Infringe investor's legitimate expectations based on investment-inducing representations or measures.[160]

Examples of this approach are:[161]

- Netherlands Model BIT (Draft, 2018), Article 9(2)

  A Contracting Party breaches the aforementioned obligation of fair and equitable treatment where a measure or series of measures constitutes:

  a) Denial of justice in criminal, civil or administrative proceedings;

[158] In this context, it is worth mentioning a recent decision by the ICJ, that arbitral tribunals should take into account, where the Court stated that there is no principle of general international law that would give rise to an obligation on the basis of what could be considered a legitimate expectation. See *Obligation to negotiate access to the Pacific Ocean (Bolivia v Chile)*, Judgment (1 October 2018) paras 160-162.
[159] UNCTAD, *Fair and Equitable Treatment: A sequel* (United Nations 2012) 107.
[160] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 98.
[161] See also, India Model BIT (Draft, 2015), Article 3.

b) Fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings;

c) Manifest arbitrariness;

d) Direct or targeted indirect discrimination on wrongful grounds, such as gender, race, nationality, sexual orientation or religious belief;

e) Abusive treatment of investors such as harassment, coercion, abuse of power, corrupt practices or similar bad faith conduct; or

f) A breach of any further elements of the fair and equitable treatment obligation adopted by the Contracting Parties in accordance with paragraph 3 of this Article.

3. The Contracting Parties shall, upon request of a Contracting Party, review the content of the obligation to provide fair and equitable treatment and may complement this list through a joint interpretative declaration within the meaning of Article 31, paragraph 3, sub a, of the Vienna Convention on the Law of Treaties.

- Colombia Model BIT (2017), Fair and Equitable Treatment

1. Each Contracting Party shall grant Covered Investors and Investments of the other Contracting Party a fair and equitable treatment.

2. The fair and equitable treatment granted to Covered Investors and Investments refers solely to the prohibition against:

a. denial of justice in criminal, civil or administrative proceedings;

b. fundamental breach of due process in judicial or administrative proceedings;

c. manifest arbitrariness;

d. targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief; or

e. abusive treatment of investors, such as coercion, duress and harassment.

The Council may review the content of this Article, upon request of a Contracting Party.

SUBJECT FET STANDARD TO DIFFERENT LEVELS OF DEVELOPMENT

An innovative possibility is to subject the FET standard to different levels of development. The inclusion of this wording may be justified since UNCTAD recommends the interpretation of protection standards that consider States' different level of development.[162] However, it should be noted that this requirement may be

[162] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 121 gives as examples of standards that could take into account the State's level of development: fair and equitable treatment,

considered as contrary to the notion of an absolute "minimum standard" on which investors can rely. Moreover, it could be argued that investors would not be in a position to be aware of the corresponding "minimum" standard for each party taking into account the development, consequently diminishing the treaty's promotional effect.[163] The only example found that follows this approach is:

- COMESA Investment Agreement (2007), Article 14(2)

  For greater certainty, Member States understand that different Member States have different forms of administrative, legislative and judicial systems and that Member States at different levels of development may not achieve the same standards at the same time. Paragraphs 1 [Fair and Equitable Treatment] and 2 [minimum standard of treatment] of this Article do not establish a single international standard in this context.

While analyzing the influence of the Host State's level of development on international treaty standards of protection through the case law it was concluded that negotiators should clarify whether they understand the standard of treatment to be an absolute minimum or whether it is influenced by the Host State's level of development.[164]

CLARIFICATION THAT OTHER BREACHES DO NOT CONSTITUTE FET VIOLATION

Through the inclusion in the clause that a violation of a different provision does not automatically imply a violation of the FET standard, a better understanding of the concept as intended by the Parties is reached.[165] This practice is to be found, *inter alia*, in:

- CPTPP (2018), Article 9.6(3)

  A determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.

- Colombia Model BIT (2017), Fair and Equitable Treatment, para 3

  A determination that there has been a breach of another provision of this Agreement, or any other international obligation owed by the Host Party to the Covered Investor or Investment does not imply that fair and equitable treatment has been breached.

full protection and security and the amount of compensation awarded. See also 'Special and differential treatment.'

[163] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 53.

[164] Nick Gallus, 'The Influence of the Host State's Level of Development on International Investment Treaty Standards of Protection' (2006) 3(5) Transnational Dispute Management.

[165] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 51.

PROVIDE FOR REVIEW OF THE CONTENT OF THE FET OBLIGATION

A further and new option is to provide that the Parties shall regularly, or upon request of a Party, review the content of the FET obligation.[166]

See, for instance, Canada – EU CETA (2016), Article 8.10(3) which states:

> *3. The Parties shall regularly, or upon request of a Party, review the content of the obligation to*
>
> *provide fair and equitable treatment. The Committee on Services and Investment, established under Article 26.2.1(b) (Specialised committees), may develop recommendations in this regard and submit them to the CETA Joint Committee for decision.*

[166] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 85.

PROTECTION AND SECURITY

Most investment treaties contain a clause granting protection and security for investments. This standard requires the Host State to exercise due diligence in protecting foreign investments from adverse effects which may stem from private parties or from actions of the Host State and its organs.[167]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Reference to physical security and protection. • Link to the degree of development of the country. • Link to CIL.	
RELEVANT AUTHORITIES	
Reference to "physical" security and protection	• EU – Singapore IPA (2018), Article 2.4(5) • Netherlands Model BIT (Draft, 2018), Article 9 • Colombia Model BIT (2017) Physical Protection and Security • Canada – EU CETA (2016), Article 8.10(5) • SADC Model BIT Template (2012), Article 9 • Dominican Republic – Netherlands BIT (2006), Article 3 • *Rumeli v Kazakhstan*[168] • *BG Group v Argentina*[169] • *Azurix v Argentina*[170] • *Paushok v Mongolia*[171]
Link to the degree of development of the country	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015)

[167] Christoph Schreuer, 'Full Protection and Security' (2010) 1 Journal of International Dispute Settlement 353, 353.
[168] *Rumeli Telekom AS and Telsim Mobil Telekomikasyon Hizmetleri AS v Kazakhstan*, ICSID Case No ARB/05/16, Award (29 July 2008) para 668.
[169] *BG Group v Argentina*, UNCITRAL, Award (24 December 2007) paras 323-328.
[170] *Azurix Corp v Argentine Republic*, ICSID Case No ARB/01/12, Award (4 July 2006) para 408.
[171] *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v Government of Mongolia*, Award on Jurisdiction and Liability (28 April 2011) para 326.

Link to CIL	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • Morocco – Nigeria BIT (2016), Article 7 • Argentina – Qatar BIT (2016), Article 3
Omission of the clause	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • Brazil's CFIA (2015) • COMESA (2007) • SADC (2006)
PRACTICES TO BE AVOIDED	
• Including of the clause without any qualification.	

DETAILED EXPLANATION

REFERENCE TO "PHYSICAL" SECURITY AND PROTECTION

The most contested issue surrounding this standard is whether it extends or not beyond the duty to provide physical security. In a number of cases, tribunals seem to have assumed that in fact the standard applies exclusively or preponderantly to physical security.[172] For example:

- In *Rumeli v Kazakhstan,*[173] the tribunal found that the standard obliges the State to provide a certain level of protection to foreign investment from physical damage and that it is an obligation of due diligence.

- In *BG Group v Argentina,*[174] the tribunal found that it was inappropriate to depart from the originally understood standard of "protection and constant security." Moreover, the tribunal referred to the fact that other tribunals had found that the standard extended beyond situations where the physical security

[172] Christoph Schreuer, 'Full Protection and Security' (2010) 1 Journal of International Dispute Settlement 353, 354.
[173] *Rumeli Telekom AS and Telsim Mobil Telekomikasyon Hizmetleri AS v Kazakhstan*, ICSID Case No ARB/05/16, Award (29 July 2008) para 668.
[174] *BG Group v Argentina*, UNCITRAL, Award (24 December 2007) paras 323-328.

of the investor or its investment was at stake. However, the tribunal found that it was inappropriate to follow this line of thought.

Nevertheless, some tribunals have expressed a different view. For instance:

- In *Azurix v Argentina,*[175] the tribunal found that when the terms "protection and security" are qualified by "full" and no other adjective or explanation is provided, the ordinary meaning of the standard goes beyond physical security.

- In *Paushok v Mongolia,*[176] the tribunal concluded that since the treaty provided clearly for "full legal protection of investments of investors" there was no reason to limit the protection guaranteed to mere physical protection.

These last two cases clearly illustrate the divergences in opinion with respect to the cases mentioned before. Additionally, they highlight the importance of including the wording "physical" to avoid an interpretation that covers more than just police protection, thereby constraining government regulatory prerogatives.

In this regard, in fact many treaties already include the term "physical" in order to limit the standard of security and protection and leave outside of its scope "legal" protection.[177]

LINK TO DEGREE OF DEVELOPMENT OF THE COUNTRY

Even though to date, no treaties include a reference to the level of development of the country in the protection and security clause. UNCTAD recommends this approach.[178]

According to Schreuer, it is an open question whether the level of due diligence should depend on the Host State's development and stability. Therefore, it can be argued that even if it is innovative, the inclusion of this phrasing will not have a negative impact on the agreement.[179]

Newcombe and Paradell note that by virtue of the protection and security clause, the Host State must exercise an objective minimum standard of due diligence which is linked to the circumstances and to the resources of the State in question. They suggest that, in practice, a tribunal should consider the State's level of development and stability when determining whether there has been due diligence. As an illustration, they give

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[175] *Azurix Corp v Argentine Republic*, ICSID Case No. ARB/01/12, Award (4 July 2006) para 408.
[176] *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v Government of Mongolia*, UNCITRAL, Award on Jurisdiction and Liability (28 April 2011) para 326.
[177] See, for example, EU – Singapore IPA (2018), Article 2.4(5); Netherlands Model BIT (Draft, 2018), Article 9; Colombia Model BIT (2017) Physical Protection and Security; Canada – EU CETA (2016), Article 8.10(5); SADC Model BIT Template (2012), Article 9; German Model for TTIP, Article 6177; Dominican Republic – Netherlands BIT (2006), Article 3.
[178] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 98.
[179] Christoph Schreuer, 'Full Protection and Security' (2010) 1 Journal of International Dispute Settlement 353, 367.

the example of an investor in an area with endemic civil strife and poor governance who cannot have the same expectation of physical security as one investing in London, New York or Tokyo.[180]

Gallus considers that the traditional interpretation of the FPS clause leaves scope to consider the Host State's level of development. According to him, the fact that several tribunals have decided that obligation requires the Host State to provide such protection is "reasonable under the circumstances." This could be used as a basis to argue that the Host State can only reasonably provide the protection that their level of development allows.[181]

Examples of cases that may allow such interpretation are:

- *Ronald Lauder v Czech Republic*, [182] where the tribunal considered that the obligation under the treaty is to exercise due diligence in the protection of foreign investment as reasonable under the circumstances.

- *CME v Czech Republic*,[183] where the tribunal noted that a government is only obliged to provide protection which is reasonable in the circumstances.

LINK TO CIL

The controversy regarding whether the standard is autonomous or whether it merely incorporates CIL has prompted States to address the issue directly in their investment treaties. As a consequence, another option is to include the provision, specifying that the obligation does not go beyond what is required by CIL. Additionally, this link to CIL will prevent a tribunal from reading the clause in the light of FET.[184]

Examples following this approach are:

- Morocco – Nigeria BIT (2016), Article 7

  > *'full protection and security' requires each Party to provide the level of police protection required under customary international law.*

- Argentina – Qatar BIT (2016), Article 3

  > *5. Full protection and security is to be referred to the provision of adequate physical protection pursuant to customary international law.*

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[180] Andrew Paul Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International 2009) 310.
[181] Nick Gallus, 'The Influence of the Host State's Level of Development on International Investment Treaty Standards of Protection' (2006) 3(5) Transnational Dispute Management.
[182] *Ronald Lauder v Czech Republic*, UNCITRAL, Final Award (3 September 2001) para 308.
[183] *CME Czech Republic BV v Czech Republic*, UNCITRAL, Partial Award (13 September 2001) para 353.
[184] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 99.

OMISSION OF THE CLAUSE

A last resort could be to omit the clause. UNCTAD has suggested this as a policy option for IIAs[185] and it has been followed by Brazil in its CFIA (2015) and by the COMESA Investment Agreement (2007), among others.

In any case, the inclusion of a clause without any kind of qualification should be avoided in order to prevent a broad interpretation of the standard.[186]

[185] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 99.
[186] To support this, refer to *Azurix Corp v Argentine Republic*, ICSID Case No ARB/01/12, Award (4 July 2006) para 408.

GENERAL EXCEPTIONS

Exceptions are intended to allow States to adopt measures aimed at specific policy objectives that could be in breach of the treaty. In other words, General exceptions are intended to identify the policy areas for which flexibility is to be preserved.

General exceptions are rare and the most common among them is for measures that are "necessary" to protect "public order" or a State's "essential security interests." These clauses are often called "non-precluded measures" provisions.[187]

To date, few IIAs include public policy exceptions in standalone clauses, however, the recent trend is to introduce general exceptions in order to reaffirm States' right to regulate.

A General Exceptions provision reduces States' exposure to claims arising from conflicts that may occur between the interests of a foreign investor and the promotion and protection of legitimate public interest objectives, such as sustainable development goals.[188]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Non-discriminatory requirement • Determine the nexus: loose test • Prudential measures • List the public policy objectives • Self-judging national security exception	
RELEVANT AUTHORITIES	
List the public policy objectives	• APEC and UNCTAD Handbook (2012) • Colombia Model BIT (2017), General Exceptions • Japan – Mozambique BIT (2013), Article 18 • Australia – Malaysia FTA (2012), Article 12.18

[187] Jonathan Bonnitcha, Lauge N Skovgaard Poulsen and Michael Waibel, *The Political Economy of the Investment Treaty Regime* (Oxford University Press 2015) 119.
[188] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 103.

Non-discriminatory treatment	• UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • APEC and UNCTAD Handbook (2012) • Colombia Model BIT (2017), General Exceptions • Australia – China FTA (2015), Article 9.8 • Canada – Peru BIT (2007), Article 10 • Canada Model BIT (2004), Article 10(1) • Jordan – Singapore (2004), Article 18 • Singapore – Australia FTA (2003), Article 19
Determine the nexus: loose test	• APEC and UNCTAD Handbook (2012) • Nigeria – Turkey BIT (2011), Article 6 • France – Uganda BIT (2003), Article 1
Self-judging national security exception	• APEC and UNCTAD Handbook (2012) • UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) • Colombia Model BIT (2017), General Exceptions • Japan – Ukraine BIT (2015), Article 19 • Canada – Côte d'Ivoire BIT (2014), Article 17(4) • Gabon – Turkey BIT (2012), Article 5(2) • Panama – US FTA (2007), Article 21.2(b)
Referring to a Joint Committee	• APEC and UNCTAD Handbook (2012)

	• ASEAN – India Investment Agreement (2014), Article 20(19) • India Model BIT (Draft, 2015), Article 18

DETAILED ANALYSIS

LIST THE PUBLIC POLICY OBJECTIVES

When listing the public policy objectives, States reduce their exposure to investor claims. The inclusion of policy objectives allows States to tailor the exceptions according to specific needs.

The formulation may use a reference to specific public policy areas, such as the environment, the protection of health, public order and morals. It can also be modeled the clause on Article XX of the GATT, or it can include any other area which the States prefer or need, such as cultural diversity, the protection of national treasures of artistic, historic or archaeological value. [189]

Examples:

- Colombia Model BIT (2017), General Exceptions

> *Provided that such Measures are not applied in a manner that would constitute means of arbitrary and discriminatory treatment against a Covered Investor or Investment, nothing in this Agreement shall preclude a Contracting Party from adopting, maintaining or enforcing Measures that such Contracting Party deems necessary for:*
>
> *a. protecting human rights;*
>
> *b. protecting human, animal or vegetable life and health;*
>
> *c. protecting the environment;*
>
> *d. preserving and protecting natural resources;*
>
> *e. protecting consumer rights;*
>
> *f. protecting the market from anti-competitive conducts;*
>
> *g. the issuance of compulsory licences granted in relation to intellectual property rights, or for the revocation, limitation or creation of intellectual property rights, to the extent that such issuance revocation, limitation or creation is consistent with the TRIPS Agreement;*
>
> *h. the preservation of the public order, the fulfilment of its obligations to maintain and restoration of international peace and security, or the protection of its own security interests; and*

[189] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 122.

i. ensuring compliance with the Host Party's laws and regulations that are not incompatible with the provisions of this Agreement;

- Japan – Mozambique BIT (2013), Article 18

Subject to the requirement that such measures are not applied by a Contracting Party in a manner which would constitute a means of arbitrary or unjustifiable discrimination against the other Contracting Party, or a disguised restriction on investments of investors of the other Contracting Party in the Area of the former Contracting Party, nothing in this Agreement other than Article 13 shall be construed so as to prevent the former Contracting Party from adopting or enforcing measures:

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

(b) necessary to protect public morals or to maintain public order, provided that the public order exception may only be invoked where a genuine and sufficiently serious threat is posed to one of the fundamental interests of society;

(c) necessary to secure compliance with the laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:

(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on contract;

(ii) the protection of the privacy of the individual in relation to the processing and dissemination of personal data and the protection of confidentiality of personal records and accounts; or

(iii) safety;

(d) imposed for the protection of national treasures of artistic, historic or archaeological value;

(e) which it considers necessary for the protection of its essential security interests:

(i) taken in time of war, or armed conflict, or other emergency in that Contracting Party or in international relations; or

(ii) relating to the implementation of national policies or international agreements respecting the non-proliferation of weapons; or

(f) in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

- Australia – Malaysia FTA (2012), Article 12.18

1. Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Parties where like conditions prevail, or a disguised restriction on investment flows, nothing in this Chapter shall be construed to prevent the adoption or enforcement by any Party of measures:

a. necessary to protect national security and public morals;

b. necessary to protect human, animal or plant life or health;

c. aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of investments or investors of the Parties; or

d. necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Chapter including those relating to:

i. the prevention of deceptive and fraudulent practices or to deal with the effects of a default on investment agreements;

ii. the protection of the privacy of individuals in relation to the processing and dissemination of personal data and protection of confidentiality of individual records and accounts; or

iii. safety;

e. imposed for the protection of national treasures of artistic, historic, or archaeological value; or

f. to conserve exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.

2. In cases where a Party takes any measures pursuant to paragraph 1 that do not conform to the obligations of the provisions of this Chapter other than the provisions of Article 12.10 (Treatment in the Case of Strife), that Party shall promptly notify the other Party on the measures.

NON-DISCRIMINATORY REQUIREMENT

Clarifying that the measures must be applied in a non-arbitrary manner and not as disguised protectionism is a safeguard in order to prevent abuse of exceptions.

Clauses modeled on Article XX of the GATT often provide that a measure must not be applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction of international trade or investment. While the requirement has been interpreted and applied in the WTO context, it has not yet been tested in investment disputes.[190]

Treaties that have followed this approach include, for example:

- Colombia Model BIT 2017, General Exceptions

  Provided that such Measures are not applied in a manner that would constitute means of arbitrary and discriminatory treatment against a Covered Investor or Investment, nothing in this Agreement shall preclude a Contracting Party from adopting, maintaining or enforcing Measures that such Contracting Party deems necessary for: […]

- Canada – Peru BIT (2007), Article 10(1)

  Subject to the requirement that such measures are not applied in a manner that would constitute arbitrary or unjustifiable discrimination between investments or between investors, or a disguised restriction on international trade or investment, nothing in this Agreement shall be construed to prevent a Party from adopting or enforcing measures necessary: […]

[190] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 122.

According to Newcombe, the inclusion of this type of wording is appropriate for the investment context given the scope of investment protections and the fact that investments are likely to have an environmental impact.[191]

DETERMINE NEXUS: LOOSE TEST

The nexus is an important element since it will determine how low or high is the threshold for the use of exceptions by States. The clause may adjust the required link between the measure and its alleged policy objective.

The wording may vary, but for the purposes of having a less strict test it can be "related to", "directed to", "designed to" or "aimed at" a specific policy objective. According to WTO jurisprudence on general exceptions, the use of "designed to" entails a different analysis, less strict than "necessity." UNCTAD proposes to lower the threshold for the use of exceptions by adjusting the required link and using "designed to achieve" or "related to" the policy objective.[192]

Examples of this more relaxed formulation are:

- Nigeria – Turkey BIT (2011), Article 6(1)

> *Nothing in this Agreement shall be construed to prevent either Contracting Party from adopting, maintaining or enforcing any non-discriminatory legal measures:*
>
> *a) Designed and applied for the protection of human, animal or plant life or health, or the environment;*
>
> *b) Related to the conservation of living or non-living exhaustible natural resources.*

- France – Uganda BIT (2003), Article 1(6)

> *Nothing in this agreement shall be construed to prevent any contracting party from taking any measure to regulate investment of foreign companies and the conditions of activities of these companies in the framework of policies designed to preserve and promote cultural and linguistic diversity.*

Arbitral practice is not yet developed on this particular issue. Therefore, it is unclear whether there is an actual difference between terms in this category.

In general, investment tribunals have been reluctant to rely on WTO jurisprudence when interpreting specific investment obligations. However, when dealing with general exceptions there is a stronger case for drawing interpretation guidance given that the

[191] Andrew Newcombe, 'General Exceptions in International Investment Agreements' 361 in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer Law International 2001).
[192] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 104.

clause is modelled almost word for word on Article XX of the GATT.[193] The VCLT requires investment treaty adjudicators "to take into account relevant rules of international law applicable in the relations between the parties." Therefore, WTO jurisprudence is clearly relevant when this modelling strategy is used.[194]

Given that the WTO context could be applicable in an investment dispute, it is easier for a respondent to defend a measure as being "in relation to" a given objective than to demonstrate that it is "necessary" to achieve that objective. For instance, in *US – Gasoline*[195] the Appellate Body suggested that a WTO member only needs to show that the measure taken is "primarily aimed at" the objective at stake. In another case, *US – Shrimps*,[196] it added that the means must be "in principle, reasonably related to the ends."

In the NT case law in the investment law context, a similar arbitral approach was taken along these lines asserting that the policy objective stated is not enough, and that there must be a correlation. In *AES v Hungary*,[197] the tribunal held *obiter*:

> *'[A] rational policy is not enough to justify all the measures taken by a state in its name... [T]here needs to be an appropriate correlation between the state's public policy objective and the measure adopted to achieve it. This has to do with the nature of the measure and the way it is implemented.'*

States should bear in mind that their discretion is not unlimited and that the analysis of the legality of the measure may entail an assessment of the effectiveness of the measure in contributing to the objective.[198]

The other option that is also found in practice is to require that the measure must be "necessary" to achieve the policy objective, which entails a very strict test.[199]

SELF-JUDGING NATIONAL SECURITY EXCEPTION

A national security exception allows States to adopt certain measures that could otherwise be deemed in breach of the treaty and require payment of compensation. This type of exception allows a balance between the level of discretion on national and

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[193] Andrew Newcombe, 'General Exceptions in International Investment Agreements' 364 in Marie-Claire Cordonier Segger, Markus W Gehring and Andrew Newcombe (eds), *Sustainable Development in World Investment Law* (Kluwer Law International 2001).
[194] Jürgen Kurtz, *The WTO and International Investment Law: Converging Systems* (Cambridge University Press 2015) 204.
[195] US – Gasoline, Report of the Appellate Body, paras 18–19.
[196] US – Shrimp, Report of the Appellate Body, para 140.
[197] *AES Summit Generation Ltd v The Republic of Hungary*, ICSID Case No ARB/07/22, Award (23 September 2010) para 10.3.9.
[198] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 119-120.
[199] See for example, Australia – Malaysia FTA (2012), Article 12.18.

international security issues, while making sure that investment protection is not undermined.

Security exceptions in recent investment treaties are usually drafted as "self-judging." This means that a State is entitled to adopt the measures it considers necessary to achieve a given objective.

Although there is no unanimity on the precise meaning of the "self-judging" nexus, its nature implies that a tribunal would be deferential to the government when assessing the measure taken. This approach gives wide discretion to States, but reduces legal certainty for investors.[200] Consequently, States should bear in mind that tribunals may still be able to review the measure in the light of the principle of good faith in order to prevent an abusive use of the exception.[201]

Some examples include:

- Colombia Model BIT (2017), General Exceptions

  > *Provided that such Measures are not applied in a manner that would constitute means of arbitrary and discriminatory treatment against a Covered Investor or Investment, nothing in this Agreement shall preclude a Contracting Party from adopting, maintaining or enforcing Measures that such Contracting Party* ***deems necessary*** *for […]*

- Japan – Ukraine BIT (2015), Article 19(1)

  > *Notwithstanding any other provisions in this Agreement other than the provisions of Article 14, each Contracting Party may take any measure: (a) which* ***it considers necessary*** *for the protection of its essential security interests;*

States can also consider as an alternative, listing the types of situations covered by the exception in order to determine its scope. For instance, they can refer to measures:

- To protect a State's essential security interests;
- To address serious economic crisis;
- To maintain international peace and security;
- To justify measures adopted in times of war;
- To justify the implementation of national policies or international agreements for the non-proliferation of nuclear weapons.[202]

REFERRING TO A JOINT COMMITTEE

Another complementing option for this provision could be to establish a mandatory mechanism whereby the cases in which a respondent State invokes an exception are

[200] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 106.
[201] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 130.
[202] UNCTAD, *Investment Policy Framework for Sustainable Development* (2015) 106.

referred to a joint committee of the Contracting Parties. This committee could either guide the tribunal's interpretation or issue a binding determination of whether or not a measure falls within the scope of the exception.

This is provided, for example in:[203]

- ASEAN – India Investment Agreement (2014), Article 20(19)

> *Joint Interpretation*
>
> *19. The tribunal shall, on its own account or at the request of a disputing Party, request a joint interpretation of any provision of this Agreement that is in issue in a dispute. The Parties shall submit in writing any joint decision declaring their interpretation to the tribunal within sixty (60) days of the request. Without prejudice to paragraph 20 of this Article, if the Parties fail to submit such a decision within sixty (60) days, any interpretation submitted by a Party individually shall be forwarded to the disputing parties and the tribunal, which shall decide the issue on its own account.*

If the counterparty is not willing to include a provision dealing with general exceptions, this absence may be compensated by:

- Clarifying certain key obligations;
- Exempting measures and/or sectors from selected treaty obligations;
- Excluding policy areas from the treaty, or;
- Excluding policy areas from the scope of dispute settlement.[204]

[203] See also, India Model BIT (Draft, 2015), Article 18.
[204] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 124.

MEASURES AIMING AT PRESERVING THE HOST STATE'S POLICY SPACE IN CERTAIN FIELDS

Recently, States have expressed their concerns about investors' claims against measures they adopt the in public interest. More specifically, States are worried about the far-reaching powers of tribunals to review Host State's regulatory measures and order compensation for their adoption. As a result, recent treaty practice shows that States have started adopting different types of provisions in order to preserve the Host State's right to regulate in the public interest.

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES
• Inclusion of a general exceptions provision that allows the State to enact laws designed to protect human health, HRs, environment, etc. • Delimitation of standards of investment protection (FET, MFN, indirect expropriation). • General restatement of the Host State's right. • Exclusion of public policy measures from ISDS.
RELEVANT AUTHORITIES
• China – Australia FTA (2015), Article 9.11(4)

DETAILED EXPLANATION

There are several alternative approaches that may contribute to safeguard the Host State's policy space. The main objective of including clauses that ensure the right to regulate is to limit the discretion of adjudicators in the circumstances of disputes concerning public welfare measures. Hereafter, some of the approaches recently adopted in investment treaty practice:

GENERAL EXCEPTIONS

First, general exception provisions generally aim to preserve the State's power to implement laws designed to protect human health, HRs, environment, etc.[205] Currently, treaty exceptions are growing in number and in scope.[206]

[205] Similar to Article XX GATT.
[206] Lise Johnson and others, 'International Investment Agreements, 2014: A Review of Trends and New Approaches' International Investment Agreements' in Andrea K Bjorklund (ed), Yearbook on International Investment Law and Policy 2014–2015 (Oxford University Press 2016) 47.

DELIMITATION OF STANDARDS OF INVESTMENT PROTECTION

In addition, the right to regulate can also be safeguarded by delimiting standards of investment protection such as FET, MFN and indirect expropriation. Indeed, it is possible to circumscribe the protection by providing detailed wording and also including carve-outs or positive lists.[207]

RIGHT TO REGULATE

A provision specifically dedicated to the Host State's right to regulate is at times included within IIAs. A general restatement may bring added value. Indeed, it may provide tribunals with further guidance on the objectives of the parties to the agreement. See, for example:

- Canada – EU CETA (2016), Article 8.9

  For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity.

- Netherlands Model BIT (Draft, 2018), Article 2(2)

  The provisions of this Agreement shall not affect the right of the Contracting Parties to regulate within their territories necessary to achieve legitimate policy objectives such as the protection of public health, safety, environment, public morals, labor rights, animal welfare, social or consumer protection or for prudential financial reasons. The mere fact that a Contracting Party regulates, including through a modification to its laws, in a manner which negatively affects an investment or interferes with an investor's expectations, including its expectation of profits, is not a breach of an obligation under this Agreement.

- Colombia Model BIT (2017), Chapeau on Investment and Regulatory Measures

  The Contracting Parties reaffirm their right to regulate within their territories, in order to achieve legitimate public policy objectives such as those enshrined in their Constitutions or in international agreements that promote and protect human rights, public health, safety and security, natural resources, the environment, sustainable development and other public policy objectives. The mere fact that the adoption, modification or enforcement of a Measure negatively affects a Covered Investment or interferes with a Covered Investor's expectations, including its expectation of profits, does not amount to a breach of any obligation under this Agreement.

[207] This possibility is analyzed in greater detail in the sections of this handbook concerning the relevant standards of investment protection.

PRECLUSION OF THE POSSIBILITY TO ACCESS ISDS WITH CLAIMS BASED ON PUBLIC POLICY MEASURES

The China – Australia FTA (2015) includes a clause that, to our knowledge, cannot be found elsewhere in IIAs. Indeed, Article 9.11(4) provides that:

> *Measures of a Party that are **non-discriminatory** and for the **legitimate public welfare objectives** of public health, safety, the environment, public morals or public order shall not be the subject of a claim under this Section [Investor-State Dispute Settlement].*

Such clause has been considered as "perhaps the broadest filter mechanism[s]"[208] to limit ISDS access. Because of the highly innovative character of the provision, its meaning and concrete application remain vague.

The objective of this provision is to completely exclude the possibility of tribunals' review of public interest measures. As a result, the possibility to access ISDS and its scope will be considerably limited.[209]

UNCTAD recommends the exclusion of specific types of claims from the scope of ISDS if the objective is "to narrow the range of situations in which foreign investors may resort to international arbitration, thereby reducing States' exposure to legal and financial risks posed by ISDS."[210]

However, this provision will likely be problematic during negotiations. Indeed, the limitation here is rather broad. A limitation extended to almost all regulatory measures adopted in the public interests will likely raise objections by counterparties, because it seems to go beyond what States currently agree on. States seem more willing to accept exclusion of claims to ISDS if related to pre-establishment obligations, financial institutions or taxation measures.[211]

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[208] Jesse Coleman and others, 'International Investment Agreements, 2015–2016: A Review of Trends and New Approaches' in Lisa E Sachs and Lise Johnson (ed), *Yearbook on International Investment Law and Policy 2015–2016* (Oxford University Press 2018) 67.
[209] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2018) 50.
[210] ibid.
[211] Lise Johnson and others, 'International Investment Agreements, 2014: A Review of Trends and New Approaches' International Investment Agreements' in Andrea K Bjorklund (ed), *Yearbook on International Investment Law and Policy 2014–2015* (Oxford University Press 2016) 47-49.

DENIAL OF BENEFITS

Under a DoB clause, "States reserve the right to deny the benefits of the treaty to a company incorporated in a State but with no economic connection with the latter." [212]

The DoB clause is included in investment treaties for two main objectives.[213] First of all, to safeguard reciprocity as a fundamental principle with regard to the benefits arising out of the protection offered by IIAs.[214] Secondly, to respond to the challenges currently facing investment regime namely, claims brought (i) by mailbox companies, (ii) by entities controlled by a Host State entity ("round-tripping"), (iii) by entities with ownership links to the investment that were purposely created in anticipation of a claim ("time-sensitive restructuring").[215]

The DoB clause is a flexible tool that entitles the Contracting States to deny protection to investors after the conclusion of the IIA and prevent forum shopping and free riding by investors to obtain benefits under the treaty.[216]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• DoB clause that clarifies the conditions for the valid exercise of the State's right to deny benefits of the treaty. • DoB clause that clarifies the time frame within which the State can exercise its rights to deny benefits of the treaty to the investor. • Combination of a DoB clause with a restrictive definition of Investor. • Absence of DoB clause but inclusion of restrictive definition of Investor.	
RELEVANT AUTHORITIES	***PRACTICES TO BE AVOIDED***
• UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) • SADC Commentary *ad* Article 26 • Colombia Model BIT (2017), DoB clause para 1(c) • Morocco – Nigeria BIT (2016), Article 22 • India Model BIT (2015), Article 35	• Including DoB clauses that do not explicitly state the time frame within which the State can exercise its right to deny the benefits of the treaty to the investor. • Including an over-broad definition of investment in the absence of a DoB clause.

[212] Rudolf Dolzer and Christoph Schreuer, Principles of International Investment Law (Oxford University Press 2012) 55.
[213] Loukas A Mistelis and Crina M Baltag, 'Denial of Benefits and Article 17 of the Energy Charter Treaty' (2008) 113 Penn State Law Review 1301.
[214] ibid.
[215] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 40.
[216] SADC Commentary *ad* Article 26.

• *Plama v Bulgaria*[217] • *Khan Resources v Mongolia*[218] • *Guaracachi v Bolivia*[219]	

DETAILED EXPLANATION

CONDITIONS FOR VALID EXERCISE OF THE STATE'S RIGHT TO DENY BENEFITS OF THE TREATY

Treaty practice on DoB provisions is not uniform. In particular, variations exist regarding the requirements established for the valid exercise of the right to deny the benefits and the combination thereof. Here follow some of the most frequent conditions included within investment treaties:

- One of the most frequent conditions for the valid exercise of the right to deny benefits reads: "the investor is owned or controlled by nationals of a third country or of the receiving State." See, for example, India Model BIT (2015), Article 35(i);

- Moreover, some treaties combine the foregoing requirement with the "absence of diplomatic relations." See, for example, Morocco – Nigeria BIT, Article 22(1)(a) and SADC Model BIT Template (2012), Article 26(1)(a);

- Another criterion is "nationals of any third country, or nationals of such Party, control such company and the company has no substantial business activities in the territory of the other Party." The absence of substantial economic activities is one of the most common. See, for instance, Colombia Model BIT (2017), DoB clause, para 1(c);

- "The company is controlled by nationals of a third country with which the denying Party does not maintain normal economic relations." See, for instance, US – Argentina BIT (1991), Article 1(2)(b);

- The India Model BIT (2015), in Article 35(ii), for the lawful exercise of the right requires that "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."

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[217] *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No ARB/03/24, Decision on Jurisdiction (8 February 2008) paras 161-162.
[218] *Khan Resources BV and CAUC Holding Company Ltd v Government of Mongolia*, UNCITRAL, Decision on Jurisdiction (25 July 2012) paras 425-431.
[219] *Guaracachi America, Inc and Rurelec PLC v Plurinational State of Bolivia*, PCA Case No 2011-17, Award (31 January 2014) paras 376-378.

Especially, it is worth noting that the foregoing requirements can be either *alternative* or *cumulative*.

In the first scenario, the word "or" is placed between the conditions provided. See, for example,

- India Model BIT (2015), Article 35

> *A Party may at any time, including after the institution of arbitration proceedings in accordance with Chapter IV of this Treaty, deny the benefits of this Treaty to:*
> *(i) an investment or investor owned or controlled, directly or indirectly, by persons of a non-Party or of the denying Party;* ***or***
> *(ii) 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.*

Conversely, the conditions can be employed as *cumulative* when between them there is the word "and". By way of example, see:

- USMCA (2018)[220], Article 14.14 (1)

> *A Party may deny the benefits of this Chapter to an investor of another Party that is an enterprise of that other Party and to investments of that investor if the enterprise:*
>
> *(a) is owned or controlled by a person of a non-Party or of the denying Party;* ***and***
>
> *(b) has no substantial business activities in the territory of any Party other than the denying Party*

- Morocco – Nigeria BIT (2016), Article 22(2)

> *A Party may deny the benefits of this Agreement to an Investor of another Party that is an investment of such other Party* ***and*** *to Investments of that Investor if the Investment has no substantial business activities in the territory of the other Party and persons of non-Party, or of the denying Party, own or control the Investment.*

POSSIBILITY TO DENY BENEFITS AT ANY TIME, EVEN ONCE A CLAIM HAS BEEN INITIATED

A State may want to clarify that it can lawfully exercise the right to deny the benefits at any time, even once a claim has been raised before dispute settlement mechanisms. For instance, the India Model BIT (Article 35) contains this kind of language.

> *A Party may* ***at any time, including after the institution of arbitration proceedings*** *in accordance with Chapter IV of this Treaty, deny the benefits of this Treaty to:*
> *[..]*

[220] It is also referred to as NAFTA 2.0. This is the pending FTA between US-Mexico-Canada. Formal agreement to the text achieved 1 October 2018.

This specification is of paramount importance in light of the fact that, in its *absence*, "several tribunals have held that the DoB clause may not be invoked against an investor after it initiates a formal arbitration claim, severely limiting the effective scope of these clauses."[221] Indeed, from the case law, it has emerged that the Contracting States *do not have* the right to deny benefits *after commencement of the arbitration.* See for example:

- *Khan Resources v Mongolia:*[222]
  - Basis for the claim: ECT, DoB clause, Article 17(1).
  - Timing frame for the valid exercise of the right to deny benefits: ABSENT.

> *It is therefore necessary to investigate with particular attention the "object and purpose" of the Treaty. The Treaty seeks to create a predictable legal framework for investments in the energy field. This predictability materializes only if investors can know in advance whether they are entitled to the protections of the Treaty. If an investor such as Khan Netherlands, who falls within the definition of "Investor" at Article 1(7) of the Treaty and is therefore entitled to the Treaty's protections in principle, could be denied the benefit of the Treaty at any moment after it has invested in the host country, it would find itself in a highly unpredictable situation. This lack of certainty would impede the investor's ability to evaluate whether or not to make an investment in any particular state. This would be contrary to the Treaty's object and purpose. In contrast, an obligation for contracting parties to exercise their Article 17 right in time to give adequate notice to investors would be consistent with the obligation of host states under Article 10(1) of the Treaty to create "transparent conditions" for investments.[..] It is difficult to imagine that any Contracting Party, whatever its general policy regarding mailbox companies, would refrain from exercising its right to deny the substantive protections of the ECT to an investor who has already commenced arbitration and is claiming a substantial sum of money.* ***A good faith interpretation does not permit the Tribunal to choose a construction of Article 17 that would allow host states to lure investors by ostensibly extending to them the protections of the ECT, to then deny these protections when the investor attempts to invoke them in international arbitration****.*

See *Plama v Bulgaria*,[223] for a similar decision.

Conversely, in *Guaracachi v Bolivia*,[224] the tribunal rejected the claimants' argument, based on *Plama v Bulgaria*, that the DoB clause cannot be invoked after a dispute arises.

- *Guaracachi v Bolivia:*
  - Basis for the claim: US – Bolivia BIT (1998) and UK – Bolivia BIT (1988).

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[221] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 40

[222] *Khan Resources Inc, Khan Resources BV and CAUC Holding Company Ltd v Government of Mongolia*, UNCITRAL, Decision on Jurisdiction (25 July 2012), paras 425-431.

[223] *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No ARB/03/24, Decision on Jurisdiction (8 February 2005) paras 161-162.

[224] *Guaracachi America, Inc and Rurelec PLC v Plurinational State of Bolivia*, PCA Case No 2011-17, Award (31 January 2014), paras 376-378.

- DoB clauses: US – Bolivia BIT, Article XII UK – Bolivia BIT, NO DoB clause.
- Timing frame for the valid exercise of the right to deny benefits: US – Bolivia BIT ABSENT.

> *The same must be said in relation to the supposedly retroactive application of the clause. The Tribunal cannot agree with the Claimants when they argue that the Respondent is precluded from applying the denial of benefits clause retroactively.* ***The very purpose of the denial of benefits is to give the Respondent the possibility of withdrawing the benefits granted under the BIT to investors who invoke those benefits. As such, it is proper that the denial is "activated" when the benefits are being claimed.*** *The Contracting Parties to the BIT could have agreed otherwise, but they decided not to do so. Instead they agreed that a Contracting Party could deny benefits (including the benefit of having a dispute decided by an arbitral tribunal) subject to meeting certain conditions, none of which entails that such denial is only effective in relation to disputes arising after the notification of such denial or imposes any other limitation period that would occur before the Respondent's submission of its Statement of Defence. On the contrary,* ***the Tribunal agrees that the denial can and usually will be used whenever an investor decides to invoke one of the benefits of the BIT.*** *It will be on that occasion that the respondent State will analyse whether the objective conditions for the denial are met and, if so, decide on whether to exercise its right to deny the benefits contained in the BIT, up to the submission of its statement of defence.*

As a result of this unpredictable and uncertain case law, explicitly including a clarification on the time frame within which a State can validly exercise the DoB may be a valuable way to provide tribunals with clear guidance and reduce their discretionary power of decision.

In addition, it is advisable not to simply refers to "*at any time*"[225] as provided by the SADC Model BIT Template (2012), Article 26. Rather, expressly adding a clause such as "*including after the institution of arbitration proceedings*"[226] may be useful to avoid practical difficulties in case of dispute and broadening the tribunal's margin of discretion.

THE COMBINATION OF DOB CLAUSE WITH A RESTRICTIVE DEFINITION OF INVESTOR: ALTERNATIVE APPROACH TO PREVENT UNFAIR INVESTORS' PRACTICES

The DoB clause can easily *coexist* with a restrictive definition of "investor." When both are present within the investment treaty, the purpose of a DoB clause is to give further effect to the requirements necessary to satisfy the definition of investor. There are many investment treaties that can be used by way of example to illustrate this. For some illustrative treaty practice, see the India Model BIT (2015):

[225] SADC Model BIT Template (2012), Article 26.
[226] India Model BIT (2015), Article 35.

- Article 35, DoB clause

> *A Party may at any time, including after the institution of arbitration proceedings in accordance with Chapter IV of this Treaty, deny the benefits of this Treaty to:*
> *(i)an investment or investor owned or controlled, directly or indirectly, by persons of a non-Party or of the denying Party; or*
> *(ii) an investment or investor that has been established or restructured with the primary purpose of gaining access to dispute settlement resolution mechanisms provided in this Treaty.*

- Article 1.5, Definition of "investor"

> *[..] For the purposes of this definition, a "juridical person" means:*
>
> *(a) a legal entity that is constituted, organised and operated under the law of that Party and that has substantial business activities in the territory of that Party; or*
>
> *(b) a legal entity that is constituted, organised and operated under the laws of that Party and that is directly or indirectly owned or controlled by a natural person of that Party or by a legal entity mentioned under subclause (a) herein.*

To prevent unfair practices of mailbox companies and roundtripping the most frequent requirements included within the definition of "investor" are the "substantial economic activities" criterion, the place of "seat" or of "effective management."[227]

However, it has been argued that a detailed definition of "investor" "may be *unnecessary* if the IIA contains a DoB clause that permits Host States to deny benefits of the treaty to companies without substantive business activities in the territory of the treaty partner."[228] Therefore, in case the negotiating parties insist on a broad definition of investor, they should make sure to include a clearly detailed DoB clause.[229]

To sum up, the inclusion of a DoB clause seems a valuable option because it is an adjustable provision that allows the Contracting States to exercise their right to deny benefits after the conclusion of the treaty and to prevent treaty shopping.

Alternatively, the same objective can be achieved, though with much less flexibility, with a restrictive definition of "investor" that combines the criterion of place of incorporation with further requirements. Indeed, in some instances, the DoB clause is absent. By way of illustration, see the *absence* of the DoB clause in the Brazil CFIA (2015) and Ukraine – Lithuania BIT (1994).

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[227] For a more detailed analysis see the part of this handbook concerning the definition of Investor.
[228] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 26.
[229] For a more detailed analysis, see the part of this handbook concerning the definition of Investor.

ANTI-CORRUPTION OBLIGATIONS

The inclusion of an express provision concerning obligations on anti-corruption reflects a recent trend in investment agreements. First of all, providing direct investor obligations is a response to the need to correct the traditional asymmetry between States' obligations and investors' rights.[230] Secondly, direct obligations on investors aim to ensure responsible business conduct and, ultimately, to promote investments as a tool for sustainable development.[231]

<table>
<tr><th colspan="2">RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES</th></tr>
<tr><td colspan="2">
State and investor obligations on anti-corruption.
Denial of substantive protection, including preclusion of the possibility to submit claims before ISDS mechanisms.
Direct enforceability and possibility to incur in liability before civil, administrative, criminal courts of the Host State and/or Home State.
The legality requirement as ad hoc provision or in the definition of Investment.
Corruption as ground for valid exercise of the DoB clause.
Internationally recognized standards and CSR on anti-corruption.
Corruption as ground for counterclaims.
</td></tr>
<tr><th colspan="2">RELEVANT AUTHORITIES</th></tr>
<tr><td>State and investor obligations on anti-corruption</td><td>
Morocco-Nigeria BIT (2016), Article 17.1 and 17.2
Draft Pan-African Investment Code (2016), Article 21
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</td></tr>
<tr><td>Denial of substantive protection, including preclusion of the possibility to submit claims before ISDS mechanisms</td><td>
Canada – EU CETA (2016), Article 8.13(3)
Morocco – Nigeria BIT (2016), Article 17.4
Slovakia – Iran Model BIT (2016), Article 14(2)
SADC Commentary ad article 10
</td></tr>
</table>

[230] UNCTAD, *Investment Policy Framework and Sustainable Development* (2015) 109.
[231] ibid.

	• *World Duty Free v Kenya*[232]
Direct enforceability and possibility to incur in liability before civil, administrative, criminal courts of the Host State and/or Home State	• Morocco – Nigeria BIT (2016), Article 17.5 • India Model BIT (Draft, 2015), Article 8(4) • SADC Model BIT Template (2012), Article 10(4) • IISD Model (2005), Article 17
The legality requirement as ad hoc provision or in the definition of Investment	• India Model BIT (2015), Article 11(i)
Corruption as ground for valid exercise of the DoB clause	• Colombia Model BIT (2017), Denial of Benefits
Internationally recognized standards and CSR on anti-corruption	• Canada – Colombia FTA (2008), Article 816
Corruption as ground for counterclaims	• ICSID Convention, Article 46
PRACTICES TO BE AVOIDED	
• Complete absence of investor obligations or responsibilities. • Absence of enforcement mechanisms of anti-corruption obligations.	

DETAILED EXPLANATION

STATE AND INVESTOR OBLIGATIONS ON ANTI-CORRUPTION

The interpretative provision of Article 8 of the India Model BIT (Draft, 2015), clearly states the purpose of including anti-corruption obligations upon investors and Contracting States in investment agreements:

> *The objective of this Chapter is to ensure that the conduct, management and operations of Investors and their Investments are consistent with the Law of the Host State, and enhance the contribution of Investments to inclusive growth and sustainable development of the Host State. The Parties agree that this Chapter prescribes the minimum obligations for Investors and their Investments for responsible business conduct.*

[232] *World Duty Free Company v Republic of Kenya*, ICSID Case No Arb/00/7, Award (5 September 2006) para 179.

It is worth noting that anti-corruption obligations can be posed either on investors, on the Contracting States or on both of them.

For instance, Article 17 of the Morocco – Nigeria BIT (2016)[233] binds both the Contracting Parties in paragraph 1 and the investors in paragraph 2. It reads:

> *1.Each Contracting Party shall ensure that measures and efforts are undertaken to prevent and combat corruption regarding matters covered by this Agreement in accordance with its laws and regulations.*
>
> *2.Investors and their Investments shall not, prior to the establishment of an Investment or afterwards, offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a public official of the Host State, or a member of an official's family or business associate or other person in close proximity to an official, for that official or for a third party, in order that the official or third party act or refrain from acting in relation to the performance of official duties, in order to achieve any favour in relation to a proposed investment or any licences, permits, contracts or other rights in relations to an investment.*

Conversely, Article 15 of the Brazil CFIA provides for an obligation only binding on Contracting States:

> 1. *Each Party shall adopt measures and make efforts to prevent and fight corruption, money laundering and terrorism financing with regard to matters covered by this Agreement, in accordance with its laws and regulations.*
> 2. *Nothing in this Agreement shall require any Party to protect investments made with capital or assets of illicit origin or investments in the establishment or operation of which illegal acts have been demonstrated to occur and for which national legislation provides asset forfeiture.*

Instead, Article 11(ii) of the India Model BIT (2015) only refers to investor obligations on anti-corruption:

> *The parties reaffirm and recognize that:[…]*
>
> *(ii) Investors and their investments shall not, either prior to or after the establishment of an investment, offer, promise, or give any undue pecuniary advantage, gratification or gift whatsoever, whether directly or indirectly, to a public servant or official of a Party as an inducement or reward for doing or forbearing to do any official act or obtain or maintain other improper advantage nor shall be complicit in inciting, aiding, abetting, or conspiring to commit such acts.*

DENIAL OF SUBSTANTIVE PROTECTION, INCLUDING PRECLUSION OF THE POSSIBILITY TO SUBMIT CLAIMS BEFORE ISDS MECHANISMS

Recently, in recent treaty practice, the provision entailing anti-corruption obligations makes clear that investments that, at any stage, are in breach of the anti-corruption obligations are not considered covered investments under the treaty and cannot benefit from its protection. By the same token, investors who commit acts of corruption cannot

[233] Not yet in force.

raise claims before ISDS mechanisms. On this point, the commentary of the SADC Model BIT Template (2012) *ad* Article 10 says that:

> *An investment achieved by corruption in breach of this article or of applicable domestic law is a breach of the treaty and domestic law related to the establishment and operation of the investment, and therefore, by virtue of the definition of an investment that requires it to be made in accordance with domestic law,* ***it is no longer a covered investment and no longer has dispute settlement rights****.* ***This is consistent with recent arbitral decisions relating to corruption in the making of an investment that have negated investment arbitration rights as a result of a finding of corruption****.*

A growing number of investment treaties preclude the access to dispute settlement when the investment is obtained through corruption.[234] The treaty language can vary from "may" provisions to "shall" provisions. We can compare:

- India Model BIT (2015), Article 13(4)

> *An investor* ***may*** *not submit a claim to arbitration under this Chapter if the investment has been made through fraudulent misrepresentation, concealment, corruption, money laundering or conduct amounting to an abuse of process or similar illegal mechanisms.*[235]

- IISD Model (2005), Article 18(A)

> *Where an investor or its investment has breached Article 13 of this Agreement, neither the investor not investment* ***shall*** *be entitled to initiate any dispute settlement process established under this Agreement. A host or home state may raise this as an objection to jurisdiction in any dispute under this Agreement, or in the procedure set out in Part 9 of this Agreement.*

DIRECT ENFORCEABILITY AND POSSIBILITY TO INCUR IN LIABILITY BEFORE CIVIL, ADMINISTRATIVE, CRIMINAL COURTS OF THE HOST STATE AND/OR HOME STATE

Some very recent investment agreements provide for the *direct enforceability* of the anti-corruption obligations. Indeed, investors may incur civil, administrative and criminal liability before the court of both the Home and Host State.

Setting out the consequences of a violation is a way to strengthen investor obligations and promote accountability. On the issue of investor liability, the language adopted by investment treaties varies. Especially, for detailed provisions on investor civil liability and obligation of *Home* States to institute proceedings, refer to the IISD Model (2005), Articles 17-18-31. Instead, for a more general language, see SADC Model BIT Template (2012), Article 10(4).

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[234] Jesse Coleman and others, 'International Investment Agreements, 2015–2016: A Review of Trends and New Approaches' in Lisa E Sachs and Lise Johnson (eds), *Yearbook on International Investment Law and Policy 2015–2016* (Oxford University Press 2018) 70.
[235] See also Slovakia – Iran BIT, Article 14(2).

THE LEGALITY REQUIREMENT AS AD HOC PROVISION OR IN THE DEFINITION OF INVESTMENT

First of all, it is possible to include an obligation for investors to be in conformity with Host State law both at the entry and post-entry stage.[236] The legality requirement can be provided in a separate *ad hoc* provision. By way of example, see the India Model BIT (2015), Article 11(i)[237]:

> *The parties reaffirm and recognize that:*
>
> *(i) Investors and their investments shall comply with all laws, regulations, administrative guidelines and policies of a Party concerning the establishment, acquisition, management, operation and disposition of investments.*
> *[…]*

By the same token, the legality requirement may be provided directly within the definition of "investment." Basically, protected investments would be only those that are *made and developed* in accordance with domestic Host State law. See, for example, India Model BIT (2015), Article 1(4):

> *"Investment" means an enterprise constituted, organised and operated in good faith by an investor* ***in accordance with the law of the Party in whose territory the investment is made*** *[…].*

CORRUPTION AS GROUND FOR VALID EXERCISE OF THE DOB CLAUSE

Investor corruption may be considered a ground for the exercise of the Host State right to deny protection under the treaty. In this regard, refer to the Colombia Model BIT (2017) where the DoB clause explicitly provides that:

> *A Contractig nParty* ***may deny the benefits*** *of this Agreement to: [..]*
>
> *d. an investor of the other Contracting Party, in case that an international court or a judicial or administrative authority of any State with which the Contracting Parties have diplomatic relations has proven that such investor has directly or indirectly: [..]*
>
> *v.* ***committed acts of corruption against the laws of the Host Party****.*

INTERNATIONALLY RECOGNIZED STANDARDS AND CSR ON ANTI-CORRUPTION

It is equally possible to include provisions that encourage investors compliance with universally recognized standards on anti-corruption such as the UN Convention against

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[236] UNCTAD, *Investment Policy Framework and Sustainable Development* (2015) 110.
[237] For a more detailed analysis on the legality requirement included within and *ad hoc* provision, see the part of this handbook regarding Admission.

Corruption[238] or the OECD Anti – Bribery Convention.[239] Contracting States can be required to take the necessary measures to ensure investor compliance with internationally recognized standards. Likewise, the treaty can impose obligations directly on investors. See, as a way of illustration, the text of the Botswana Draft Model BIT:[240]

> *Investors of one Contracting Party in the Territory of the other Contracting Party shall abide by its national laws and act in accordance with internationally accepted standards applicable to foreign investors.*

Provisions that encourage investors to comply with voluntary CSR standards on anti-corruption may also be included.[241] See, for example, the wording of the Canada – Colombia FTA (2008), Article 816:

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

CORRUPTION AS GROUND FOR COUNTERCLAIMS

The deterrent function of substantive anti-corruption obligations may be reinforced by the possibility of counterclaims. Indeed, in the circumstances of a dispute brought by the investor, the defendant Host State may raise counterclaims regarding violations of the former under the treaty. The possibility of counterclaims can be provided directly in investment agreements. In addition, Article 46 of the ICSID Convention has established three conditions that have to be met for the Host State to be allowed to bring a counterclaim in investment arbitration under ICSID rules. First, the "incidental or additional claims or counterclaims" must arise "directly out of the subject-matter of the dispute". Secondly, those claims must be "within the scope of the consent of the parties" or "otherwise within the jurisdiction of the Centre." Host States in practice face obstacles to have their counterclaims accepted. [242]

[238] UN Convention against Corruption, UNGA 58/4, 31 October 2003.
[239] OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions entered into force on 15 February 1999.
[240] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 181-182.
[241] ibid.
[242] For a more detailed analysis on the legality requirement included within and *ad hoc* provision, see the part of this handbook regarding Investor-State Dispute Settlement.

HOW CAN THE HOST STATE ACTUALLY PROVE A BREACH OF THE ANTI-CORRUPTION OBLIGATIONS BY THE INVESTOR?

In recent years, corruption allegations have increasingly been raised in international arbitration.[243] Investment tribunals have frequently allowed Host States to invoke a corruption defense against the investor's claim.

> *Unlike in the domestic context, the rules and instruments relevant to the arbitration are typically silent on how arbitrators should address corruption allegations. Arbitral tribunals faced with such allegations must thus determine several issues that may significantly affect the outcome of the arbitration. We address four key issues that arbitrators may face: (i) where corruption fits in the context of an arbitral proceeding, (ii) the applicable standard of proof, (iii) whether domestic court findings on corruption are relevant to the proceedings, and (iv) the legal consequences that may result from corruption allegations.*[244]

In ISDS, "tribunals appear more likely to treat corruption as an issue of jurisdiction when the alleged corruption is said to have induced the investment and when the treaty expressly specifies that investments must be made legally, and to treat such allegations as an issue of admissibility or merits when the alleged corruption arises later during performance."[245]

In addition, in *World Duty Free v Kenya*,[246] the tribunal held that investments obtained through corruption do not allow the investor to access dispute settlement mechanisms.[247] Arbitrators declined jurisdiction by asserting that the legality requirement does not necessarily need to be express, but can also be implicit because the prohibition of corruption is part of international public policy.[248]

The main issue is related to the fact that tribunals have to determine the applicable standard of proof and arbitral rules are typically silent on this matter.[249] The objective of tribunals consists of striking an appropriate balance between promoting anti-corruption and fairness to the parties with regard to proof evaluation. In *EDF v Romania*, the tribunal highlighted that "in any case, however, corruption must be proven and is notoriously difficult to prove since, typically, there is little or no physical evidence."[250]

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[243] Mark W Friedman, Floriane Lavaud and Julianne J Marley, 'Corruption in International Arbitration: Challenges and Consequences' (2017) Global Arbitration Review.
[244] ibid.
[245] ibid.
[246] *World Duty Free Company v Republic of Kenya*, ICSID Case No Arb/00/7, Award (5 September 2006) para 179. The tribunal held that "the Claimant is not legally entitled to maintain any of its pleaded claims in these proceedings on the ground of *ex turpi causa non oritur action*" (from a dishonorable cause an action does not arise).
[247] Law Commission of India, Analysis of the 2015 Draft Model Indian Bilateral Investment Treaty, Report No 260 (2015).
[248] Mark W Friedman, Floriane Lavaud and Julianne J Marley, 'Corruption in International Arbitration: Challenges and Consequences' (2017) Global Arbitration Review.
[249] ibid.
[250] *EDF (Servs) Ltd v Romania*, ICSID Case No ARB/05/13, Award (8 October 2009) para 221.

For the time being, tribunals have applied different standards of proof, requiring to meet a different threshold.

- Some tribunals have applied a "*clear and convincing evidence*" standard when assessing corruption. This is a *heightened evidentiary standard;*[251]
- Other tribunals have rejected the idea of a higher standard of proof. For example, in *Metal-Tech*, the tribunal concluded that it would "determine on the basis of the evidence before it whether corruption has been established with *reasonable certainty"* and it admitted *circumstantial evidence*.[252]

In addition, when the corruption allegations are also the subject of domestic criminal proceedings, the tribunal may also decide whether to take into account domestic courts' findings.[253]

The problem is that in most of the cases involving corruption allegation, the facts at issue were largely undisputed or the evidence submitted was clearly insufficient. As a result, it may be difficult to suggest a State how to successfully bring corruption allegations before ISDS because there is no clear indication of how tribunals deal with the issue. This is a case-by-case analysis that requires tribunals to focus on factual allegations raised by the disputing parties.

Two are the options available:

- If the investor has already raised a claim, the responding State might consider raising corruption as a defense in order to either challenge the jurisdiction of the tribunal or at the merits stage;
- Corruption allegations can also form a basis for counterclaim, when the principal proceedings have already been initiated by the investor against the Host State.

In both scenarios, the State will necessarily need to bring before the tribunal as much factual evidence as possible and to argue that the latter is clear and convincing (to satisfy the highest threshold that may be required by the adjudicators), or at least it provides a reasonable level of certainty. Likely, rumors or innuendo will not be considered enough.[254]

[251] ibid. See also *Fraport AG Frankfurt Airport Servs. Worldwide v Republic of the Philippines*, ICSID Case No ARB/11/12, Final Award (10 December 2014) para 479; *EDF (Servs.) Ltd v Romania*, ICSID Case No ARB/05/13, Award (8 October 2009) para 221.
[252] *Metal-Tech Ltd v Republic of Uzbekistan*, ICSID Case No ARB/10/3, Award (4 October 2013) para 243.
[253] Mark W Friedman, Floriane Lavaud and Julianne J Marley, 'Corruption in International Arbitration: Challenges and Consequences' (2017) Global Arbitration Review.
[254] *Himpurna California Energy Ltd (Bermuda) v PT (Persero) Perusahaan Listrik Negara (Indonesia)*, UNCITRAL, Final Award (4 May 1999) paras 219–220.

EXPROPRIATION AND COMPENSATION

The Expropriation clause in investment agreements regulates the conditions and consequences of the exercise of the customary State's right to expropriate. Indeed, expropriation remains the most severe form of interference of the investors' assets.[255] The three key issues concerning expropriation remain what does constitute expropriation, under what conditions it can be considered lawful and what are the related legal consequences.[256]

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• "Investments" as rights protected against expropriation. • Conditions for lawful expropriation. • Mitigating factors for the determination of due amount of compensation: a recent trend. • Moral damages and goodwill. • Date of valuation. • Interest rate. • Possibility of staged payment. • Indirect expropriation.	
RELEVANT AUTHORITIES	
"Investments" as rights protected against expropriation	• Colombia Model BIT (2017), Expropriation • India Model BIT (2015), Article 5(1) • Brazil CFIA (2015), Article 7(1) • SADC Model BIT Template (2012), Article 6(1)
Conditions for lawful expropriation	• APEC and UNCTAD Handbook (2012) • India Model BIT (2015), Article 5(1) • Brazil CFIA (2015), Article 7 • SADC Model BIT Template (2012), Article 6
Mitigating factors for the determination of due amount of compensation: a recent trend	• APEC and UNCTAD Handbook (2012)

[255] Rudolf Dolzer and Christoph Schreuer, Principles of International investment Law (Oxford University Press 2012) 99.
[256] ibid.

	• Colombia Model BIT (2017), Compensation arising from an Expropriation • Draft Pan-African Investment Code (2016), Article 12 • India Model BIT (Draft, 2015), Article 5 (7) • SADC Model BIT Template (2012), Article 6 • SADC Commentary *ad* Article 6
Moral damages and goodwill	• Draft Pan-African Investment Code (2016), Article 12 • India Model BIT (Draft, 2015) Explanation I ad article 5 • *Oxus v Uzbekistan*[257] • *Tecmed v Mexico*[258]
Date of valuation	• Netherlands Model BIT (Draft, 2018), Article 12(5) • Draft Pan-African Investment Code (2016), Article 12 • India Model BIT (2015), Article 5.1 • Brazil CFIA (2015), Article 7(3) • India Model BIT (Draft, 2015), Explanation II ad Article • *Yukos v Russia*[259] • *Teinver v Argentina*[260]
Interest rate	• Colombia Model BIT (2017), Compensation arising from expropriation • Draft Pan-African Investment Code (2016), Article 12 • India Model BIT (Draft, 2015), Article 5 (8) • SADC Model BIT Template (2012), Article 6(3) • *Santa Elena v Costa Rica*[261]

[257] *Oxus Gold plc v Republic of Uzbekistan*, UNCITRAL, Final Award (17 December 2015) paras 895-901.
[258] *Técnicas Medioambientales Tecmed, SA v United Mexican States*, ICSID Case No ARB (AF)/00/2, Award (29 May 2003) para 198.
[259] *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No AA 227, Final Award (18 July 2014) para 1763.
[260] *Teinver SA, Transportes de Cercanías SA and Autobuses Urbanos del Sur SA v The Argentine Republic*, ICSID Case No ARB/09/1, Final Award (21 July 2017) para 1035.
[261] *Compañia del Desarrollo de Santa Elena SA v Republic of Costa Rica*, ICSID Case No ARB/96/1, Award (17 February 2000) para 103.

	• *ADM v Mexico*[262] • *Gemplus v Mexico*[263] • *Hulley Enterprises v Russia, Yukos v Russia, Veteran Petroleum v Russia*[264]
Possibility of staged payment	• SADC Model BIT Template (2012), Article 6(4) • SADC Commentary *ad* Article 6
Indirect expropriation	• USMCA (2018), Article 14.8, ANNEX 14-B and ANNEX 14-D (Article 3.1.(a)(i)(B)) • Brazil – Suriname BIT (2018), Article 7(5)[265] • Brazil – Ethiopia (2018), Article 7(5)[266] • Brazil CFIA (2015), Article 7(5)
PRACTICES TO BE AVOIDED	
• Absence of criteria for calculating compensation and interests. • Omitting the clarification on the date of valuation. • Omitting a specific reference to indirect expropriation.	

DETAILED ANALYSIS

"INVESTMENTS" AS RIGHTS PROTECTED AGAINST EXPROPRIATION

In IIAs, investments that satisfy the requirements provided in the definition of "investments" are protected investments under the treaty and, as a result, receive protection against expropriation. When the expropriation provisions refers to "investments", protection is not strictly limited to property rights, as originally

[262] *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v The United Mexican States*, ICSID Case No ARB (AF)/04/5, Final Award (21 November 2007) paras 296-297.
[263] *Gemplus, SA, SLP, SA and Gemplus Industrial, SA de CV v United Mexican States*, ICSID Case No ARB(AF)/04/3 & ARB(AF)/04/4, Award (16 June 2010) para 26.
[264] *Hulley Enterprises Limited (Cyprus) v Russian Federation*, PCA Case No AA 226, Final Award (18 July 2014) para. 1698; *Yukos Universal Limited (Isle of Man) v Russian Federation*, PCA Case No AA 227, Final Award (18 July 2014) para 1698; *Veteran Petroleum Limited (Cyprus) v Russian Federation*, PCA Case No AA 228, Final Award (18 July 2014) para 1698.
[265] Not yet entered into force.
[266] Not yet entered into force.

understood.[267] Because the broad reference to the term "investment" has in practice progressively broadened the discretionary power of interpretation of investment tribunals, some more recent investment treaties provide further details on what can receive protection under the expropriation provision of the treaty. This is a way to restrict the outreach of expropriation as a traditional standard of protection under IIAs. By way of illustration, see:

- CPTPP (2018)
    - Article 9 (8): Expropriation and Compensation

No Party shall expropriate or nationalise a covered investment [..].

    - Annex 9-B (1)

*An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with **a tangible or intangible property right or property interest in an investment**.*

- Colombia – Korea FTA (2013)
    - Article 8.7: Expropriation and Compensation

Neither Party may expropriate or nationalize a covered investment [..].

    - Annex 8-B (1)

*An action or a series of actions by a Party cannot constitute an expropriation unless it interferes with a **tangible or intangible property right in an investment**.*

CONDITIONS FOR LAWFUL EXPROPRIATION

Today, the most part of IIAs contain certain similar conditions to be met for the lawful exercise of Host State's right to expropriate.[268] First, the expropriation measures shall be adopted for purposes of public utility or social and national interests and in accordance with the principle of due process. Moreover, the investor shall receive adequate compensation. Public purpose, due process, adequate compensation and the reference to fair market value are the traditional requirements for lawful expropriation.[269]

[267] Rudolf Dolzer and Christoph Schreuer, *Principles of International investment Law* (Oxford University Press 2012) 99.
[268] ibid.
[269] ibid, 99 – 100.

In addition, to be considered lawful, expropriation measures shall be adopted in accordance with domestic regulations of the Host State. For treaty practice, see, for instance:

- Oman – Switzerland BIT (2009), Article 6: Dispossession

> *Neither of the Contracting Parties shall take measures of expropriation, nationalisation or any other measures, the effects of which would be tantamount to expropriation or nationalisation, against investments of investors of the other Contracting Party, unless the measures are taken in the public interest, against prompt and adequate compensation and on condition that such measures are taken on a non-discriminatory basis and* ***in accordance with domestic laws of general application.***

- Egypt – Russia BIT (1997), Article Six: Expropriation

> *The capital investments of the investors of one Contracting Party, carried out on the territory of the other Contracting Party, shall not be subject to expropriation, nationalization or to measures, equivalent to expropriation or nationalization (hereinafter in the text referred to as expropriation), with the exception of cases, when such measures are launched in the interest of society* ***in conformity with the procedure, laid down by legislation****, when they are not of a discriminative nature and when they entail the payment of a prompt, adequate and effective compensation.*

Notwithstanding, UNCTAD has lighted that including this condition may raise some practical difficulties. Indeed, "the approach could be problematic (i) if domestic law is incompatible with international due-process standards and (ii) if a violation of domestic law is irrelevant from the viewpoint of international law. International tribunals may be unfit to assess formalities of domestic law beyond the fundamental due process requirements."[270] The requirement of conformity of Host State's laws is *not* an essential element of IIAs.

LIST OF MITIGATING FACTORS FOR THE DETERMINATION OF THE FAIR MARKET VALUE

Some very recent Model BITs provide a non-exhaustive list of *mitigating factors* for the determination of the amount of compensation. The purpose of this indicative list is, in theory, to achieve an equitable balance between public interest and investors' interests and, ultimately, to clarify that the appropriate evaluation shall be case specific.[271] On this issue, IISD Best Practices highlighted:

> *It is possible to envisage compensation that would not cover the entire market value of the investment [..]. Indeed, the assessment of compensation could* ***take into account other financial and non-financial factors in order to achieve a result that strikes a balance between the interests of investors***

[270] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 61.
[271] ibid 62.

> ***and those of the host State.*** *In certain situations, compensation equal to the fair market value of the investment may be inappropriate or unjust. A* ***balancing*** *of factors therefore becomes necessary. In this option,* ***fair market value is only one factor to be considered among others.***[272]

See, by way of illustration, some relevant treaty practice in this light:

- Colombia Model BIT (2017), Compensation arising from an Expropriation

> *Compensations referred to in paragraph 1 of Article [##]-Expropriation, or those resulting from the determination of existence of an indirect expropriation (hereinafter, "Compensations for Expropriations"), shall be determined on the assessment of an equitable balance between the public interest and the interest of the affected Covered Investor, having regard for all relevant circumstances, and taking into account the current and past use of property, depreciation, the history of its acquisition, the fair market value of the Covered Investment, the purpose of the expropriation, the extent of previous profit made by the Covered Investor through the Covered Investment, and the duration of the Covered Investment.*

- Pan-African Investment Code (draft, 2016), Article 12

> *Where appropriate, the assessment of adequate compensation shall be based on an equitable* ***balance between the public interest and interest of the investor affected, having regard to all relevant circumstances*** *and taking into account the current and past use of the property, the history of its acquisition, the extent of previous profit made by the foreign investor through the investment, and the duration of the investment.*

See for further examples: India Model BIT (Draft, 2015), Article 5 and SADC Model BIT Template (2012), Article 6 (Option 2). It is also worth noting what IISD Best Practices says about the SADC Model BIT Template (2012):

> *The SADC Model BIT introduces a major innovation by requiring "fair and adequate" compensation. In doing so, the SADC Model BIT clarifies that this means taking into account all relevant circumstances when calculating compensation. This rule therefore obliges arbitrators to go beyond fair market value and purely financial factors in general.*

It is worth highlighting here that some Model BITs explicitly include damages to the environment and local communities caused by the investor as one of the factors than can mitigate the due compensation. This may be considered a valuable way to indirectly strengthen investor obligations toward responsible business conduct. This mitigating factor is, for instance, provided by the India Model BIT (Draft, 2015), Article 5. Instead, it not expressly included within the list of factors of the SADC Model BIT Template (2012), Article 6 (Option 2).

[272] Suzy H Nikièma, 'Compensation for Expropriation' (2013) IISD Best Practice Series, 10.

However, it is necessary to underline that these lists are by very nature indicative, therefore non-exhaustive. As a result, tribunals can take into account damages to the environment or local communities even where not explicitly mentioned in the text of the agreement.

Moreover, it is worth mentioning here that breaches of investor obligations can already be considered as grounds for offsetting the amount of compensation for expropriation do the investor.

As a result of the presence of a list of mitigating factors, tribunals retain the discretion to consider balancing other factors with the fair market value for the determination of compensation. However, this clause may create some practical concerns. Indeed, there is no guidance on how tribunals should in practice balance an economic concept (such as fair market value) with factors of various nature and reach. These recent Model BITs do not provide tribunals with clear guidelines on how to proceed in case of an expropriation claim. As a result of this exercise of balancing, the nature of fair market value would be completely transformed.

If negotiating parties intend to push toward investors' accountability for responsible business conduct, they might consider including such a list in their IIAs. However, the States may also consider providing further guidance on how tribunals should proceed in case of disputes.

EXCLUSION OF MORAL DAMAGES AND GOODWILL

Case law on matter of moral damages is variable. It seems that there is a trend in excluding moral damages, though tribunals have often recognized that they may be awarded. Tribunals seem to be willing to award moral damages only in exceptional circumstances where the investor suffers substantive prejudice.

See some illustrative case law on this issue:

- *Oxus v Uzbekistan*:[273]

> ***Moral damages have been considered admissible under international law and it is recognized that legal persons may be awarded moral damages, including for loss of reputation, but the bar for recovery of such damages has been set high and they have been awarded only in exceptional circumstances****; Claimant itself acknowledged as much in quoting approvingly the Desert Line Projects Projects v Ukraine award which stated: "(e)ven if investment treaties primarily aim at protecting property and economic values, they do not exclude, as such, that a party may, in exceptional circumstances, ask for compensation for moral damages". Desert Lines Projects is one of the rare cases in which such damages were awarded; the tribunal in that case noted that "the physical duress exerted on the executives of the Claimant, was malicious and is therefore constitutive of a fault-based liability".*

[273] *Oxus Gold plc v Republic of Uzbekistan*, UNCITRAL, Final Award (17 December 2015) paras 895-901.

[..] In the Lemire case also quoted approvingly by Claimant, the tribunal held as follows: "The conclusion which can be drawn from the above cases is that, as a general rule, moral damages are not available to a party injured by the wrongful acts of a State, but that ***moral damages can be awarded in exceptional cases****, provided that*
(i) the State's actions imply physical threat, illegal detention or other analogous situations in which the ill-treatment contravenes the norms according to which civilized nations are expected to act;
(ii) the State's actions cause a deterioration of health, stress, anxiety, other mental suffering such as humiliation, shame and degradation, or loss or reputation, credit and social position; and
(iii) both cause and effect are grave and substantial*."*
Similarly, in Waguib Elie George Siag & Clorinda Vecchi v Arab Republic of Egypt, the Tribunal declared that "the recovery of punitive or moral damages is reserved for ***extreme cases of egregious behavior****". [..]*
Upon careful review of the facts, the Arbitral Tribunal has come to the conclusion that Claimant is not entitled to such damages in the present case.

- *Tecmed v Mexico*:[274]

The Arbitral Tribunal finds ***no reason to award compensation for moral damage****, as requested by the Claimant,* ***due to the absence of evidence*** *proving that the actions attributable to the Respondent that the Arbitral Tribunal has found to be in violation of the Agreement have also affected the Claimant's reputation and therefore caused the loss of business opportunities for the Claimant [..].*

Hereafter, treaty practice on the express exclusion of moral damages and goodwill:

- Draft Pan-African Investment Code (2016), Article 12

The computation of the fair market value of the property shall exclude any consequential or exemplary losses or speculative or windfall profits claimed by the investor, ***including those relating to moral damages or loss of goodwill****.*

- India Model BIT (Draft, 2015), Explanation I *ad* Article 5

The computation of the fair market value of the property shall exclude any consequential or exemplary losses or speculative or windfall profits claimed by the Investor, ***including those relating to moral damages or loss of goodwill****.*

This explanation is not included within the Final version of the India Model BIT (2015). This elimination may be an indicative factor of the difficulties that negotiators may face with potential treaty counterparties.

[274] *Técnicas Medioambientales Tecmed, SA v United Mexican States*, ICSID Case No ARB (AF)/00/2, Award (29 May 2003) para 198.

DATE OF VALUATION

A further essential element of the expropriation provision is the date that serves as the basis for the calculation of the market value. IISD Best Practices[275] stresses the two fundamental reasons why the date of valuation is of paramount importance: "on the one hand, the value of the investment can vary over time, especially when the tribunal takes market value and market fluctuation into account. On the other hand, the amount of interest can vary substantially depending on the selected reference date."[276] As a result, investors have a practical interest in the date of valuation for determining the amount of compensation. Indeed, the investment may increase or decrease its value between the day immediately prior to the date of expropriation and the date of the award of the arbitral proceedings. If the value of the investment increases after the expropriation, the investor has an interest in requesting the tribunal to assess the compensation at the date of the final award.

Regarding lawful expropriation, the case law shows that the evaluation is with no doubts based on the day immediately prior to expropriation. Differently, with regard to *unlawful* expropriation, case law is rather inconsistent. Under certain circumstances related to the specific case at issue, tribunals have accepted to move to the date of the final award as the date of valuation when the latter is more favourable to the investor.

With regard to case law on this issue, see the final Award of *Yukos v Russia*:[277]

> *The Tribunal also holds that, in the case of an unlawful expropriation, as in the present case, Claimants are entitled to select either the date of expropriation or the date of the award as the date of valuation.*

In opposition, in *Teinver v Argentina*,[278] although this was also a case of unlawful expropriation, the tribunal held that:

> *The relevant time period for determining whether the compensation paid for the expropriation of an investment is adequate is* ***immediately before the taking or immediately before the taking became known.***

Usually, in treaty practice, the date of evaluation is the day immediately prior to the expropriation. See, for example:

- Netherlands Model BIT (Draft, 2018), Article 12(5)

  > *The compensation referred to in paragraph 1 of this Article shall amount to the fair market value of the investment* ***at the time immediately before***

[275] Suzy H Nikièma, 'Compensation for Expropriation' (2013) IISD Best Practice Series, 11.
[276] ibid.
[277] *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No AA 227, Final Award (18 July 2014), para 1763.
[278] *Teinver SA, Transportes de Cercanías SA and Autobuses Urbanos del Sur SA v The Argentine Republic*, ICSID Case No. ARB/09/1, Final Award (21 July 2017) para 1305.

> ***the expropriation*** *or the impending expropriation became known, whichever is earlier.*

For further examples see: Colombia Model BIT (2017), Compensation arising from an Expropriation; Draft Pan-African Investment Code (2016), Article 12; Brazil CFIA (2015), Article 7(3); India Model BIT (2015), Article 5.1

However, for the purpose of increasing the consistency and predictability in the system, this wording may not be enough. Indeed, investment agreements only contain substantive rules and do not deal with issues of determining breaches and liability.[279] Therefore, it is still possible to argue that this clause only applies with regard to lawful expropriation and consequences of unlawful expropriation are not regulated by IIAs. As a result, tribunals will maintain their margin of appreciation and would likely move the date of valuation to the date of final award in case of unlawful expropriation, if the latter is more favourable to the investor.

If the negotiating parties intend to prevent investment tribunals from moving the valuation date, both in circumstances of lawful and unlawful expropriation, they might consider adopting a more powerful phrasing similar to that employed in the India Model BIT (Draft, 2015), Explanation II *ad* article 5.1, that says:

> *The valuation date for computation of compensation shall be the day immediately before the expropriation takes place. In* ***no event the valuation date shall be moved to any future date****.*

It is worth noting here that this explanation is not included within the Final version of the India Model BIT and this may be sign of potential objections that counterparties may raise during negotiations.

Although the prohibition of moving the valuation date to the date of final award may in practice have a negative impact on investors, this specification can help to increase the predictability and consistency of the system. As a result, if negotiating parties intend to restrict the power of discretion of tribunals and fix one for all the date of valuation as to the day prior to expropriation, it might consider adopting this alternative wording as a really viable option.

INTEREST RATE

Turning to the matter of interests, these can be either simple or compound. Case law on this issue is variable.

[279] This is the traditional distinction between primary and secondary rules in international law. Primary rules are those that define what is allowed or prohibited. Secondary rules determine the criteria for responsibility and consequences of breaches.

In a first phase, investment tribunals used to hold that there was no uniform rule. The final determination of interest used to be determined on a case-by-case basis, by taking into account all the specific circumstances of the dispute. See for example:

- *Santa Elena v Costa Rica:* [280]

> *In other words, while simple interest tends to be awarded more frequently than compound, compound interest certainly is not unknown or excluded in international law.* ***No uniform rule of law has emerged*** *from the practice in international arbitration as regards the determination of whether compound or simple interest is appropriate in any given case. Rather,* ***the determination of interest is a product of the exercise of judgment, taking into account all of the circumstances of the case at hand and especially considerations of fairness which must form part of the law to be applied by this Tribunal****.*

- *ADM v Mexico:* [281]

> *[..] Tribunal believes that only simple interest, rather than compound, should be awarded. In Compañía del Desarrollo de Santa Elena, SA v the Republic of Costa Rica the Tribunal analyzed the international arbitration case law in relation to the question whether compound interest should be awarded. [..] In Santa Elena, the Tribunal referred to the jurisprudence of the Iran-U.S. Claims Tribunal as a persuasive reference regarding the standard for the assessment of interest. This Tribunal agrees. [..] The purpose of this interest is to ensure that the compensation awarded is appropriate in all circumstances.*

Subsequently, a form of *jurisprudence constante* has emerged for the awarding of compound interests. See, for instance:

- *Gemplus v Mexico:*[282]

> *The Parties have expressed diverging views on whether this is an appropriate case for the application of compound, as opposed to simple, interest. As noted above, the BITs contain no express provision on compound interest. [..] In addition, it is clear from the legal materials cited by the Claimants [..] that the* ***current practice of international tribunals (including ICSID) is to award compound and not simple interest.*** *In the Tribunal's opinion, there is now a form of "jurisprudence constante" where the presumption has shifted from the position a decade or so ago with the result it would now be more appropriate to order compound interest, unless shown to be inappropriate in favour of simple interest, rather than vice-versa. [..]*

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[280] *Compañia del Desarrollo de Santa Elena SA v Republic of Costa Ric*a, ICSID Case No ARB/96/1, Award (17 February 2000) para 103.
[281] *Archer Daniels Midland Company and Tate & Lyle Ingredients Americas, Inc v The United Mexican States*, ICSID Case No. ARB (AF)/04/5, Final Award (21 November 2007) paras 296-297.
[282] *Gemplus SA, SLP, SA and Gemplus Industri*al, *SA de CV v United Mexican States*, ICSID Case No ARB(AF)/04/3 & ARB(AF)/04/4, Award (16 June 2010) para 26.

However, it is worth noting that tribunals have at times decided to diverge from the *jurisprudence constante* to respond to the specific circumstances of the cases. By way of illustration, see:

- *Hulley Enterprises v Russia*,[283] *Yukos v Russia*,[284] *Veteran Petroleum v Russia*: [285]

> *As to whether the interest awarded should be simple or compound, while the Tribunal recognizes that the awarding of compound interest under international law now represents a form of "jurisprudence constante" in investor-state expropriation cases, the Tribunal has concluded that,* ***in the circumstances of this case, it would be just and reasonable to award Claimants simple pre-award interest*** *and post-award interest compounded annually if Respondent fails to pay in full to Claimants the damages for which it has been held liable before the expiry of the grace period hereinafter granted.*

Some IIAs expressly provide that interests can *only* be simple. By way of example, see: Colombia Model BIT (2017), Compensation arising from Expropriation; Draft Pan-African Investment Code (2016), Article 12; India Model BIT (Draft, 2015), Article 5(8); India Model BIT (2015), Article 5(2); SADC Model BIT Template (2012), Article 6(3).

From a review of diverging case law and treaty practice, it has emerged clearly that for the purpose of ensuring consistency and predictability, it is of paramount importance to clarify whether interest is simple or compound in the text of the treaty.

With regard to rate of interest, the SADC Commentary *ad* Article 6 says that:

> *The calculation of interest can be a difficult issue. Two alternatives are presented. One is the Host State commercial interest rate. The second is a neutral alternative using the London inter-bank rate known as LIBOR. This reduces the potential volatility factor as well for interest rates in some States.*

Some investment agreements provide for the LIBOR rate. For instance, the India Model BIT (Draft, 2015), Article 5(8) and SADC Model BIT Template (2012), Article 6(3). LIBOR seems to be a common interest rate.

Nonetheless, alternative interest rates exist. One of them, which is also quite usual in IIAs, is the commercial rate. It is, for instance, established by: Netherlands Model BIT (Draft, 2018), Article 12(6); Colombia Model BIT (2017), Compensation arising from

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[283] *Hulley Enterprises Limited (Cyprus) v Russian Federation*, PCA Case No AA 226, Final Award (18 July 2014) para 1698.
[284] *Yukos Universal Limited (Isle of Man) v Russian Federation*, PCA Case No AA 227, Final Award (18 July 2014) para 1698.
[285] *Veteran Petroleum Limited (Cyprus) v Russian Federation*, PCA Case No AA 228, Final Award (18 July 2014) para 1698.

Expropriation; Pan African Investment Code (2016), Article 12; India Model BIT (2015), Article 5(2); SADC Model BIT Template (2012), Article 6(3) (in alternative to the LIBOR rate).

Alternatively, some IIAs provide for *general guidance* on the applicable interest rate. This alternative approach aims to ensure:

> *Full compensation by compensating investor for the loss of use of money between the date of the taking and the date of payment of compensation. General guidance on interest rate leaves the ultimate choice of the specific rate to be applied in a concrete case to the compensating State or, if compensation is determined by the arbitral tribunal, to arbitrators.*[286]

POSSIBILITY OF STAGED PAYMENT

Some recent IIAs provide that the payment of compensation can be fragmented within a period of three years or another period agreed between the investor and the State receiving the investment, with the interest rate agreed by the Contracting Parties. In this regard, see the SADC Commentary *ad* Article 6:

> *The language on a reasonable time period is meant to leave some flexibility but also respond to realities on the ground, that determining compensation may take some time, including for a negotiated agreement.*

Indeed, IISD Best Practices[287] highlighted that the traditional obligation to pay compensation immediately or without delay may be particularly burdensome in some circumstances, especially for less developed countries that have constrained financial resources. As a result, some recent investment treaties try to address this problem by expressly including the possibility of staged payment. By way of illustration, see the SADC Model BIT Template (2012), Article 6(4):

> *Awards that are significantly burdensome on a Host State may be paid yearly over a three-year period or such other period as agreed by the parties to the arbitration, subject to interest at the rate established by agreement of the parties to the arbitration or by a tribunal failing such agreement.*

As a result, and following the recommendations of IISD Best Practices, it is advisable to include within new generation IIAs the possibility of staged payment in order to preserve a reasonable level of flexibility in accordance with the specific circumstances.

[286] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 64.
[287] Suzy H Nikièma, 'Compensation for Expropriation' (2013) IISD Best Practices Series, 7.

INDIRECT EXPROPRIATION

Today, indirect expropriation has become increasingly frequent, whereas direct expropriation is more rare.[288] "An indirect expropriation leaves the investor's title untouched but deprives him of the possibility of utilizing the investment in a meaningful way".[289]

A very recent practice consists of explicitly excluding measures that tantamount to indirect expropriation from protection under the investment agreement.

The exclusion of indirect expropriation is a way to address one of the main challenges of the current international investment regime that is the preservation of the Host State's right to regulate in the public interest.[290]Indeed, investors have exploited traditional protection against indirect expropriation to challenge regulatory measures that have negative effects on their investments.[291]As a result, States have raised concerns about the limits that IIAs imposed on the regulatory space of national governments.[292] In this light, the express exclusion of indirect expropriation is considered consistent with the purpose of preserving Host States' regulatory powers. UNCTAD[293] has highlighted that:

> *Refraining from including certain types of clauses that have proven controversial or that are susceptible to receiving contradictory interpretations by arbitral tribunals can increase legal certainty help safeguard the right to regulate and improve investment dispute settlement.*[294]

From the review of treaty practice, it has emerged that indirect expropriation is excluded in:

- Brazil CFIA (2015), Article 7(5)

> *For greater certainty, this article only provides for direct expropriation, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or ownership rights.*

In addition, indirect expropriation is excluded by two BITs signed by Brazil in 2018 but that have not yet entered into force:

- Brazil – Suriname BIT (2018), Article 7(5) and Brazil – Ethiopia BIT (2018), Article 7(5). The provision reads the same:

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[288] Rudolf Dolzer and Christoph Schreuer, Principles of International investment Law (Oxford University Press 2012) 101.
[289] ibid.
[290] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 25-26.
[291] ibid 33.
[292] ibid 16.
[293] ibid 25-26.
[294] ibid 25-26.

> ***For greater certainty, this Article only provides for direct expropriation****, where an investment is nationalized or otherwise directly expropriated through formal transfer of title or ownership rights,* ***and does not cover indirect expropriation****.*

However, expressly excluding indirect expropriation is the narrowest approach that IIAs may adopt. [295] Expressly eliminating indirect expropriation as one of the fundamental standards of protection may be considered as a relevant reduction of the protective value of investment treaties.[296] In addition:

> *Such protection is particularly desirable in governance-weak economies where protection from measures of this nature under the domestic laws of the relevant host State may not be seen as reliable. In the absence of IIA protection for indirect expropriation, investors may seek investment insurance from private or public providers.*[297]

In light of UNCTAD's recommendations, negotiating States should take into account that expressly excluding indirect expropriation may be problematic, especially when one of the parties is particularly interested in ensuring a high level of protection of investors.

From a different perspective, omissions of indirect expropriation may also be problematic and *de facto* broaden the discretion of investment tribunals. In treaty practice, indirect expropriation is at times merely not mentioned in the expropriation clauses. See for example the Morocco – Serbia BIT (2013), Article 4 and Jordan – Lebanon BIT (2002), Article 4.

With regard to the omission of indirect expropriation, UNCTAD highlighted that "the simple omission of a specific reference to 'indirect' expropriation may not eliminate the possibility of liability for indirect expropriations: a mere reference to 'expropriation' in an IIA may be interpreted as subsuming both direct and indirect expropriation in subsequent arbitral proceedings."[298] As a result, vague omissions on the issue of indirect expropriation should be avoided to prevent uncertainties in the system.

If negotiating counterparties intend to safeguard their right to regulate in the public interest, they might consider viable alternative approaches, not as narrow as completely excluding protection against indirect expropriation.

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[295] Lise Johnson, Lisa Sachs, Jesse Coleman, 'International Investment Agreements ,2014: A Review of Trends and New Approaches' in Andrea K. Bjorklund (ed), *Yearbook on International Investment Law and Policy 2014–2015* (Oxford University Press 2016) 34.
[296] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 27. See also UNCTAD, *Investment Policy Framework and Sustainable Development* (2015).
[297] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017) 34.
[298] ibid 34.

Indeed, it is possible to include both protection against direct and indirect expropriation and at the same time preserving the regulatory space of the Host State. This objective may be achieved by expressly clarifying what does constitute indirect expropriation through *positive lists* and negative *carve outs*. In addition, some investment treaties include provisions in the explanatory annexes that include lists of *interpretative factors* intended to provide tribunals with guidance while assessing indirect expropriation claims.[299] This a valuable way to more clearly define what does constitute indirect expropriation and limit tribunals' discretion. See, by way of example:

- CPTPP (2018)
    - Article 9.8 (Expropriation and Compensation)
    - ANNEX 9-B

> *The second situation addressed by Article 9.8.1 (Expropriation and Compensation) is indirect expropriation, in which an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.*
>
> *(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, requires a case-by-case, fact-based inquiry that considers, among other factors:*
>
> *(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;*
>
> *(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and*
>
> *(ii) the character of the government action.*

- Netherlands Model BIT (Draft, 2018), Article 12

> *3. Indirect expropriation occurs if a measure or a series of measures of a Contracting Party has an effect equivalent to direct expropriation, in that it substantially deprives the investor of the fundamental attributes of property in its investment, including the right to use, enjoy and dispose of its investment, without formal transfer of title or outright seizure.*
> *4. The determination of whether a measure or a series of measures by a Contracting Party, in a specific factual situation, constitutes an indirect expropriation requires a case-by-case, fact-based inquiry that considers, amongst other factors:*
> *a) the economic impact of the measure or series of measures, although the sole fact that a measure or a series of measures of a Contracting Party has an adverse effect on the economic value of an investment does not establish that an indirect expropriation has occurred;*
> *b) the duration of the measure or series of measures by a Contracting Party; and*

[299] Suzy H Nikièma, 'Indirect Expropriation' (2012) IISD Best Practices Series, 7.

c) the character of the measure or series of measures, notably their object and context.

- UAE – Colombia BIT (2018), Article 7(2)[300]

It is understood that
(a) indirect expropriation results from a measure or series of a measures of a Contracting Party having equivalent effect to direct expropriation without formal transfer of title or outright seizure;
(b) the determination of whether a measure or series of measure of a Contracting Party constitute indirect expropriation requires a case-by-case, fact-based inquiry. Such determination will consider
(i) the scope of the measure or series of measure
(ii) the economic impact of the measure or series of measures
(iii) the level of interference on the reasonable and distinguishable expectations concerning the investment
In such a way that the effect of the measures or series of measure have similar effects to the expropriation of in whole or part of the use or reasonable expected economic benefit of the investment.

It is worth noting the very recent approach adopted by USMCA (agreed on 1st October 2018):

- Article 14.8: indirect expropriation is expressly included
- ANNEX 14-B: factors to be taken into account for determination of indirect expropriation:

The second situation addressed by Article 14.8.1 is indirect expropriation, in which an action or series of actions by a Party has an effect equivalent to direct expropriation without formal transfer of title or outright seizure.
(a) The determination of whether an action or series of actions by a Party, in a specific fact situation, constitutes an indirect expropriation, ***requires a case-by-case, fact-based inquiry*** *that considers, among other factors:*
(i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
(ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
(iii) the character of the government action, including its object, context, and intent.
(b) Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances.

- Annex 14-D, Article 3.1.(a)(i)(B): a claimant may submit to arbitration a claim EXCEPT WITH RESPECT TO INDIRECT EXPROPRIATION.
- CARVE-OUT: only claimants with a "covered government contract" in one of the five "covered sectors" (activities with respect to oil and natural gas,

[300] Not yet into force.

> power generation, telecommunications, transportation, infrastructure) may file a claim for indirect expropriation under Article 14.8.[301]

From the combination of the USMCA expropriation clause (Article 14.8) and its interpretative annexes, it emerges clearly that the protection against indirect expropriation must be balanced with the fact that the assessment will be conducted on a case-by-case basis. Arguably, *the facts-specific assessment* will likely decrease the possibility of finding indirect expropriation. In addition, *indirect expropriation is removed from dispute resolution*, except for five specific sectors. "It should be noted that the preservation of investor-State arbitration in these key sectors is likely due to successful lobbying by American industry groups during negotiations."[302]

Negotiating parties might consider adopting one of the alternative approaches aforementioned, as preferable to the complete exclusion of indirect expropriation. It may, indeed, be helpful to achieve more accurate protection against expropriation while limiting tribunals' discretion. The ultimate goal is that of safeguarding the States' regulatory powers while confirming investors' protection against measures that tantamount to indirect expropriation[303].

A further alternative approach consists in expressly including a clause that establishes that regulatory measures adopted in a non-discriminatory manner to pursue public interest do not amount to indirect expropriation but rather constitute legitimate regulatory measures.[304] In this light, see, for instance:

- Netherlands Model BIT (Draft, 2018), Article 12(8)

> *Except in the rare circumstance when the impact of a measure or series of measures is so severe in light of its purpose that it appears manifestly excessive, non-discriminatory measures of a Contracting Party that are designed and applied in good faith to protect legitimate public interests, such as the protection of public health, safety, environment or public morals, social or consumer protection or promotion and protection of cultural diversity, do not constitute indirect expropriations.*

- CPTPP (2018), ANNEX 9-B

> *Non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations, except in rare circumstances.*

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[301] Robert Landicho, Andrea Cohen, 'What's in a Name Change? For Investment Claims Under the New USMCA Instead of NAFTA, (Nearly) Everything' (*Kluwer Arbitration Blog*, 5 October 2018).
[302] ibid.
[303] Suzy H Nikièma, 'Indirect Expropriation' (2012) IISD Best Practices Series, 12.
[304] ibid 7.

For further examples, refer to Colombia Model BIT (2017), Expropriation provision, para 4; India Model BIT (2015), Article 5.5; SADC Model BIT Template (2012), Article 6(7); ASEAN Comprehensive Investment Agreement (2009), Annex 2 para 4; COMESA Investment Agreement (2007), Article 20(8).

This is an innovative type of clause whose concrete effects in interpretation and application remain to be assessed.[305] Nonetheless, it seems a viable way to clarify and reinforce the objective of safeguarding the State's right to regulate. As a result, the negotiating parties intend to ensure their policy space *vis-à-vis* each other and before investment tribunals, they might consider negotiating for the inclusion of a such a clause.

[305] ibid 11.

RESPONSIBILITIES OF THE INVESTOR

In light of UNCTAD's recommendations for the reform of the investment regime, recent IIAs address the issue of investor obligations toward responsible business conduct. Indeed, investments should contribute to the sustainable development of the Host State. This is one of the most compelling challenges of the reform of the investment regime.[306] To that effect, providing investors with detailed obligations may help to strike a balance between rights and duties borne by investors and Contracting States.[307] The step forward consists of ensuring investors accountability by making the provision directly enforceable. Investor obligations can be implemented in several ways both under IIAs and domestic laws.

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Investor responsibilities in the definition of Investment. • Requirement of investor compliance with national legislations of the Host State. • Requirement of investor compliance with relevant international standards. • Voluntary incorporation of CSR standards. • Not-lowering-standards provisions. • Inclusion of provision that aims to ensure that investments contribute to the sustainable development of the Host State. • Enforcement of investor obligations. • Denial of protection under the terms of treaty and preclusion of the possibility to access ISDS. • Counterclaims.	
RELEVANT AUTHORITIES	
Investor responsibilities in the definition of Investment	• Colombia Model BIT (2017), Definitions
Requirement of investor compliance with national legislations of the Host State	• Draft Pan-African Investment Code (2016), Article 22(1) • India Model BIT (2015), Article 11 • India Model BIT (Draft, 2015), Article 8 and 12 • SADC Model BIT Template (2012), Article 11

[306] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2017).
[307] Nathalie Bernasconi - Osterwalder, 'Investor Obligations' International Institute for Sustainable Development available at: http://investmentpolicyhub.unctad.org/Upload/Documents/IDB%20%20BERNASCONI%20Investor%20Obligations.pdf

	• COMESA Investment Agreement (2007), Article 13 • IISD Model (2005), Article 11 • SADC Commentary *ad* Article 11
Requirement of investor compliance with relevant international standards	• Colombia Model BIT (2017), Investors' Social Responsibility, para 2 • Draft Pan-African Investment Code (2016), Article 19 • SADC Model BIT Template (2012), Article 15 • IISD Model (2005), Article 14
Voluntary incorporation of CSR standards	• India Model BIT (2015), Article 12 • Canada-Colombia FTA (2008), Article 816
Not-lowering-standards provisions	• Netherlands Model BIT (Draft, 2018), Article 6(3) • Colombian Model BIT (2017), Non-detraction from environmental, human rights and labour standards • Morocco – Nigeria BIT (2016), Article 15
Inclusion of provision that aims to ensure that investments contribute to the sustainable development of the Host State	• Netherlands Model BIT (Draft, 2018), Article 6(1) • Draft Pan-African Investment Code (2016), Article 22(2)
Enforcement of investor obligations	• Morocco – Nigeria BIT (2016), Article 20 • SADC Model BIT Template (2012), Article 17 and Article 19(3) • IISD Model (2005), Article 18 (F)
Denial of protection under the terms of treaty and preclusion of the possibility to access ISDS	• Colombia Model BIT (2017), Investors' Social Responsibility, para 2
Counterclaims	• COMESA Investment Agreement (2007), Article 28(9)

PRACTICES TO BE AVOIDED
• Absence of investor obligations. • General non-binding provisions. • Absence of sanction mechanisms.

DETAILED ANALYSIS

INVESTOR RESPONSIBILITIES IN THE DEFINITION OF INVESTMENT

The inclusion of a clause that expressly provides for investor responsibilities in an *ad hoc* clause represents a step beyond the simple condition that an investment must be "made and developed in accordance with the national legislation of the State receiving the investment", as usually provided by the definition of "investment."[308] Indeed, this is an innovative approach that aims to strengthen investors' commitment to conduct their business properly and to contribute to the development of the Host State.[309] This type of provision reflects a recent trend in investment treaties that contain a strong "policy message"[310] in order to clarify that not only States but also investors bear obligations.

REQUIREMENT OF INVESTOR COMPLIANCE WITH NATIONAL LEGISLATIONS OF THE HOST STATE

Recent IIAs contain a provision establishing a requirement of investor compliance with applicable *national* legislations of the Host State. See, for example:

- Draft Pan-African Investment Code (2016), Article 22(1)

  Investors shall abide by the laws, regulations, administrative guidelines and policies of the host State.

- India Model BIT (2015), Article 11

  The parties reaffirm and recognize that: (i) Investors and their investments shall comply with all laws, regulations, administrative guidelines and policies of a Party concerning the establishment, acquisition, management, operation and disposition of investments.

- India Model BIT (Draft, 2015), Article 8

[308] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 179.
[309] ibid.
[310] ibid.

> *The objective of this Chapter is to ensure that the conduct, management and operations of Investors and their Investments are consistent with the Law of the Host State, and enhance the contribution of Investments to inclusive growth and sustainable development of the Host State. The Parties agree that this Chapter prescribes the minimum obligations for Investors and their Investments for responsible business conduct.*

For further examples, see: SADC Model BIT Template (2012), Article 11; COMESA Investment Agreement (2007), Article 13; IISD Model (2005), Article 11.

It is worth noting what the SADC Commentary says on the issue of required compliance with applicable national legislations:

> *[...] This seeks only to establish an obvious legal obligation and does not go beyond what would be in the domestic law of the Host State. This is, or should be, a basic expectation of all parties. It also means that an investor cannot plead a provision of this agreement as a legal excuse for not complying with the domestic law, though it may seek damages afterwards if the law is inconsistent with a protection in this agreement.*[311]

On a side note, it is worth noting that it is generally accepted that reparation has to be determined in accordance with international law (secondary rules). Whereas, the scope of national laws is limited to primary rules of investor obligations.

REQUIREMENT OF INVESTOR COMPLIANCE WITH RELEVANT INTERNATIONAL STANDARDS IN THE FIELD OF HUMAN AND ENVIRONMENTAL RIGHTS

Provisions on investor obligations usually require investors to comply with relevant *international* standards, especially in the field of HRs, protection of the environment and labour standards. This type of obligation is frequent in recent treaty practice. By way of illustration, see:

- Colombia Model BIT (2017), Investors' Social Responsibility, para 2

  > *Claimant Investors **shall respect the prohibitions established in international instruments,** to which any Contracting Party is or becomes a party, pertaining to human rights and the environment. [..]*

- Draft Pan-African Investment Code (2016), Article 19

  > *Investments shall meet national and **internationally accepted standards** of corporate governance for the sector involved, in particular for transparency and accounting practices.*

- SADC Model BIT Template (2012), Article 15(3)

[311] SADC Commentary *ad* Article 11.

> ***Investors and their investments shall not [establish,] manage or operate Investments in a manner inconsistent with international environmental, labour, and human rights obligations*** *binding on the Host State or the Home State, whichever obligations are higher.*

- Morocco – Nigeria BIT (2016), Articles 18 and 19.

> Article 18: POST-ESTABLISHMENT OBLIGATIONS
> *Investments shall, in keeping with good practice requirements relating to the size and nature of the investment, maintain an environmental management system. Companies in areas of resource exploitation and high-risk industrial enterprises shall maintain a current certification to ISO 14001 or an equivalent environmental management standard. vestments shall uphold human rights in the host state.*
>
> *Investors and investments shall uphold human rights in the host state.*
>
> *Investors and investments shall act in accordance with core labour standards as required by the ILO Declaration on Fundamental Principles and Rights of Work, 1998.*
>
> *Investors and investments shall not manage or operate the investments in a manner that circumvents international environmental, labour and human rights obligations to which the host state and/or home state are Parties.*
>
> Article 19 CORPORATE GOVERNANCE AND PRACTICES
> *In accordance with the size and nature of an investment,*
> *a) Investments shall meet or exceed national and internationally accepted standards of corporate governance for the sector involved, in particular for transparency and accounting practices.*
> *b) Investments shall establish and maintain, where appropriate, local community liaison processes, in accordance with internationally accepted standards when available.*
> *c) Where relevant internationally accepted standards of the type described in this Article are not available or have been developed without the participation of developing countries, the Joint Committees may establish such standards.*

The purpose of expressly referring to relevant international standards is a viable strategy to strengthen relevant domestic legislations and where necessary fill gaps and weaknesses.[312] In addition, such an obligation clarifies that international obligations are directly binding on investors.[313]

Because treaty practice is increasingly common in the field of investor obligations, negotiating counterparties will likely not face difficulties in adopting such obligations in new generation IIAs.

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[312] Nathalie Bernasconi - Osterwalder, 'Investor Obligations' International Institute for Sustainable Development available at: http://investmentpolicyhub.unctad.org/Upload/Documents/IDB%20%20BERNASCONI%20Investor%20Obligations.pdf

[313] Report of the Expert Meeting, 'Integrating Investor Obligations and Corporate Accountability Provisions in Trade and Investment Agreements', International Institute for Sustainable Development (IISD) and the Friedrich Ebert Stiftung (Versoix, January 2018) available at https://www.iisd.org/sites/default/files/publications/report-expert-meeting-versoix-switzerland-january-2018.pdf.

VOLUNTARY INCORPORATION OF CSR STANDARDS

Some IIAs include provisions for encouraging investors to voluntary comply with CSR standards. With regard to CSR, UNCTAD highlighted that "CSR stands for voluntary adherence by companies to good business practices in the areas such as the environment, labour rights, anti-bribery, disclosure, consumer interests and competition. The relevant rules and standards are codified in a number of non-binding international instruments."[314] In this regard, obligations may be imposed either directly on investors or on Contracting States.

The major part of investment treaties provides for hortatory language. State have raised concerns about the practical consequences of non-legally binding approaches.[315] Nonetheless, UNCTAD still recommends "soft" provisions because the latter may indeed have specific advantages.[316] Hereafter, examples of treaty practice on *non-legally binding* obligations for voluntary incorporation of CSR standards:

- India Model BIT (2015), Article 12

> *Investors and their enterprises operating within its territory of each Party **shall endeavor**[317] to voluntarily incorporate internationally recognized standards of corporate social responsibility in their practices and internal policies [..]*

- Canada-Colombia FTA (2008), Article 816

> *Each Party **should** encourage enterprises operating within its territory or subject to its jurisdiction to voluntarily incorporate internationally recognized standards of corporate social responsibility in their internal policies, such as statements of principle that have been endorsed or are supported by the Parties [..].*

For further examples, see USMCA (2018), Article 14.17; Netherlands Model BIT (Draft, 2018), Article 7; Colombia Model BIT (2017), Investors' Social Responsibility; Brazil CFIA (2015), Article 14(2).

NOT-LOWERING STANDARD CLAUSE

The objective of not-lowering-standard clauses is to include a bottom line of HRs, labour rights and environmental protection. This language aims to prevent the regulatory race of States to the bottom in lowering standards to attract foreign investors. For instance, see:

- Netherlands Model BIT (Draft, 2018), Article 6(3)

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[314] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 182.
[315] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2018) 67.
[316] ibid.
[317] It is worth highlighting that "shall endeavour" is not a legally binding obligation.

The Contracting Parties recognize that it is inappropriate to lower the levels of protection afforded by domestic environmental or labor laws in order to encourage investment.

- Colombia Model BIT (2017), Non-detraction from environmental, human rights and labour standards

The Contracting Parties recognise that they are not promoting investment by detracting from or diminishing environmental, human rights or labour standards. Hence, each Contracting Party shall not modify or derogate, or offer to modify or derogate its laws and regulations on these fields as a Measure to promote the establishment, maintenance or expansion of foreign investment in its Territory, in a way that such modification or derogation implies the detracts from their environmental, human rights or labour standard.

- Morocco – Nigeria BIT (2016), Article 15(2) and 15(3)

2) The parties recognize that it is inappropriate to encourage investment by weakening or reducing the protection accorded in domestic labour laws. Accordingly, each Party shall ensure that it does not waive or otherwise derogate from or offer to waive or otherwise derogate from its labour laws where the waiver or derogation would be inconsistent with the labour rights conferred by domestic laws and intemationallabour instruments in which both are parties are signatories, or fail to effectively enforce its labour laws through a sustained or recurring course of action or inaction.

3) The Parties recognize that it is inappropriate to encourage investment by relaxing domestic labour, public health or safety. They shall not waive or otherwise derogate from, or offer to waive or otherwise derogate from, such measures as an encouragement for the establishment, acquisition, expansion, or retention in their territories, of an investment.

INCLUSION OF PROVISION THAT AIMS TO ENSURE THAT INVESTMENTS CONTRIBUTE TO THE SUSTAINABLE DEVELOPMENT OF THE HOST STATE

Including a clause that explicitly refers to the idea that investments must contribute to the sustainable development of the Host State can bring value added. Indeed, such a clause will be used to inform the overall objective of the IIAs and can provide tribunals with guidance on how to interpret the agreement in case of a dispute. For treaty practice in this regard, see for example:

- Netherlands Model BIT (Draft, 2018), Article 6(1)

*The Contracting Parties are committed to promote the development of international investment in such a way as to **contribute to the objective of sustainable development.***

- Draft Pan-African Investment Code (2016), Article 22(2)

*Investors shall, in pursuit of their economic objectives, ensure that they do not conflict with the **social and economic development objectives** of host States and shall be sensitive to such objectives.*

For further alternative approaches and explanation, please refer to UNCTAD policy options.[318]

ENFORCEMENT OF INVESTOR OBLIGATIONS

In addition, some very recent IIAs make investor obligations *directly enforceable*, entitling mechanisms of dispute settlement to review alleged investors' violations.

First, the provision may establish that the Host State is entitled to raise a claim against investors' breaches and obtain proportional reparation. Investors' violations can be found either under international law or under domestic law, depending on the terms of the agreement. For treaty practice on this issue, see:

- SADC Model BIT Template (2012), Article 19(3)

> *In accordance with its applicable domestic law, the* ***Host State****, including political subdivisions and officials thereof, private persons, or private organizations,* ***may initiate a civil action in domestic courts against the Investor or Investment for damages arising from an alleged breach of the obligations set out in this Agreement****.*

- IISD Model (2005), Article 18 (F)

> *In accordance with the applicable domestic law, a* ***host state*** *or private person or organization,* ***may initiate actions for damages under the domestic law of the host state, or the domestic law of the home state where such an action relates to the specific conduct of the investor, for damages arising from an alleged breach of the obligations set out in this Part.***

Secondly, IIAs can strengthen the role of the Home State of the investor. UNCTAD has highlighted that an increasing number of States are currently starting to adopt this approach.[319] Recent IIAs include a provision that entitles the Home State to initiate proceedings against an investor to determine its civil liability. This approach relies on the "Home-country efforts to regulate foreign investments for sustainable development."[320] The IISD Model notes that such an approach may be helpful in order to prevent decisions of *forum non conveniens*.[321] This alternative approach is recommended in order to increase the possibilities of finding a corporation liable and ordering to pay compensation. As a result, accountability of investors in conducting their business will be highly reinforced. For treaty practice in this direction, see:

- Morocco – Nigeria BIT (2016), Article 20

> ***Investors shall be subject to civil actions for liability in the judicial process of their home state*** *for the acts or decisions made in relation to the investment*

[318] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2018) 64-67.
[319] UNCTAD, *UNCTAD's Reform Package for the International Investment Regime* (2018) 67.
[320] ibid.
[321] IISD Model (2012), footnote *ad* Article 31.

where such acts or decisions lead to significant damage, personal injuries or loss of life in the host state.

- SADC Model BIT Template (2012), Article 17

> ***Investors and Investments shall be subject to civil actions for liability in the judicial process of their Home State for the acts****, decisions or omissions made in the Home State in relation to the Investment where such acts, decisions or omissions lead to significant damage, personal injuries or loss of life in the Host State.*
> *Home States shall ensure that their legal systems and rules allow for, or do not prevent or unduly restrict, the bringing of court actions on their merits before domestic courts relating to the civil liability of Investors and Investments for damages resulting from alleged acts, decisions or omissions made by Investors in relation to their Investments in the territory of the Host State.*

For similar treaty practice refer also to India Model BIT (Draft, 2015), Article 13(1) and IISD Model (2005), Articles 17 and 31.

DENIAL OF PROTECTION UNDER THE TERMS OF TREATY AND PRECLUSION OF THE POSSIBILITY TO ACCESS ISDS

Investors who breach their obligations may be precluded from obtaining protection under the agreement and from raising a claim against the Host State is ISDS. Arguably, it would be for the tribunal to decide. In case the investor brings a claim before ISDS, the tribunal will dismiss the case for lack of jurisdiction in case of breaches of investor obligations. This approach is recommended. Indeed, it directly put pressure on investors by warning them that in case of violations they will lose essential rights under the IIA. For treaty practice in this direction see, for example, Colombia Model BIT (2017), Investors' Social Responsibility, para 2:

> *[..] A Claimant Investor shall accept the aforementioned prohibitions as mandatory throughout the making of its investment and its operation in the Host Party's Territory in order to submit a claim to a Court or an Arbitral Tribunal pursuant to SECTION on INVESTOR-STATE DISPUTE SETTLEMENT.*

COUNTERCLAIMS

Some recent IIAs expressly provide for the possibility for the defendant party to the dispute (the Host State) to raise a counterclaim. This would allow the Host State in case of a claim brought before ISDS by the investor to raise a counterclaim concerning violation of investor obligations under national laws and internationally recognized standards. To further confirm this possibility, negotiating parties might consider clarifying in the dispute settlement clause that investor obligations can form the basis for counterclaims.

More broadly speaking, it is generally accepted that breaches of investor obligations are considered by tribunals as grounds for mitigating the amount of compensation due to the investor. As a result, while assessing an investor's claim, tribunals will be

required to take into account violations of investor obligations under the IIA for the determination of the amount of compensation that is due. See, for example, the provision of the COMESA Investment Agreement (2007), Article 28(9):

> *A Member State against whom a claim is brought by a COMESA investor under this Article may assert as a defence, counterclaim, right of set off or other similar claim, that the COMESA investor bringing the claim has not fulfilled its obligations under this Agreement, including the obligations to comply with all applicable domestic measures or that it has not taken all reasonable steps to mitigate possible damages.*

INVESTOR STATE DISPUTE SETTLEMENT

From the investors' perspective, it is generally considered that arbitration is a more efficient dispute settlement mechanism than litigation before domestic courts. However, conventional ISDS clauses may be interpreted in a way that goes beyond the intent of the Contracting Parties. To avoid any abuse, States may limit the scope of arbitration, by requiring exhaustion of local remedies and explicitly allowing counterclaims.

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES	
• Both the investor and the State can bring claims under this clause. • The requirement of exhaustion of local remedies, fork in the road provision, and the possibility of counterclaims. • A reverse umbrella clause. • Limit the exhaustion of local remedies to a certain time period. • Leaving the possibility to opt to the permanent court upon its establishment.	
RELEVANT AUTHORITIES	
Scope of arbitration	• India Model BIT (2015), Article 13(2) • India – South Korea CEPA (2009), Article 10(21) • ECT (1994), Article 26(1) • *Kardassopoulos v Georgia*[322]
Exhaustion of local remedies	• India Model BIT (2015), Article 15(1) • Romania – Sri Lanka BIT (1981), Article 7(2) • Germany – Israel BIT (1976), Article 10(5) • *Kilic v Turkmenistan*[323]
Consultation period	• Colombia – Japan BIT (2011), Article 24(5) • Uruguay – US BIT (2005), Article 24(3) • *Burlington Resources v Ecuador*[324]
Fora	• Egypt – Switzerland BIT (2010), Article 12(3) • BLEU – Colombia BIT (2009), Article 12(6) • Japan - Malaysia EPA (2005), Article BIT 84(4)

[322] *Ioannis Kardassopoulos v The Republic of Georgia*, ICSID Case No ARB/05/18, Decision on Jurisdiction (6 July 2005) para 249.
[323] *Kilic Insaat Ithalal Iharacat Sanayi Ve Ticaret Anonim Sirketi v Turkmenistan*, ICSID Case No ARB/10/1, Award (2 July 2013) para 6.6.1.
[324] *Burlington Resources Inc v Republic of Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction (2 June 2010) para 335.

Fork in the road	• Nigeria – Singapore BIT (2016), Article 13(3) • COMESA Investment Agreement (2007), Article 28(3) • *Pantechniki v Albania*[325]
Counterclaims	• SADC Model BIT Template (2012), Article 19(2) • COMESA Investment Agreement (2007), Article 28(9) • *Goetz v Republic of Burundi*[326]
Permanent Multilateral Investment Court	• EU – Viet Nam FTA (2018), Article (15)[327] • Canada – EU CETA (2016), Article 8(29)
PRACTICES TO BE AVOIDED	
• Allowing all kinds of disputes to fall under the arbitration scope. • Limiting the right of the State to bring counterclaims.	

DETAILED EXPLANATION

SCOPE OF ARBITRATION

States have adopted several variations that narrow the scope of jurisdiction of arbitral tribunals to:[328]

- Claims brought by owned and controlled entities in the territory. This is followed by Article 11 of the Japan – Russia BIT (1998).
- The amount of compensation rather than the legality of the act.[329] This is provided by Article 17 of the Cambodia – Japan BIT (2007).
- Claims only based on treaty breaches.[330] For instance, as in Article 26(1) of the ECT (1994).

[325] *Pantechniki SA Contractors & Engineers v The Republic of Albania*, ICSID Case No ARB/07/21, Award (30 July 2009) para 67.
[326] *Antoine Goetz et consorts v République du Burundi*, ICSID Case No ARB/95/3, Award (10 February 1999).
[327] Not yet into force.
[328] UNCTAD, *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking* (United Nations 2007) 102.
[329] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 135.
[330] Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (Oxford University Press 2017) 310.

A narrow language aims to avoid the so called "*cafeteria style*" approach.[331] This is intended to limit the subject matter of the dispute to breaches under the treaty, excluding breaches of contract or local law. Article 13(2) of the India Model BIT (2015) explicitly limits the scope of dispute settlement to claims "in respect of a breach of [the] treaty […] and not disputes arising solely from an alleged breach of a contract between a Party and an investor."

Certain IIAs further require material loss or damage "emphasizing casual connection between the breach and the damage."[332] For example, Article 10(21) of the India – Korea CEPA (2009):

> *This article shall apply to disputes between a Party and an investor of the other Party concerning an alleged breach of an obligation of the former Party under this Chapter, which causes loss or damage to the investor or its investment.*

An example of a tribunal rejecting a claim outside the scope of the arbitration clause, is the case *Kardassopoulos v Georgia* where the tribunal held that the jurisdiction is confined to breaches of the treaty rather than any dispute related to the investment. The tribunal stated that the "provision lays down a further requirement which has to be fulfilled in order for the tribunal to have jurisdiction over a dispute. This is that the dispute must 'concern an alleged breach of an obligation of the [Host State] under Part III of the ECT.'"[333]

EXHAUSTION OF LOCAL REMEDIES

States may condition their consent to dispute settlement by requiring that the investor pursues local remedies before seeking arbitration.[334] Exhaustion of local remedies has its roots in CIL. Article 14 of the ILC Articles on Diplomatic Protection states that "a State may not present an international claim in respect of an injury to a national or other person […] before the injured person has, subject to draft article 15, exhausted all local remedies." Exhaustion of local remedies aim to preserve the sovereignty of the Host State and provide it with the opportunity, within its internal legal system, to remedy the breach.[335]

There are several variations of the requirement to exhaust local remedies:[336]

- Requiring exhaustion of judicial recourse in the Host State prior to arbitration**.** This is adopted in Article 10(5) of the Germany – Israel BIT (1976).

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[331] ibid.
[332] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 135.
[333] *Ioannis Kardassopoulous v Georgia,* ICSID Case No ARB/05/18, Decision on Jurisdiction (6 July 2005) para 249.
[334] UNCTAD, 'Series on Issues in International Investment Agreement II' (2014) 35.
[335] Martin Dietrich Brauch, 'Exhaustion of Local Remedies in International Investment Law' (2013) IISD Best Practices Series 2.
[336] ibid 7.

- Conditioning the consent to arbitrate to the exhaustion of local remedies. This is adopted in Article 7(2) of the Romania – Sri Lanka BIT (1981).
- Confining the condition to a limited period of time, and if the dispute is not resolved before the judiciary during that set period, then parties may refer the dispute to arbitration. This is adopted in Article 8(2) of the Albania – Lithuania BIT (2007).
- Confining exhaustion of local remedies to those administrative in nature to the exclusion of judicial means. This is adopted in Article 12(2) of the Albania – Korea BIT (2010).

Article 14 of the ILC Draft Articles on Diplomatic Protection defines local remedies to include legal remedies before administrative courts or bodies. From a legal point of view, requiring recourse to local remedies under IIAs may not be the same as exhaustion of local remedies as required for diplomatic protection under CIL.[337]

To expand the scope of the exhaustion of local remedies requirement, it is advisable to require both judicial and administrative means for a certain period of time. In numerous cases, the tribunals regarded the time-limit requirement as a mandatory condition of consent, which, if not complied with by the investor, should prompt a tribunal to dismiss the case on jurisdictional grounds.[338] To give an example of a case upholding the exhaustion of local remedies, the majority in *Kilic v Turkmenistan* held that "neither it, nor the Centre, has jurisdiction over this arbitration, due to the Claimant's failure to comply with the mandatory requirement of prior submission of the dispute to Turkmenistan's courts under Article VII.2 of the BIT. In the absence of jurisdiction, the Tribunal has no power to suspend these proceedings even if it was minded to do so."[339] Similarly in *Ömer Dede and Serdar Elhüseyni v Romania,* the tribunal upheld the requirement to locally litigate for a period of one year before bringing an international claim.[340]

A recent example of time limited recourse to local remedies is Article 15(D)(5) of USMCA (2018), which conditions the consent to arbitration to the pursue of local remedies for a period of 30 months, unless, as explained in a footnote, seeking local remedies is "obviously futile". The article states as follows:

> *The claimant or the enterprise obtained a final decision from a court of last resort of the respondent or 30 months have elapsed from the date the proceeding in subparagraph (a) was initiated;*

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[337] Jeswald W Salacuse, *The Law of Investment Treaties* (Oxford University Press 2015) 429.
[338] Martin Dietrich Brauch, 'Exhaustion of Local Remedies in International Investment Law' (2013) IISD Best Practices Series 18.
[339] *Kilic Insaat Ithalal Iharacat Sanayi Ve Ticaret Anonim Sirketi v Turkmenistan*, ICSID Case No ARB/10/1, Award (2 July 2013) para 6.6.1.
[340] *Omer Dede and Serdar Elhuseyni v Romania*, ICSID Case No ARB/10/22, Award (2 July 2013) para 262.

It is worth noting that exceptions to the exhaustion of local remedies exist under CIL. Article 15 of the ILC Draft Articles on Diplomatic Protection (2016) provide for five exceptions. Namely: (a) there are no reasonably available local remedies to provide effective redress, or local remedies provide no reasonable possibility of such redress, (b) there is undue delay in the remedial process which is attributable to the State alleged to be responsible, (c) there is no relevant connection between the injured person and the State alleged to be responsible at the date of injury, (d) the injured person is manifestly precluded from pursuing local remedies, or (e) the State alleged to be responsible has waived the requirement that local remedies be exhausted.

These exceptions have been successfully invoked in a few cases. For example, in *Abaclat v Argentina*, the tribunal held that "in light of the Emergency Law and other relevant laws […] Argentina was not in a position to adequately address the present dispute within the framework of its domestic legal system."[341]

It is also worth noting that in some instances the tribunals flexibly applied the requirement of exhaustion of local remedies in light of the procedural economy principle.[342] These instances include situations where the claimant filed the case only after 15 months of the 18-month period stipulated in the IIA because it would be deemed waste of time and resource "to require the Claimants to start over and re-file this arbitration now that their 18 months have been met would be a waste of time and resources.[343]

CONSULTATION PERIOD

Consultation periods provide parties to the dispute with an opportunity to settle the conflict amicably.[344] A 6-month period is common practice.[345] However, the period may vary among different IIAs.[346] For example, Article 13 of Austria – Kazakhstan BIT (2012) provide for a 60-day period, while Article 10 of Germany – Argentina BIT provide for a 24-month period.

[341] *Abaclat and Others v Argentine Republic*, ICSID Case No ARB/07/5, Decision on Jurisdiction and Admissibility (4 August 2011) para 588.
[342] Martin Dietrich Brauch, 'Exhaustion of Local Remedies in International Investment Law' (2013) IISD Best Practices Series 19.
[343] *Teinver SA, Transportes de Cercanias SA and Autobuses Urbanos del Sur SA v Argentine Republic*, ICSID Case No ARB/09/1, Decision on Jurisdiction (21 December 2012) para 135-136.
[344] Crina Baltag, 'Not Hot Enough: Cooling-Off Periods and the Recent Developments Under the Energy Charter Treaty' (2017) 6 Indian Journal of Arbitration Law 190.
[345] UNCTAD, 'Series on Issues in International Investment Agreement II' (2014) 55.
[346] Joachim Pohl, Kekeletso Mashigo, Alexis Nohen, 'Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey' (2012) OECD Working Papers on International Investment, 2012/02, 17.

Moreover, requiring more elaborate procedural requirements for the consultation period has been evident in other investment agreements.[347] For example, Article 24(4) of the Colombia – Japan BIT (2011) states that:

> *The proceeding for consultations and negotiations shall begin with a request in writing delivered to the competent authority of the disputing Party set out in Article 41 [Service of Documents]. The request shall be accompanied by a brief summary of the factual and legal basis of the investment dispute sufficient to present the problem clearly. Such request shall be delivered to the disputing Party before the submission of the notice of intent.*

Other IIAs require that the claimant submit his/her consent with the notice. For example, Article 24(6) of the Uruguay – US BIT (2005) requires the consent to arbitrate to be submitted with the notice of claim. Usually, the commencement of arbitral proceedings conveys the consent of the investor. Nevertheless, providing written consent with the notice may be important for the purpose of submitting counterclaims.[348]

Case law on consultation periods is not uniform.[349] Some tribunals found that these periods are simply procedural and do not affect their jurisdiction. For example, in *Biwater Gauff v Tanzania*, the tribunal held that "the six months period is procedural and directory in nature, rather than jurisdictional […]. Its purpose is not to impede arbitration." [350] It *Burlington Resources v Ecuador*, the tribunal held that "this requirement makes sense as it gives the State an opportunity to remedy a possible treaty breach and thereby avoid arbitration proceedings under BIT, which would not be possible without knowledge of an allegation of treaty breach."[351]

To avoid the potential debate on whether the consultation is jurisdictional or merely procedural, it is advisable to plainly state that it is a condition to the consent of the Host State to submit a claim to the ISDS.

FORA

National courts, in theory, may be a *forum* to settle investor-State disputes. However, national courts may be considered impractical mainly due to unattractiveness to

[347] ibid.
[348] ibid 148.
[349] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 269.
[350] *Biwater Gauff (Tanzania) Ltd v United Republic of Tanzania,* ICSID Case No ARB/05/22, Award (24 July 2008) paras 338-350.
[351] *Burlington Resources Inc v Republic of Ecuador*, ICSID Case No ARB/08/5, Decision on Jurisdiction (2 June 2010) para 335.

investors, risk of not applying international law, and possibility of the State to invoke its immunity.[352]

Treaties have adopted a variety of *fora* to settle investor-State disputes.[353] The most common fora in IIAs are (i) arbitration under the auspices of ICSID, and (ii) *ad hoc* arbitration under UNCITRAL Rules.[354]

Very few States promote their own arbitration centers. For example, Sweden does not include in its BITs arbitration under the auspices of the Stockholm Chamber of Commerce. Nonetheless, there are few occasions where States promote their own institutions,[355] namely:

- Egypt included CRCICA in Article 12(3) of the Egypt – Switzerland BIT (2010);
- Colombia included the Bogota Center in Article 12(6) of the BLEU – Colombia BIT (2009);
- Malaysia included KLRCA in Article 84(4) of the Japan – Malaysia EPA (2005).

Arbitration in the Host State may be conceived on equal footing with local courts, especially if parties cannot waive the local annulment process.

It is worth noting that some Latin American countries have restrictions against international arbitration. On 10 August 2016, IISD reported that 80% of relevant work to establish the UNASUR arbitration center has been achieved.[356] It is understood that the center will be competent in adjudicating disputes between Host States and investors of non-member States.[357] However, it highly likely that non-members would be hesitant to accept arbitration proceedings before a regional treaty based body given that the these centers are proposed as a backlash towards ICSID.[358]

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[352] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 235.
[353] ibid 238.
[354] Joachim Pohl, Kekeletso Mashigo and Alexis Nohen, 'Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey' (2012) OECD Working Papers on International Investment 2012/02, 20.
[355] ibid 21.
[356] Katia Fach Gomez and Catharine Titi, 'UNASUR Centre for the Settlement of Investment Disputes: Comments on the Draft Constitutive Agreement" (2016) Investment Treaty News available at <https://www.iisd.org/itn/2016/08/10/unasur-centre-for-the-settlement-of-investment-disputes-comments-on-the-draft-constitutive-agreement-katia-fach-gomez-catharine-titi/> accessed 19 October 2018.
[357] Silvia Karina Fiezzoni, 'The Challenge of UNASUR Member Countries to Replace ICSID Arbitration' (2011) 2 Beijing Law Review 134.
[358] ibid.

ICSID ADDITIONAL FACILITY ARBITRATION RULES AS AN ALTERNATIVE

According to the ICSID Additional Facility Arbitration Rules, the ICSID Secretariat is authorized to administer disputes that are beyond the scope of the ICSID Convention.[359] The Additional Facility is "not self-contained and delocalized, and the law of the seat of the arbitration governs the proceeding."[360] In other words, even if the arbitration is administered by the ICSID Secretariat, the dissatisfied Host State may challenge the award before its own courts or the legal seat of the arbitration.

Arbitration should be in a country that is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) pursuant to the requirements of Article 19 of the ICSID Arbitration Additional Facility Rules which states that:

> *Arbitration proceedings shall be held only in States that are parties to the 1958 UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards.*

In addition to the lack of self-containment, the Additional Facility also lacks a crucial feature of ICSID arbitration which is the relative ease of enforcement pursuant to Article 54 of the ICSID Convention which obliges ICSID members "to recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligation imposed by that award within its territories as if it were a final judgment of a court in that State."

Should the Parties opt to provide their consent to arbitrate under the ICSID Additional Facility Rules, the treaty should explicitly designate the city and State of arbitration, because, absent an agreement, the tribunal itself will decide upon the seat of arbitration. Indeed, Article 20(1) of the ICSID Additional Facility Rules states that:

> *Subject to Article 19 of these Rules the place of arbitration shall be determined by the Arbitral Tribunal after consultation with the parties and the Secretariat.*

It is worth noting that States may choose from several institutions to administer the arbitration. To name a few examples:

- Arbitration under the ICC Rules;
- PCA Rules;
- Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce.

[359] Antonio Parra, 'The Development of the Regulations and Rules of the International Centre for Settlement of Investment Disputes', 22 ICSID Review, 55, 56.
[360] Frauke Nitschke and Kamel Ait-El-Hadj, 'Determining the Place of Arbitration in ICSID Additional Facility Proceedings' (2015) 30 ICSID Review 243, 244.

FORK IN THE ROAD

A considerable number of the IIAs that allow recourse to domestic courts include a fork in the road condition[361] which "forecloses the possibility of electing any other dispute resolution procedures potentially available."[362] This provision risks of not interplaying smoothly with the requirement of prior exhaustion of local remedies.

It should be noted that dismissing a case based on a fork in the road violation is unlikely in practice. The criteria adopted by tribunals require actual mirroring of the parallel cases in term of parties involved and the subject matter. [363] In *Pantechniki v Albania*, [364] one of the rare occasions where a violation of fork in the road was found, the tribunal held that "the Claimant's grievance thus arises out of the same purported entitlement that it invoked in the contractual debate […]. It cannot now adopt the same fundamental basis as the foundation of a Treaty claim."[365]

To make the fork in the road rule effective, the language should clearly identify that it does not only cover the same dispute but also the underlying measure or fundamental basis of the dispute.[366] A good example of a fork in a road provision that encompasses this notion is Article 28(9) of the COMESA Investment Agreement (2007) which states:

> *If the COMESA investor elects to submit a claim at one of the forums set out in paragraph 1 of this Article [it includes national courts of the host State], that election shall be definitive and the investor may not thereafter submit a claim relating to the same subject matter or underlying measure to other forums.*

COUNTERCLAIMS

The idea of bringing forward a counterclaim is acceptable in theory, however, it faces several legal obstacles in practice. Most notably, a procedural inequality may exist because the counterclaim will likely be contractual, while the main claim will likely be confined to treaty breaches. [367] Moreover, it will not be an easy task to find a nexus

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[361] Joachim Pohl, Kekeletso Mashigo, Alexis Nohen, 'Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey' (2012) OECD Working Papers on International Investment, 2012/02, 12.
[362] Campbell McLachlan, Laurence Shore and Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (Oxford University Press 2017) 63.
[363] Fiona Marshall, 'Bulletin #4 Risks for Host States of the Entwining of Investment Treaty and Contract Claims' (2009) International Institute for Sustainable Development, 29.
[364] Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford University Press 2012) 268.
[365] *Pantechniki SA Contractors & Engineers v The Republic of Albania*, ICSID Case No ARB/07/21, Award (30 July 2009) para 67.
[366] Christian Klausegger, *Austrian Yearbook on International Arbitration 2010* (Beck, Stämpfli & Manz 2010) 273; APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 145.
[367] Dafina Atanasova, Adrian Martinez Benoit and Josef Ostransky, 'The Legal Framework for Counterclaims in Investment Treaty Arbitration' (2014) 31 Journal of International Arbitration 357, 368.

between the claim and the counterclaim.[368] Among the issues faced with bringing counterclaims is that claims are confined to treaty breaches, while the responsibility of the investor generally stems from the municipal laws of the Host State.[369] The IIA should include a set of investor responsibilities that could be the direct basis of the counterclaims.

In rare occasions, counterclaims have been upheld in investment cases. For example, in *Goetz v Republic of Burundi*, the tribunal found the counterclaim admissible, while dismissing it on the merits.[370] In its award, the tribunal held that the "presence of an investment is therefore both the *quid pro quo* for the tribunal's competence over the claims (primary competence), and for the tribunal's competence over the counterclaims (derivative competence) in investment treaty arbitration."[371]

The State may bring against the investor a claim related to violations of Investor Obligations. The obligations should not be limited to HRs and environment protection. The State should consider widening the scope of claims against investors by including an obligation, in the treaty, concerning the respect of the laws and regulations of the Host State. Such an insertion may elevate local violations to treaty breaches.

One of the treaties that elevate local laws to the international level is Article 13 of the COMESA Investment Agreement (2007), which states that the investor "shall comply with applicable domestic measures of the Member State in which their investment is made."[372] More importantly, Article 28(9) of COMESA plainly provides that the State may bring claims concerning failure of the investor "to comply with all applicable domestic measures."[373]

A possible complexity, according to UNCTAD, from elevating local rules to the international level is that those rules are meant to deal with local investors and may not be tailored to international investment.[374] UNCTAD recommends making reference to more explicit CSR standards such as "voluntary adherence by companies to good business practices in the areas such as anti-bribery, disclosure, environment as found in the instruments prepared by UN Global Impact, the OECD Guidelines for Multinational Enterprises, ICC Guidelines for International Investment or the ISO 2600 standard

[368] Zachary Douglas, *The International Law of Investment Claims* (Cambridge University Press 2009) 260.
[369] UNCTAD, 'Series on Issues in International Investment Agreement II' (2014) 116.
[370] Andrea M Steingruber, 'Antoine Goetz and Others v Republic of Burundi: Consent and Arbitral Tribunal Competence to Hear Counterclaims in Treaty-Based ICSID Arbitrations' (2013) 28 ICSID Review 291, 300.
[371] ibid 293.
[372] ibid 117.
[373] ibid.
[374] ibid.

Guidance on Social Responsibility."[375] For example, Article 816 of the Canada – Colombia FTA (2008) requires the following:

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

In conclusion, to maintain the nexus between the claim and counterclaim and reduce the risk of dismissal on both jurisdiction and merits, the IIA should plainly provide for the right of the State to bring a counterclaim in relation to the investor's failure to comply with her responsibilities under the treaty and/or the laws and regulations of the Host State. Moreover, to assure the right of the Host State to bring forward a contractual counterclaim under the ambit of the IIA, a reverse umbrella clause may be added under the Investor Responsibilities Article. A provision as such would "provide host States with a purely treaty-based cause of action for violation by foreign investors of their investment obligations toward them". [376] This provision may read as follows:

> *The investor of each Contracting Party shall observe any contractual obligation it may have entered into with the other Contracting Party with regard to the investment of the investor in the territory of the other Contracting Party.*

THE PERMANENT MULTILATERAL INVESTMENT COURT

In late 2015, the EU proposed a two-tiered Investment Court System for the purpose of its Transatlantic and Trade and Investment Partnership (TTIP).[377] In its TTIP draft, the EU proposed, in Chapter II Section 3 Article (9), the establishment of a tribunal of First Instance to hear investment claims. Among the most notable features proposed in this Article are as follows:

- Both parties will appoint fifteen judges: five nationals of the EU, five nationals of the US, and five nationals of third parties. The number of judges may be increased or decreased;
- Cases will be heard by divisions consisting of three judges consisting of two nationals and chaired by the national of a third party. By agreement, the dispute may be heard by a sole judge. Each judge will serve for a 6-year term renewable once;

[375] APEC and UNCTAD, 'International Investment Agreements Negotiators' Handbook' (2012) 182.
[376] Gustavo Laborde, 'The Case for Host State Claims in Investment Arbitration', (2010) 1 Journal of International Dispute Settlement 97, 112.
[377] Stephen Kho and others, 'The EU TTIP Investment Court Proposal and the WTO Dispute Settlement System: Comparing Apples and Oranges?' (2017) 32 ICSID Review 326, 327.

- The judges are required to be available at all times and on a short notice. Judges are not full time, but such a possibility is left open;
- The EU proposed either the Secretariat of ICSID or of the PCA to act as secretariat.

The EU has proposed the establishment of an appeal mechanism. The main features of the appeal mechanism are as follows:

- The appeal tribunal will consist of six members: two EU judges, two American judges and two third-country judges. There is a possibility to increase or decrease the number of judges. Each judge will serve a term of 6 years, renewable once;
- Cases will be heard on appeal by divisions of three judges.

The dispute settlement proposed in TTIP is structurally based on the WTO dispute settlement system, and the EU is of the view that such a mechanism "would increase judicial independence and safeguard the public from judicial bias by insulating the arbitrators from any real or perceived risk of bias."[378]

The EU has advocated that such a court would eliminate the judicial bias, enhance consistency and predictability and increase transparency.[379] It has been argued, however, that the EU proposal faces several challenges:[380]

- Based on the decision of the Court of Justice of the EU, investment treaties fall outside the EU exclusive competence, and thus require the ratification of Member States;
- The reform of BITs suffices to limit the exposure of States and raise the credibility of the system, and the EU's proposal is disproportionate to the concerns regarding international arbitration;
- Some States may not be interested in a permanent dispute settlement mechanism;
- The proposal does not take into consideration the perception of the international community as a whole, and it is perceived as a unilateral Western initiative.

The EU further planted the seed for a comparable universal court in its FTAs with both Canada and Vietnam.[381] For example, in Article 8(29) of CETA both Canada and the EU vowed "to pursue with other trading partners the establishment of a multilateral investment tribunal and appellate mechanism for the resolution of investment disputes." As stated in press statement issued by the European Commission, the EU and Canada "are working together to establish a multilateral investment court" for the purpose of "moving away from

[378] ibid 338.
[379] ibid 343.
[380] Julien Chaisse and Mattero Vaccaro-Incisa, 'The EU investment court: challenges on the path ahead' (2018) 219 Columbia FDI Perspectives 2.
[381] N Jansen Calamita, 'The Challenge of Establishing a Multilateral Investment Tribunal at ICSID' (2017) 32 ICSID Review 611.

the ad hoc system of investor to state dispute settlement."[382] It is worth noting that "Argentina, Brazil, India, Japan and other nations reportedly rejected the initiative".[383]

It seems that to date, a Multilateral Investment Court has not gained enough momentum.

[382] Press Release of the European Commission dated 13 December 2016, available at <http://europa.eu/rapid/press-release_MEMO-16-4350_en.htm> last visited 2 December 2018.
[383] Investment Treaty News, 'European Union and Canada co-host discussions on a multilateral investment court', 13 March 2017, available at <https://www.iisd.org/itn/2017/03/13/european-union-and-canada-co-host-discussions-on-a-multilateral-investment-court/> last visited 2 December 2018.

APPEAL

In the context of ISDS reform, the possibility to appeal arbitral awards has been advocated. Indeed, setting an appeal mechanism may be capable of vetting dubious claims, ensure consistency in case law and enhance the legitimacy of the process.

Numerous proposals were made, and still remain to be made, in this regard.

RECENT TRENDS IN TREATY PRACTICE AND RECOMMENDED APPROACHES
• Require in the IIA the right to raise preliminary objections against frivolous claims and transparency requirements. • Possibility to appeal once an appeal mechanism is set.
RELEVANT AUTHORITIES
• UNCTAD, 'World Investment Report 2013' (2013) • EU – Viet Nam FTA (2018), Article 14 • Canada – EU CETA (2016), Article 27(2)

DETAILED EXPLANATION

UNCTAD advocates that an "appeal mechanism: has the potential to become an authoritative body capable of delivering consistent – and balanced – opinions, which could rectify some of the legitimacy concerns about the current ISDS regime."[384] Instead, experts advising the OECD asserted that "they were not all convinced of the objective necessity of an appeal mechanism."[385] Likewise, the facility appeal mechanism proposed by ICSID received criticism.[386]

[384] UNCTAD, 'World Investment Report 2013: Global Value Chains: Investment and Trade For Development' (2013) 115.
[385] Gabrielle Kaufmann - Kohler and Michele Potesta, 'Can the Mauritius Convention Serve as a Model for the Reform of Investor-State Arbitration in Connection with the Introduction of a Permanent Investment Tribunal or an Appeal Mechanism?' (Geneva Center for International Dispute Settlement 2016) 22.
[386] Katia Yannaca-Small, 'Improving the System of Investor-State Dispute Settlement' (2006) OECD Working Papers on International Investment 2006/01; Gabrielle Kaufmann - Kohler and Michele Potesta, 'Can the Mauritius Convention Serve as a Model for the Reform of Investor-State Arbitration in Connection with the Introduction of a Permanent Investment Tribunal or an Appeal Mechanism?' (Geneva Center for International Dispute Settlement 2016) 22.

The OECD Report highlighted as disadvantages of an appeal mechanism, among others, the following:[387](i) against the principle of finality; (ii) additional delays and costs; and (iii) additional caseload.

Conversely, there are numerous advantages of an investment appeal mechanism,[388] namely that the appeal mechanism helps may contribute to ensure coherence and consistency.[389]

Appellate mechanisms are included, for example, in the Canada – EU CETA (2016) and in the EU – Viet Nam FTA (2018). These mechanisms are permanent[390] and include multiple States. In this light, UNCTAD opined that appeal facilities would "be more pronounced in a pluri – or multilateral context."[391]

States may consider deferring the appeal mechanism to a future point of time. This would prevent creating a stalemate.[392] For example, Annex 10-H of the US – Chile FTA (2003) states that:

> *Within three years after the date of entry into force of this Agreement, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article … in arbitrations commenced after they establish the appellate body or similar mechanism.*

Another way to preserve the integrity of the arbitral process is to insert a preliminary dismissal mechanism of frivolous claims. For example, Article 21(1) of the India Model BIT (2015) states that:

> *Without prejudice to a Tribunal's authority to address other objections, a Tribunal shall address and decide as a preliminary question any objection by the Defending Party that a claim submitted by the investor is: (a) not within the scope of the Tribunal's jurisdiction, or (b) manifestly without legal merit or unfounded as a matter of law.*

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[387] Katia Yannaca-Small, 'Improving the System of Investor-State Dispute Settlement' (2006) OECD Working Papers on International Investment 2006/01.
[388] Katia Yannaca-Small, 'Improving the System of Investor-State Dispute Settlement' (2006) OECD Working Papers on International Investment 2006/01.
[389] ICSID Secretariat Discussion Paper, 'Possible Improvements of the Framework of ICSID Arbitration' (2005) <https://icsid.worldbank.org/en/Documents/resources/Possible%20Improvements%20of%20the%20Framework%20of%20ICSID%20Arbitration.pdf> accessed 16 October 2018.
[390] Gabrielle Kaufmann - Kohler and Michele Potestà, 'Can the Mauritius Convention Serve as a Model for the Reform of Investor-State Arbitration in Connection with the Introduction of a Permanent Investment Tribunal or an Appeal Mechanism?' (Geneva Center for International Dispute Settlement 2016) 20.
[391] UNCTAD, 'World Investment Report 2013: Global Value Chains: Investment and Trade For Development' (2013) 115.
[392] Katia Yannaca-Small, 'Improving the System of Investor-State Dispute Settlement' (2006) OECD Working Papers on International Investment 2006/01.

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- *World Duty Free Company v Republic of Kenya*, ICSID Case No ARB00/7, Award (5 September 2006)
- *Yaung Chi OO Trading PTE LTD, v Government of the Union of Myanmar*, ICSID Case No ARB/01/1, Award (31 March 2003)
- *Yukos Universal Limited (Isle of Man) v The Russian Federation*, PCA Case No AA 227, Final Award (18 July 2014)