

Investment and Sustainable Development

A Guide to the Use and Potential of International Investment Agreements

By
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The International Institute for Sustainable Development contributes to sustainable development by advancing policy recommendations on international trade and investment, economic policy, climate change, measurement and indicators, and natural resources management. By using Internet communications, we report on international negotiations and broker knowledge gained through collaborative projects with global partners, resulting in more rigorous research, capacity building in developing countries and better dialogue between North and South.

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Executive Summary

It is hard to overstate the importance of investment for sustainable development. Sustainable development is increased well-being of people (particularly poor people), achieved with deference to environmental limits. It requires structural economic change, and that change can only be brought about by investment. In those countries with low levels of domestic savings, that investment must come from abroad, typically in the form of foreign direct investment (FDI).

This book looks at the role played by international investment agreements (IIAs)—which, at their core, are designed to make foreign investment a less risky activity—in fostering sustainable development. This is not an unreasonable framework for evaluation; it is becoming more and more widely accepted that the proper goal in attracting investment is *quality*, rather than *quantity*. In the end, if investment does not increase well-being on a sustainable basis, it is not worth having, much less actively chasing.

There are currently more than 2,000 bilateral investment treaties (BITs) in force. There is also a growing number of investment agreements folded into broader trade agreements, NAFTA's Chapter 11 being the best known. These agreements oblige host states to abide by certain standards of behaviour in relation to foreign investors and their investments. The typical agreement demands non-discrimination against foreigners; places conditions on the state's ability to expropriate; guarantees compensation where expropriation does occur; provides for some minimum standards of fair and equitable treatment; and offers other forms of protection for foreign investors and investments.

IIAs will also spell out processes whereby investors can seek remedy for breaches of those obligations—usually direct arbitration between the investor and the host state. These processes—to different degrees, depending on the rules used—lack the basic qualities of legitimacy, accountability and transparency that we are accustomed to finding in the judicial processes of most democracies. In all but two cases to date the hearings have been closed to the public. Until recently, the arguments in the proceedings were never made public; pressure from civil society has caused this to change in the NAFTA context, but not elsewhere. Final awards are released in all NAFTA cases and many BITs cases, but a large number are still not made public. The exact number is unknown; depending on the system of arbitral rules chosen, there may not even be a requirement to give public notice that an arbitration is proceeding. Arbitrators are chosen by the disputing parties, and are not drawn from a standing roster, but from a pool of practicing lawyers who may subsequently use their decisions to argue cases on behalf of other foreign investor clients (a situation of moral hazard). There is no effective appeals process, often no provision for consolidating similar or related cases, and no means to ensure consistency in the applied law.

None of this would be so problematic if the system were simply handling commercial disputes between contracting parties. But treaty-based arbitration between investors and states has often gone to important issues of public policy, such as the state's right to tax or regulate in the areas of public health and environment. In such a context, the current system, while showing encouraging signs of evolution in some quarters, is alarmingly inadequate.

Recent years have seen an explosion of investor-state arbitrations, in part due to the successful use of their provisions in novel ways arguably unintended by the drafters. It has been held, for example, that government regulation in the public interest, if its impacts on an investor are great enough, can constitute a compensable expropriation. It has also been held that even a good faith measure by a government might violate legal obligations for minimum standards of fair treatment, if proper but largely undefined procedural steps have not been followed—a much lower bar than has traditionally been set. Obligations for most-favoured nation (MFN) treatment have been used to “import” law from agreements to which the home state is not even party. And the definition of national treatment is such that it has spawned challenges to legitimate regulations that happen to have a greater impact on some foreign investors than on competing domestic investors.

Again, the problem would not be so acute were these cases not dealing with key matters of public policy, with implications for the ability of states to act in the public interest. There needs to be a balance between the rights of investors to be protected from wrongful acts by governments (an important right, given our need for investment), and the rights of citizens to protection from the adverse

impacts of some economic activities. This kind of balance is regularly struck by governments making policies that balance competing objectives. But it is dangerous to leave such a balancing act to trade lawyers being guided by rules that are too often narrowly cast toward commercial objectives, rules that, moreover, are based on trade law traditions, and therefore aren't geared to handle the rich complex of relationships between an investment and its host state.

The balancing act is not an easy one. There have been several spectacular failures at the multilateral level to draft rules for foreign investment, starting with the stillborn post-war effort to create an International Trade Organization, running through the remarkable closure of the United Nations Centre on Transnational Corporations, and to the more recent and much-publicized derailment of the OECD's Multilateral Agreement on Investment. Current efforts to craft an investment agreement in the WTO Doha Round of negotiations seem likely to soon join this illustrious list.

In all of these cases, the failure was due to fundamental disagreement about the proper purpose of an investment agreement. Should an IIA promote investment? Should it promote economic development? Should it bind investors to behaviour in the public interest?

The answer comes from the argument with which we started: investment should foster sustainable development. As such, IIAs should aim to promote investment that is consistent with that objective. This will necessarily involve protecting investors and their investments along the lines followed by traditional IIAs (though with important changes to process as well as substance in light of the concerns expressed above). But it will also necessarily involve reinforcing the rights of states to regulate. Put another way, it will assign obligations, as well as rights to investors. It is not unreasonable to demand, in exchange for the extraordinary protection provided by IIAs and their investor-state dispute mechanisms, that investors follow certain basic minimum standards of acceptable conduct, such as full disclosure of past practice, conduct of consultations and environmental impacts assessments and other widely-practiced expressions of corporate social responsibility. It is also conceivable that IIAs should assign obligations to home states—the states from which the investment originates—such as to ensure that investors can ultimately be held accountable at home for their actions abroad.

The path toward such a new breed of investment agreement is fraught with obstacles, both legal and political. There is intense opposition to watering down the protection provided by several thousand existing BITs, and no practical way to amend them all even if there were agreement on the need to do so. And most investors are predictably opposed to elevating their responsibilities to the same level as legally enforceable rights. While the obstacles may be daunting in the short term, a clear-headed look at the fundamentals—the reason we value investment in the first place, and what we hope it might accomplish—will necessarily lead us in the right direction.

1. Introduction

It is hard to overstate the importance of investment for sustainable development. Sustainable development is increased well-being of people (particularly poor people), achieved with deference to environmental limits. It requires structural economic change; it is well established that the current pattern of economic activity is unsustainable, in the double sense that it is environmentally destructive and does not sufficiently promote equity among and within nations. Consequently, the pursuit of sustainable development is the pursuit of a changed economy. This structural change can only be brought about by investment, and in those countries with low levels of domestic savings that investment must come from abroad.¹ Thus the promotion of sustainable development in many countries is ultimately the promotion of investment that improves sustainability. In this sense, there is no economic activity that is more important to the attainment of sustainable development than investment.

Part of the importance of investment stems from its long-term character. While many market analysts emphasize the short-term nature of business, with a focus on the next quarterly report, investments are routinely undertaken with a long-term perspective, frequently reaching 30 years and more. Even investments in the dynamic technology sector are taken within a five-year time horizon. Investments in agriculture, forestry or mining may take as long as 10 years to show a positive return. Some investments establish patterns of production that can persist for decades, even centuries. Most power plants will be rebuilt and refurbished over and over again; some of the sites in the U.S. Midwest that are the source of acid rain in the northeast were established more than 100 years ago. An investment to transform virgin land for agricultural production or forestry changes that land for centuries: crops may vary but the original ecosystem will not return. A mining operation can create an impact that is irreversible within a human time-scale. Any policy that looks to the longer term—as does sustainable development—must look to investment as one of the central factors determining the chances for attaining the goals that have been set.

But, for a variety of reasons, investment does not always go to the destinations most in need of sustainable economic development. For productive investments, access to inputs and (skilled) labour is critical, as is access to markets for the products and services generated by investment. The existence of reliable infrastructure and the quality of services—transport, banking, insurance and government services in particular—are also vitally important.² To a significant degree, investment depends on a number of prerequisites in the host country that, in many developing countries, are not present in any strong measure. Thus we have a paradox: the countries that need investment for sustainable development are those that, by dint of their underdevelopment, may not receive much.

One of the steps commonly taken by governments in the pursuit of investment is to conclude international agreements which clarify the standards of treatment applicable to foreign investors. These international investment agreements are, in theory, a good way to reduce the risks faced by foreign investors, endowing any given destination with a higher rate of expected return.

However, despite the existence of large numbers of such agreements, it remains difficult to establish how effective they are at attracting investment. Indeed, much recent literature seems to find no significant correlation between investment agreements and volume of investment flows.³ This is hardly surprising, given the myriad of other variables that a firm must consider in making an investment decision. But it does raise the question: if our objective is sustainable development, and our interest is in fostering investment that supports it, what is the place of international investment agreements?

The end point of this paper explores that question by asking what type of international investment agreement would actually promote sustainable development. The answer, considered in Chapter 4, bears little resemblance to the existing models.

But first, the paper looks at the experience of existing agreements, not in attracting investment, but in the types of public policy concerns to which they give rise. Investment agreements will typically end up granting rights to foreign investors that create tensions between a host state's commercial policy objectives, and non-commercial objectives such as the environment, and public health and safety. Chapter 2 first looks at the way that the rules under a typical investment agreement might create those types of tension. While there is not a single template for such agreements, there are a number of elements that most hold in common. The analysis here looks at the experience under the invest-

ment rules of the North American Free Trade Agreement, and under the many existing bilateral investment treaties.

Given the public policy implications of investment agreements, the mechanisms they create for resolving disputes are also important. The second part of Chapter 2 looks at the process of investor-state dispute settlement that is common to almost all modern international investment agreements. It raises questions about the legitimacy, transparency and accountability of those processes, noting that these three qualities are essential for institutions mandated to balance private rights against non-commercial policy objectives.

Chapter 3 looks at the experience of investment rules at the multilateral level, both historically—in fora such as the United Nations Centre on Transnational Corporations—and more currently in the failed OECD Multilateral Agreement on Investment and the current and proposed investment rules in the World Trade Organization.

Chapter 4 builds on the analysis described above, and asks how we can do better. What sorts of changes need to be made to the typical international investment agreement, both in terms of process and in terms of substantive provisions? This chapter also explores the potential obstacles to progress, and asks hard questions about the type of institutional home we might posit for the “model investment agreement” we have described.

Endnotes

- 1 Throughout this text, unless otherwise specified, the term “investment” will be used as shorthand for “foreign direct investment.”
- 2 For a list of factors that are key in attracting investment, see: V.N. Balasubramanyam, “Foreign Direct Investment in Developing Countries: Determinants and Impacts,” paper prepared for OECD “Global Forum on International Investment,” Mexico City, November 26–27, 2001.
- 3 See, for example, Hallward-Driemeier, May, 2003. “Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit ... and They Could Bite.” World Bank Policy Research Working Paper 3121, Washington, D.C.: World Bank and UNCTAD, 1998. *Bilateral Investment Treaties in the Mid-1990s*. New York: United Nations.

2. Regional and Bilateral Investment Agreements

This book will consider three broad types of international investment agreements (IIAs): the bilateral investment treaties (BITs); investment rules embedded in regional or bilateral trade agreements; and multilateral agreements on investment. This section groups together the first and second types, as they share a number of common features, while the next section considers the multilateral approach. The analysis here looks first at the rules and processes used in arbitrating investment disputes, explaining the investor-state dispute settlement mechanisms and voicing concerns about the process from a public interest perspective. It then discusses the types of substantive obligations found in most investment agreements, again highlighting those areas of concern raised by our experience to date.

Of the two types of treaties addressed in this section, by far the more prevalent is the BIT. For most of their more than 40-year existence, BITs have enjoyed an exceedingly low profile. They represent an evolution from an earlier generation of treaties of amity—or friendship, commerce and navigation. But they tend to be narrowly focused on a limited number of investment issues, seeking to provide various rights and protections for investors of one nation operating in the other. In particular, they were designed to provide greater legal certainty and protection in a period of decolonization and fierce international debate about the compensation owing to investors in the event of nationalization or expropriation.

Having been virtually ignored by analysts and investors alike for much of their history, since the mid-1990s the BITs have been increasingly turned to by foreign investors navigating their way around the developing world. At last count, the number of these treaties stood at 2,099.⁴ OECD nations have sewn up dozens of BITs with a cross-section of developing countries, often with very little fanfare or publicity.

Lately, some countries such as the U.S. and Canada have also begun to incorporate investment provisions into broader bilateral or regional trade agreements negotiated with trading partners.⁵ The best known of these is perhaps the 1994 North American Free Trade Agreement (NAFTA), which covers Canada, the U.S. and Mexico and which occasioned the first investment disputes to come to broad public attention.⁶ But in the first few years of the decade there has been a flurry of new bilateral trade agreements that also cover investment. The proposed Free Trade Area of the Americas (FTAA), covering 34 countries of the western hemisphere and slated (but not expected by many) to be negotiated by 2005, is also supposed to contain investment provisions.

Both the BITs and the bilateral and regional trade agreements offer an array of investor rights and protections that vary from case to case but which have a more or less standard character. As well, the majority of these treaties (particularly those negotiated since the 1980s) offer investors the right to challenge their treatment at the hands of host states before international arbitration tribunals. The following section considers the process of arbitration as offered by the typical bilateral or regional agreement. It is followed by an in depth analysis of the substantive rights and obligations that form the basis of these disputes.

2.1 Investment arbitration rules used in BITs and trade agreements

Bilateral investment treaties and investment agreements embedded in trade agreements typically allow for private parties (investors) to directly initiate arbitration with host states, using what is known as an investor-state dispute mechanism. This procedure contrasts to the process of trade law disputes, for example in the WTO, which are strictly state-to-state.

These treaties do not typically include detailed procedural rules for the arbitration of investment disputes. Rather they tend to refer to pre-existing rules of arbitration, or to the possibility of so-called classical ad hoc arbitration under rules agreed upon by the two disputing parties. There are five sets of pre-existing arbitral rules which are commonly referenced in investment treaties. These can be divided into institutional rules (i.e., those where a supervising institution administers the arbitration)

and ad hoc arbitration (where there exists a set of rules to be used but there is no supervisory institution, as under the 1976 UN Commission on International Trade Law [UNCITRAL] rules).

Of the institutional forms of arbitration referenced in treaties, the two most common are those offered by the International Centre for Settlement of Investment disputes (ICSID). ICSID was established in 1965 as part of the World Bank Group. The Centre provides for supervised arbitration and conciliation of investment disputes, and is unique insofar as its cases are listed on a central docket which is available to the public. The standard ICSID rules are available where both parties are ICSID member states (or, in the case of the investor, hail from an ICSID member state), whereas the so-called ICSID Additional Facility (AF) rules are available where one party does not qualify for arbitration under the regular ICSID rules.

Two other international arbitration bodies that are referred to in some investment treaties, and which may be used where the parties do not qualify for ICSID arbitration, are the Stockholm Chamber of Commerce's Arbitration Institute and the International Chamber of Commerce's Court of Arbitration. However, reference to these rules is much more rare. The SCC rules tend to be found more often in treaties between Western nations and those in Eastern Europe or Asia, reflecting Stockholm's historical role as a forum for resolving commercial disputes between East and West. The ICC rules are less often found in investment treaties, but do appear in some treaties concluded by countries such as the U.K. and Cuba, and were proposed for inclusion in the ill-fated OECD negotiations for a multilateral agreement on investment (MAI).⁷

Typically, where countries accede to the purpose-built ICSID facility (at the time of this writing 140 nations had done so) they will not include references to other institutional arbitration forums in their subsequent investment treaties.

Of the ad hoc procedures for arbitration, by far the most used are the 1976 UNCITRAL rules, which are very often included in bilateral investment treaties. The de-localized and unsupervised nature of UNCITRAL arbitration makes it particularly elusive for analysts who seek to monitor investor-state disputes.

An important distinction between the ICSID rules and the other fora for arbitration discussed above—and one that explains some of ICSID's unique features—is that the former were designed expressly for the resolution of investor-state disputes; ICSID does not handle commercial arbitration between two firms. The other fora, by contrast, were set up precisely to handle that type of commercial dispute, but have (probably increasingly of late) also been used for the settlement of investor-state disputes.

The following sections explore some of the implications and shortcomings of these various rules used for investor-state arbitration.

2.1.1 Lack of transparency and openness

Transparency and participation are essential safeguards used by most democratic societies to ensure the legitimacy and accountability of judicial proceedings. There are several types of desirable mechanisms of transparency and openness that would be found in the ideal international investment agreement. They are:

- public release of notice of intent to arbitrate (filed by the investor), and of the initiation of proceedings;
- public release of all arguments submitted to a tribunal;
- public release of tribunal awards and decisions;
- public access to arbitral hearings; and
- the ability to petition an arbitral proceeding for friends of the court (*amicus curiae*) status.⁸

The institutions surveyed in the previous section, of themselves, have surprisingly rudimentary requirements for transparency and openness. Of the various fora for investment arbitration only ICSID provides even a public registry listing all disputes. The UNCITRAL Secretariat is notable for not even maintaining internal records of cases brought pursuant to the UNCITRAL arbitration

rules. This owes to the ad hoc nature of these rules, which may be used in arbitrations anywhere in the world without any need for assistance from the UNCITRAL Secretariat. The ICC and SCC rules fall somewhere in between: while they are administered by a permanent secretariat, no public record of treaty disputes is maintained by either institution.

As to the tribunal decisions and awards, the rules of ICSID, UNCITRAL and the SCC provide that where both parties consent, awards can be published (and in the case of ICSID, usually are). Under ICSID, each party also enjoys the right to publish the award unilaterally, should it wish to do so. Where ICSID does not have the consent of the parties it may, nevertheless, publish particular excerpts from the awards to illustrate key legal developments.

As to the permitting of *amicus curiae* status to non-disputants, all known arbitral rules, including those of ICSID, require the express permission of the two parties in order to allow other interested parties to attend or intervene in *oral* arbitral proceedings⁹ (but they make no mention of written submissions). And none allows the opening of procedures to the public—something which is, of course, standard fare for judicial processes in most democracies (though this could conceivably be done with the express consent of the parties).

This lack of transparency reflects the fact that rules such as those of UNCITRAL, the ICC or the SCC were originally intended for the resolution of private commercial disputes, typically between two business entities, a form of commercial arbitration characterized by one pair of authors as a system of “private justice in the service of merchants.”¹⁰ However, the modern usage includes an ever increasing number of arbitrations between investors and states, in cases with implications that go far beyond the commercial, to impact such public policy objectives as the environment, health and safety. In such cases, a wider group of stakeholders than the two disputants will share a legitimate interest in the dispute, which argues for some measure of transparency and openness to public involvement.¹¹

In response to public criticism of the closed nature of the proceedings mandated under existing IIAs, there has been—at least in the North American context—a welcome move to draft improved conditions of openness and transparency in the agreements themselves, in effect altering the nature of the proceedings that will take place under the existing arbitral institutions. In the NAFTA context, the arguments of the disputants and third parties in any given dispute are now routinely posted to the government Web sites of the NAFTA Parties.¹² Further, the NAFTA Parties in October 2003 issued, among other things, a joint statement of suggested guidelines to tribunals considering petitions for *amicus curiae* status.¹³ And a precedent was recently set when a NAFTA Chapter 11 tribunal approved petitions to intervene as *amici curiae* by the International Institute for Sustainable Development and another NGO.¹⁴

Also in October 2003, Canada and the U.S. issued statements indicating that they will push for public hearings in all Chapter 11 cases that involve them—a commitment that Mexico apparently was not ready to make.¹⁵ While this is encouraging, the final result will be determined by the tribunal in each case, which will also take note of the wishes of the investor. The NAFTA Parties have the power to issue binding interpretations of Chapter 11’s substantive provisions, but their power over the tribunals’ proceedings—which are governed by the rules of ICSID or UNCITRAL—are limited.

This is not a problem for future agreements, however, which can simply direct the manner in which the Parties would like to see arbitral proceedings take place.¹⁶ In fact, in no small part due to recognition of the NAFTA’s shortcomings, the U.S. has begun to do this. In February 2004, the U.S. produced an altered draft of what it calls its “model BIT”—the template it uses to negotiate BITs. The new draft included obligations for:

- mandatory public disclosure of legal pleadings, transcripts and final awards of investment tribunals;
- hearings conducted in a manner open to the public; and
- a right of non-parties to apply for permission to intervene as *amicus curiae*.¹⁷

This welcome change in practice had already been put into effect in the U.S. free trade agreements (as opposed to BITs) with Chile, Singapore and the five Central American states, concluded in late 2003. For the time being, however, these developments seem to be confined to the U.S.

2.1.2 Selection of arbitrators

Another concern arises as a result of the methods by which tribunals are chosen. Typically, each of the disputing parties will select one of the three arbitrators to handle the dispute, and these two nominees will together select the third arbitrator. As might be expected, it is not uncommon for parties to a dispute to appoint an arbitrator who, while not partial to their case, will nevertheless be “sympathetic” to it. Two expert commentators note:

“The ability to appoint one of the decision-makers is a defining aspect of the arbitral system and provides a powerful instrument when used wisely by a party. It is also a truism that a party will strive to select an arbitrator who has some inclination or predisposition to favor the party’s side of the case such as by sharing the appointing party’s legal or cultural background or by holding doctrinal views that, fortuitously, coincide with a party’s case.”¹⁸

Other experts on international investment law have been far more scathing in their assessment of the process by which arbitrators are selected. Professor M. Sornarajah in a recent keynote lecture has raised fears about the commercial-bias of arbitrators:

“Their concern for the values of the international community is weaker than their concern for contractual sanctity and the securing of their next appointment to a tribunal on the basis of their display of commercial probity and their loyalty to the values of multinational business.”¹⁹

There are also grounds to be concerned that lawyers work both sides of the arbitral street, so to speak, in their roles as arbitrators in some cases, and as advocates in others. Arbitrating panelists are not necessarily drawn from a permanent roster of arbitrators, but are generally drawn from what might be called the international commercial arbitration bar. This is especially the case for the third arbitrator selected as President of the panel. As a result, arbitrators can be deciding cases on one file, and arbitrating on behalf of clients in other files facing similar legal issues. Decisions they make as arbitrators may impact the positions of their own clients, or of colleagues in their firms or through other contacts.

In a recent example of this dynamic, a former President of the International Court of Justice acted as counsel to a multinational water firm alleging violations of BIT provisions on expropriation, “fair and equitable treatment,” and “protection and full security” at the hands of the Argentine government. In other cases, the same individual was given a direct hand, as a party-appointed arbitrator, in interpreting these same treaty commitments in a dispute involving the Czech Republic and a Dutch-registered broadcasting enterprise. In so doing, he enjoyed the opportunity to help influence the direction of substantive treaty interpretation in areas of interest to his clients.

The point here is not that the arbitrators lack personal integrity, but simply that the system for the selection of arbitrators permits individuals to argue for broad interpretations of the treaty rights on behalf of clients, at the same time as those individuals might be acting as arbitrators in other treaty claims. The most basic legal principle of any legal process, that justice must be blind, is clearly not at play here.

2.1.3 Lack of precedence

Due to arbitration’s origins as a method of private dispute resolution, arbitral awards are only binding on the two parties involved; indeed, in one its most famous cases, an ICSID annulment committee explicitly warned that there is no rule of precedent in the ICSID arbitration system.²⁰ Nonetheless, tribunals often look to and rely upon earlier arbitral decisions as guidance in their deliberations. Indeed, observers first noted over a decade ago that the disputes were contributing to “a new international law of foreign investment to respond to the demands of the new global economy.”²¹

Given the likelihood that earlier arbitral decisions will be taken into consideration by subsequent tribunals, it is remarkable, as noted above, that there are no uniform requirements that such decisions be publicized. For example, a prominent Washington law firm boasts on its Web site that it has obtained an award on behalf of a multinational oil company against the government of Kazakhstan, under the U.S.-Kazakh BIT. However, this award has not been published due to a confidentiality agreement between the parties. Nevertheless, it is clear that the award saw an interpretation—and hence, elaboration—of the circumstances under which a host state’s regulatory and permitting processes will have effectively operated so as to expropriate an investor’s assets.²²

Beyond the obvious problem that this entails for host states who cannot be fully apprised of the possible substantive meaning of the commitments to which they have acceded in the various BITs, this creates an unfair information imbalance. States or investors with the financial resources to hire major international law firms specializing in this area will enjoy greater entrée to this disparate body of arbitral decisions through the formal and informal links those firms maintain, than will many developing country counsel relying on scattered and incomplete sources.

2.1.4 The possibility of multiple arbitrations

A further problem posed by investor-state arbitration is that most treaties allow for the possibility of multiple arbitrations arising out of essentially the same facts, with the risk of separate tribunals reaching widely divergent conclusions. Because BITs (unlike investment rules within trade agreements) do not typically include provisions requiring the consolidation of related cases, there is broad scope for such parallel proceedings. Two recent UNCITRAL arbitrations brought under different BITs negotiated by the Czech Republic illustrate this shortcoming.

In the first case, a broadcasting enterprise brought a BIT claim, and in the second case, the major shareholder of that same enterprise, brought another claim under a different BIT.²³ The two arbitral Tribunals reviewed essentially the same facts and claims, and reached opposite conclusions. One Tribunal found no significant violation of the relevant BIT, while the other Tribunal handed down an award which held the Czech Republic to be in violation of five key treaty provisions, paving the way for an unprecedented compensation payment of more than one third of a billion dollars (U.S.) to be disbursed to the investor.

It will be difficult for any emerging corpus of international investment law to incorporate such flatly contradictory awards. In the same vein, many fear that a string of related but separate claims lodged against the Argentine Republic could throw the investment arbitration scene into confusion.²⁴ Indeed, with multiple arbitrations by related, but legally distinct, investors now increasingly common, there is a growing risk to the very credibility of the investor-state process.

2.1.5 Post-award remedies

Another weakness of the existing system of investor-state dispute settlement is that it is difficult to review the decisions of the arbitral tribunals. Depending upon which arbitral rules are used, post-award remedies will vary significantly. Under the ICSID rules, arbitrations are insulated from domestic legal systems and the parties have recourse only to a handful of narrow, exacting grounds for annulment of the final award by another panel of ICSID arbitrators. Some critics have raised concerns about this insulation of ICSID awards from external review; Professor Sornarajah warns, “(T)he extent to which sovereignty becomes undermined by the development of a regime that is totally beyond the control of states is a disquieting factor.”²⁵

Conversely, in arbitrations brought under any other set of arbitral rules, including ICSID’s AF rules, the disputants enjoy an ability to review the award in the courts where the arbitration had been legally sited. Indeed, the Czech Republic attempted (unsuccessfully) to challenge one of the two awards related to its aforementioned broadcasting dispute. Because arbitrations are often confidential—and even the existence of a case may not be publicly known—review in local courts sometimes serves to expose hitherto unknown cases to the light of day.²⁶

Where available, judicial review of awards will be guided by applicable domestic arbitration acts and international arbitration conventions. These generally contain much more limited grounds for review than a genuine appeal process would have; reviewing courts can return cases to the original tribunals only when an egregious error of law has been committed—an error of a magnitude that vitiates the tribunal’s jurisdiction to make the award as it did.²⁷ Parties may also attempt to challenge enforcement of the award in any domestic legal system where the victorious party seeks enforcement of the award. Thus, some awards will be subject to a limited review by domestic legal systems, while others, for example under the ICSID Convention, will never come into contact with those systems.

In the end, there is no real appeal process; the review cannot rule on simple errors of fact or law, or substitute a decision for the one made by the tribunal. The widely acknowledged value of the WTO’s

permanent Appellate Body in giving consistency and predictability to the process should be seen as instructive.

Here, as in the area of transparency and openness, there have been some promising signs in the context of new agreements. The U.S. model BIT envisions the Parties considering, within three years of the entry into force of the treaty, the possible establishment of an appellate body to review arbitral decisions. This language is also found in the investment chapters of the U.S. free trade agreements with Chile, Singapore and the five Central American states.

2.1.6 Summary of dispute settlement procedures

Given that portions of the existing dispute settlement process evolved from the world of international commercial arbitration, where opaque ad hoc resolution was seen as desirable by the business community, it may not be surprising that there are growing calls for a more formalized and transparent process to apply to investment treaty disputes. Even the ICSID process, which was expressly designed for investor-state arbitrations, has been criticized for the lack of transparency surrounding ongoing cases, and the insulation of the regime from the review of domestic courts. In the NAFTA context, there have been calls for a permanent North American Trade Court or appellate review process, and for the creation of such mechanisms in any proposed Free Trade Area of the Americas.²⁸ The recent U.S. trade deals with Chile and the Central American states contain provisions for the investor-state mechanism to append an appeals process from the FTAA context, should one eventually be established. To date, however, there have been fewer proposals for reformed and consolidated dispute settlement procedures in the context of the BITs.²⁹

None of these concerns would be as pressing were it not for the fact that the disputes heard in such fora are dealing increasingly with matters of public policy—such as environmental regulation, protection of public health and safety, the provision of public services—in which the public at large clearly has a legitimate interest. This interest was clearly identified by the tribunal in the case *Methanex v. the United States of America*: “There is undoubtedly a public interest in this case. The substantive issues extend far beyond those raised by the usual transnational arbitration between commercial parties.”³⁰

Beyond the issues dealt with in this section is the question whether the existing fora and processes are appropriate for such cases in the first place, given that they perform a balancing of competing public policy objectives, with final results that impact on the public welfare. In one pending NAFTA case, for example, the right of the investor to import its product must be balanced against the right of the public to limit its exposure to suspected carcinogens.³¹ This type of balancing is done on a regular basis by dedicated domestic institutions, including the judiciary and various governmental bodies. There is, however, a striking contrast in the attributes of these well-developed institutions and the arbitration model described above. In democratic systems of governance, the former are usually carefully constructed so as to operate with legitimacy, accountability and transparency; qualities that are lacking in the latter. Where the task at hand is balancing private rights against public good, the decision-making forum offered by the investor-state dispute settlement mechanism is wholly inadequate.

But even the best-designed forum for dispute settlement would be only as good as the rules on which it was expected to base its judgement. The next section turns to a critical analysis of the rights and obligations afforded investors and host governments under international investment agreement.

2.2 Rights and obligations under IIAs³²

The previous section of this paper looked at the process used to arbitrate investor-state disputes under investment agreements in BITs and bilateral/regional trade agreements. This section looks at the rights and obligations on which those disputes are based—the rights accorded to investors under the agreements, and the concomitant obligations accepted by signatory states (investment agreements typically give host states no rights, nor do they impose obligations on investors).

The provisions of IIAs are not uniform; while some of the key countries in the OECD have their own preferred templates for such agreements, these are constantly evolving, such that the “standard”

agreement of the mid-twentieth century is markedly different from the “standard” agreement today. The result is a complex web of agreements, with provisions that differ even among parties to agreements with the same third country.

That said, there is an identifiable core set of provisions that characterize most of the recent treaties, and this section will devote itself to their analysis. In examining the implications of those provisions, the paper will necessarily rely heavily on case law drawn from the NAFTA context, NAFTA being the only agreement that systematically makes awards and argumentation public.

The core provisions include obligations by host governments to foreign investors for:

- absolute standards of treatment, such as “fair and equitable treatment,” or “full security and protection”;
- national treatment, or treatment no worse than that accorded domestic investors in “like circumstances;”
- most-favoured nation treatment, or treatment no worse than that accorded investors in “like circumstances” from third countries;
- compensation in the case of direct or indirect expropriation; and
- freedom from mandatory performance requirements as a condition of entry or operation, such as requirements to transfer technology, requirements to export a certain percentage of production, or requirements to purchase inputs domestically.³³

Each of these provisions is examined below. But first it is useful to set the obligations in context by describing the scope of the typical agreement: what exactly is covered by these commitments?

2.2.1 Scope and coverage

All sectors are normally covered by investment agreements, with the exception of those explicitly carved out; most agreements have exceptions for certain sensitive sectors.

Investments are defined broadly, particularly in the new generation of agreements. Under the NAFTA, for example, investment encompasses not only direct investment by an enterprise, but also such things as a debt security or loan to an enterprise, or equity securities in an enterprise. A holder of a bond from a multinational enterprise is thus an investor, conferred with the extensive legal rights discussed below. This definition has been extended by several rulings that have held that a company’s *market share* is an investment asset that can be protected. So when the U.S. market share of Pope & Talbot—a U.S.-owned forest products company operating in Canada—decreased as a result of Canadian government policy, the Tribunal agreed that this market share itself was an asset of the investor protected by the provisions of Chapter 11.³⁴ In effect, this approach has the potential to bring the full gamut of *trade* measures, such as bans and restrictions, under the purview of NAFTA’s *investment* law, as most trade measures will affect market share.

The measures that are covered—those acts that might affect investments—are also broadly defined. Again, from the NAFTA’s Chapter 11, a measure is “any law, regulation, procedure, requirement or practice.” This covers most conceivable acts of government (at all levels from federal to municipal), from lawmaking to zoning codes, and even extending to cover the actions of the courts.

Generally, treaty provisions will only apply to investments once they have been permitted to be established in the host state. However, some treaties—particularly those championed by the U.S., Canada and Japan—may extend *entitlements to invest* into the host state, so-called pre-establishment rights.³⁵ Extending this right of establishment either eliminates or significantly restricts a host state’s legal right to screen investments for those most suitable to domestic priorities, or to protect “infant industries” by barring investment in particular sectors. Pre-establishment rights can be made generally applicable, subject to certain declared and listed exceptions (as was done in NAFTA), or be set out for specifically listed sectors only (as was done in the WTO’s General Agreement on Trade in Services). Whichever approach is chosen, if a sector is covered, then the host state must let foreign investors with these rights come as they will, though once there they must abide by the same rules applicable to similar domestic operators.

2.2.2 National treatment

This keystone obligation is found in all standard investment treaties. NAFTA's language on national treatment obliges Parties to "accord to investments of investors of another Party treatment that is no less favourable than that it accords, in like circumstances, to those of its own investors." It is important to note that finding a breach of national treatment obligations does not seem to involve proving *intent* to discriminate—two NAFTA tribunals found that a *de facto* difference in treatment was sufficient.³⁶ If followed by other tribunals, this reasoning would place a heavy burden on government policy-makers and regulators; most measures will have differential impacts on the various market actors, and it is not clear what types of "armour" a legitimate regulatory measure would need in order to avoid breaching the national treatment obligation.

From an environmental perspective, the main cause for concern with the national treatment obligation is the difficulty in determining whether circumstances are "like."³⁷ Clearly the text does not mean "identical," but neither do any of the treaties give any guidance on how to determine whether circumstances are sufficiently similar as to trigger this obligation.

For example, if several existing firms are already established at a location with emission permits that exhaust the receptive capacity of the relevant ecosystem, would it amount to a breach of national treatment obligations to issue a permit with much more stringent requirements to a foreign investor seeking to open another plant at the same site? Certainly, the foreign investor is not being treated as well as the existing domestic firms. If there is existing legislation that clearly authorizes this kind of differentiation this may not be an issue—any reasonable panel would give deference to regulatory authority in such a case. But if the differentiation is a matter of administrative discretion, and the new entrant faces a licensing process that reduces its prospects of competing successfully, or faces new legislation designed to deal with excess pollution at the site, then the jury is out as to how a panel would interpret such a situation.

NAFTA rulings to date have been mixed, and have left us not much closer to an agreed understanding of how to determine like circumstances. In a particularly convoluted piece of reasoning, a NAFTA panel (*S.D. Myers*) ruled that a Canadian processor of hazardous waste was in like circumstances with a Canadian office established by the U.S. investor for the purpose of brokering the export of hazardous waste. That being established, it was a simple matter to show that an export ban on hazardous waste accorded very different treatment to the two and, therefore, represented *de facto* discrimination.

The ruling in another NAFTA panel (*ADF*) also gives pause for thought. ADF was a contractor bidding to supply structural steel components in a Virginia highway construction project, but as its offices are located in Canada it ran afoul of the federal "Buy USA" regulations that cover any project with federal support. The Tribunal ruled that both ADF and the U.S. competitors were in like circumstances—both had to comply with the same local content regulations. But it also seemed to suggest that if ADF had more strongly made a case for economic damage as a result of the regulation, it would have successfully demonstrated a breach of the national treatment obligations.³⁸

The NAFTA Tribunal in *Pope & Talbot*, on the other hand, used reasoning that seems a more rational application of national treatment obligations. Pope & Talbot, a U.S.-owned forest products company operating in the Canadian province of British Columbia, had argued that it was in like circumstances with producers in those provinces that were not restricted by the quotas of the Canada-U.S. Softwood Lumber Agreement. The tribunal rejected these arguments, noting that the differential treatment bore a "reasonable relationship to rational policies not motivated by preference of domestic over foreign-owned investments." This is a welcome sign of deference to governmental authority in balancing the many competing priorities of public policy.

2.2.3 Most-favoured nation treatment

This obligation requires that states accord to foreign investors treatment no less favourable than they accord, in like circumstances, to investors of any other country. In other words, all investors covered under such provisions should be "most-favoured."

There is, of course, the same problem here as in the national treatment provisions: what constitutes like circumstances? But another concern haunts the MFN obligations. That is, they may provide a way to import into IIAs the most favourable treatment found in any of the investment treaties signed

by the defendant in a dispute. If a party is obliged under a BIT to provide a certain standard of protection, but a higher standard exists in a BIT signed by that party with another country, does the most-favoured nation obligation mean that the higher standard prevails? For example, if the existing U.S.-Zaire (now Democratic Republic of the Congo) BIT were to set a very low threshold for finding regulatory expropriation, could that standard be accorded to non-DRC foreign investors in the U.S. by means of Chapter 11 or BIT-based MFN obligations?

This possibility is more than speculative. At least one bilateral investment treaty dispute (*Maffezini vs. the Kingdom of Spain*³⁹) found in favour of such a use of the treaty's MFN provisions in relation to some procedural elements. Similar arguments have been made in a number of NAFTA cases arguing this should be extended to substantive elements as well.⁴⁰ So far, however, they have been without success.

The issue remains controversial. In the *Maffezini* context the Tribunal was careful to stress that MFN could not, in their view, be applied in a way that would be inconsistent with the clear intent of the parties. Subsequent cases have also limited the possible application of third party treaties to situations where any "imported" rights do not significantly impact the substantive rights so as to "go to the core of matters that must be specifically negotiated by the contracting parties."⁴¹

The controversy over this type of use of MFN is unlikely to be resolved any time soon. It points to the need to carefully consider the relationship between different treaties when they are drafted. If the MFN obligations result in the risk of a "reading in" of investor rights and remedies negotiated in another context, and the potential expansion of any rights, obligations and remedies negotiated in the WTO context, this would raise very significant concerns from both a legal and policy perspective.

This issue provides one more illustration of the hazards involved in taking rules and concepts developed for one purpose—in this case MFN for trade in goods—and applying them to a different activity, such as investment. While MFN for trade in goods generally applies to standards and other regulatory requirements for products as well as taxes, MFN for investment deals with rights acquired by an investor. While the principle of non-discrimination is of course unimpeachable as a goal, the means to achieve it in relation to investments will have to differ notably from those deployed to ensure non-discrimination for trade in goods.

2.2.4 Minimum international standards of treatment: fair and equitable treatment; and full security and protection

The typical investment agreement contains an absolute standard of treatment for foreign investors, irrespective of the treatment accorded to domestic investors in like circumstances: some sort of minimum standard of treatment. Most BITs frame this in terms of the twin obligations of full security and protection and fair and equitable treatment. The former relates primarily to periods of insurrection, civil unrest and other public disturbances. It covers damages sustained by an investor during such periods, whether due to acts by the government itself, or to acts by others against which the government or police failed to protect the investment.

The latter has been more frequently used as grounds for dispute to date. Its historical roots are in customary international law cases where the general state duty to protect aliens was seen to be breached only when the conduct was of an egregious and shocking nature.⁴²

However, recent cases in the NAFTA and BITs contexts have seen this bar raised to a more stringent standard for government behaviour.⁴³ One recent ruling (in the case of a court proceeding) characterized the relevant test as "manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety."⁴⁴

The Tribunal in *Mondev v. United States* made three findings of key interest with respect to minimum international standard of treatment. First, it held that the standard is evolutionary in character, such that the standard today is much different than that found in the early BITs from which it derives.⁴⁵ Second, the standard does not involve each tribunal applying its own "idiosyncratic" interpretation to the case at hand, but must derive in each case from existing international law.⁴⁶ Finally, the Tribunal noted, in a finding that has been echoed by subsequent cases, that under the modern standard a state may in fact breach this obligation without necessarily acting in bad faith.⁴⁷ This represents a major departure from the "egregious and shocking" standard.

In the BIT case *Tecmed v. Mexico*, the tribunal made its central focus the breach of the investor's expectations for fair and equitable treatment.⁴⁸ Here the bar for government behaviour was set fairly high, with the Tribunal in effect requiring the host state to act in a manner that is among other things transparent, free from ambiguity, and consistent. These, of course, are reasonable expectations. But by holding them to be elements of a minimum international standard of treatment, the Tribunal elevated them beyond expectations to legally binding obligations.

Only two BITs cases seem to have adopted more traditional approach to the standard. In one of these, *Genin v. Estonia*, the Tribunal defined it to include “acts showing a wilful neglect of duty, an extreme insufficiency of action falling far below international standards, subjective bad faith, or a wilful disregard of due process.”⁴⁹ This is closer to the egregious and shocking test found in *Neer* than the reasoning found in most other recent rulings.

The final state of play—the result of the “evolution” of the conception of minimum international standard of treatment—is the existence of a much more stringent standard for government behaviour than the traditional one. Under this standard, open good faith efforts that violate investor expectations may be treated as breaches. The result is that a range of measures that would not be challengeable in domestic courts under traditional administrative law rules can now be brought to arbitration under a mechanism for redress only available to foreign investors. Among the recent cases where this standard has been applied to find a violation of host state obligations are:

- the non-renewal of a land-fill operations licence in Mexico;⁵⁰
- the requirement to produce what was termed excessive documentation for export permits in the forestry sector in Canada;⁵¹
- the improper transfer by a government official of funds from a private bank account in Spain;⁵² and
- the breach of an investor-state contract.⁵³

To be clear, in many of these cases the behaviour of the governments involved was far from exemplary. The point of listing them here is not to defend those actions, or to argue that the awards were misguided, but rather simply to demonstrate that the modern standard covers a wide range of government behaviour, leaving states much more open to this kind of challenge than was the case under the traditional “egregious and shocking” test.

The implication for governments is a requirement for a level of institutional development that may not exist in many states, particularly in developing countries. Measures affecting foreign investors should be supported by rigorous analysis, transparency and fairness of process, openness to public input, rights of appeal and a number of other institutions that may still be in their infancy in many jurisdictions. There is some irony here, since one of the key ostensible reasons for IIAs in the first place is the underdevelopment of domestic institutions for managing investment in developing countries. The emerging standard on fair and equitable treatment now risks setting an international procedural bar that these countries cannot reach.

2.2.5 Expropriation

Just as the minimum international standard obligations have seen significant development in the past few years, so has the very common obligation on expropriation contained in virtually all international investment agreements.

The language on expropriation usually, but not always, stipulates that any expropriation must fulfill four conditions. It must be:

- a) for a public purpose;
- b) non-discriminatory (that is, not targeted at a specific company or nationality);
- c) in accordance with the due process of law; and
- d) compensated by the expropriating government.

Most agreements also note that its strictures cover both direct and indirect expropriation (some just refer to expropriation and measures tantamount to expropriation). But, importantly, they provide little in the way of definition for these terms. This is not so problematic with the former; direct expropriation—the physical taking or nationalization of an enterprise, usually involving a transfer of ownership to the state—is easy to identify, and there is a significant body of international law to guide arbitrators in addressing it.

But indirect expropriation is much more difficult. Several forms have been discussed in different comments or cases to date:

- a measure tantamount to expropriation, where a measure while not directly taking the property has the same impact in effect of depriving the owner of all benefits of the property (e.g., the replacement of the Board of Directors or blockading the perimeter of a facility to prevent goods moving in or out);
- creeping expropriation, or the use of a series of measures in order to achieve a direct or indirect expropriation. In this case, no individual measure in itself would amount to an expropriation but the sum of the measures could be looked at as such; and
- what has come to be argued as regulatory expropriation (in fact a subset of measures tantamount to expropriation), where a measure is taken for traditional regulatory purposes but has such an impact on a foreign investor that it is deemed an expropriation.

This last form follows the so-called U.S. doctrine of regulatory takings which, according to some, holds that a regulation can amount to a form of indirect expropriation by virtue of having a significant negative impact on the economic value of an investment. For example, a government might ban the use of a product hazardous to the environment that an investor either makes or uses, causing that investor significant economic damage. Under a takings doctrine, compensation would be due. With the advent of NAFTA's Chapter 11, the debate about this expanded concept of expropriation moved from the U.S. judicial and political systems to centre stage in the international arbitrations, propelled there by foreign investors testing its provisions. The comments that follow are focused on this third form of indirect expropriation.

The key question in regard to regulatory expropriation is this: if a government measure is undertaken for a clear public welfare purpose (such as health and safety, environment, public morals or order, etc.), and is non-discriminatory, but has the effect of harming a foreign investor, are there any circumstances under which that measure can be held to be an indirect expropriation, for which the government must pay compensation? If so, what are those circumstances?

The concern is obvious: most people would agree that taxpayers should not be paying investors to alter behaviour that is contrary to the public interest. A secondary concern is that regulators who are held liable for their impacts on investors will not regulate to the extent that they should (the *regulatory chill* argument).

What might allay these concerns? Most obvious would be a clear statement that regulations that apply to all firms (that is, non-discriminatory regulations of general application) cannot be held to constitute expropriation. However, such an approach would leave a very wide scope for governments to cloak expropriation in the guise of regulation. Analysts from both sides of the investment rules debate agree that such a broad statement is not workable.⁵⁴

Failing that, we might look for some delineation that would exempt *bona fide* public welfare regulations from being considered expropriation. That is, non-discriminatory regulations that are obviously intended to serve the public good, such as environmental protection and human health and safety measures, while they might impact on the profitability of some companies, could not be held to be expropriation. This would involve defining the “untouchable” regulations, or at least giving guidance as to their characteristics. While drawing that line in the sand has proven too difficult a task for NAFTA negotiators to date (due largely to Mexican reluctance to move in this area), the U.S. has established fairly strong limits on the reach of the regulatory takings doctrine in its new draft model BIT, and in the obligations set out in its free trade agreements with Chile, Singapore and the Central American states.⁵⁵

Finally, failing guidance from the rule-makers, we might hope to see at least some signs that the tribunals were considering the purpose and intent of regulations, as opposed to simply looking at the extent to which they affected investors. Such a consideration would in the end come close to being a case-by-case determination of what regulations should be exempt, presumably on the basis of their *bona fides* and their public welfare objectives. In one of the first cases to consider the regulatory expropriation argument, the *Metalclad* Tribunal considered the case of a U.S. hazardous waste company (Metalclad Corp.) that was denied the ability to establish a hazardous waste processing facility in Mexico, first by bureaucratic means and finally by a decree that the land on which the plant was located would henceforth be a nature reserve for the preservation of rare cactus species. The Tribunal in this case ruled that “The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree.”⁵⁶ The fact that there was substantial interference was enough to establish expropriation, and it was unnecessary in its view to ask *why* that interference had occurred.

The Tribunal in *Pope & Talbot*, considering whether that company’s Canadian forest products export business had been expropriated by Canadian forest management regulations, took a similar tack: the test of whether there has been an expropriation has nothing to do with the measure’s objectives but is judged only by whether the degree of interference is great enough.⁵⁷ If followed, this reasoning threatens to seriously erode the ability of governments to regulate in the public interest. Or, more precisely, it would have governments pay each time such regulations sufficiently impacted a foreign investor, even if the regulations were non-discriminatory and were legitimately designed to serve the public good.

Subsequent rulings have taken a somewhat different approach, specifying that while a regulation can clearly constitute an expropriation, this will only rarely be the case. The Tribunal in the *S.D. Myers* case, where a U.S.-based processor of PCBs complained that its investment in Canada had been expropriated by a Canadian export ban on PCBs, ruled that “Regulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, although the Tribunal does not rule out that possibility. Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference.”⁵⁸ But the majority of the Tribunal looked only to the temporary nature of the measure in this case, as opposed to considering its purpose, in denying a finding of expropriation.

This same tack was followed in the subsequent *Feldman* case, where the Mexican tax authorities in effect shut down a “grey market” cigarette exporting business through tax measures (not strictly regulations) with which the business could not possibly comply.⁵⁹ In that case, the Tribunal was guided in its considerations by the American Law Institute’s “Restatement of the Law Third, the Foreign Relations of the United States,” which says on the subject of regulatory expropriation:

“... A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory....”⁶⁰

In other words, if the measure in question is propounded and implemented in good faith and is non-discriminatory, then it cannot constitute an expropriation no matter what the extent of the damage. The *Feldman* Tribunal did not go so far as to explicitly use this reasoning in its findings, and did not actually consider whether the measure met these criteria. But the fact that it referenced this passage and used it as guidance shows at least that there is a viable alternative to the approach used in *Metalclad* and *Pope & Talbot*.

A more recent BITs case, however, goes back to using the extent of impact test for expropriation. In *Tecmed v. Mexico*, the Mexican government effectively shut down a hazardous waste processing plant by refusing to re-issue its operating permit.⁶¹ The Tribunal in that case ruled that

“... the measures adopted by a State, whether regulatory or not, are an indirect *de facto* expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that ‘...any form of exploitation thereof...’ has disappeared. ... The government’s intention is less important than the effects of the measures on the owner of the assets or on the benefits arising from such assets affected by the measures; and the form of the deprivation measure is less important than its actual effects.”⁶²

The Tribunal followed its tests of the nature and extent of impact with a further test designed to assess whether that impact was proportional to the stated aims of the measure. But what is most important here is that the Tribunal actually set a hierarchy of interests to be protected: if the government's intention is less important than the effects on the investor, then the reasoning must extend to a determination that *the public interest is less important a factor than the interests of private foreign investors*.

In the final analysis, the state of interpretation of expropriation in IIAs is ambiguous, and in a state of flux.⁶³ From a public policy perspective, it is of clear importance that whatever interpretation eventually prevails allows governments to engage in legitimate regulatory and other activities free of the constraint of liability for any significant economic impact on foreign investors.

2.2.6 Summary of investor rights and obligations

In drawing any conclusions on the state of investor rights and obligations under the existing IIAs, it should be cautioned that dispute settlement under these treaties is in its infancy, as the vast majority of claims brought to arbitration are still pending before arbitral tribunals. At the time of this writing (March 2004), no more than 15 BIT cases have seen awards handed down by tribunals, not all of which have been made public; by contrast, ICSID alone is known to have at least 39 BIT claims currently pending on its docket, with an indeterminate number of other cases pending under other arbitral rules.

Nevertheless, we now have enough of a basis in case law to at least see the key issues of public interest to be addressed by future arbitrations, and to have at least some picture of the possible evolutionary paths down which each might proceed. Of course the various rulings do not actually amount to formal precedent—as noted above, this is one of the problems we face—but past decisions are undoubtedly important in influencing the interpretations rendered by any subsequent tribunal.

The concerns argued above amount to disquiet about the balance being struck between the public interest and the interest of foreign investors. That is, in many of the cases surveyed above, the tribunals were performing a balancing act weighing, for example, the rights of a citizenry to be free of a hazardous waste facility in the immediate vicinity versus the rights of the investors to operate such a business. Both ideas have legitimate claims. And, as noted above, this kind of balancing is done on a regular basis by most governments worldwide. But the question is whether the tribunals to date, and those in future, will find the right balance. It has been suggested above that, in some aspects of the substantive law, more guidance might be helpful in ensuring that they do. In this respect, advances such as the new draft U.S. model BIT language on expropriation are welcome. But they do not address the issues raised by the thousands of existing treaties—an issue examined further in Section 4.1, below.

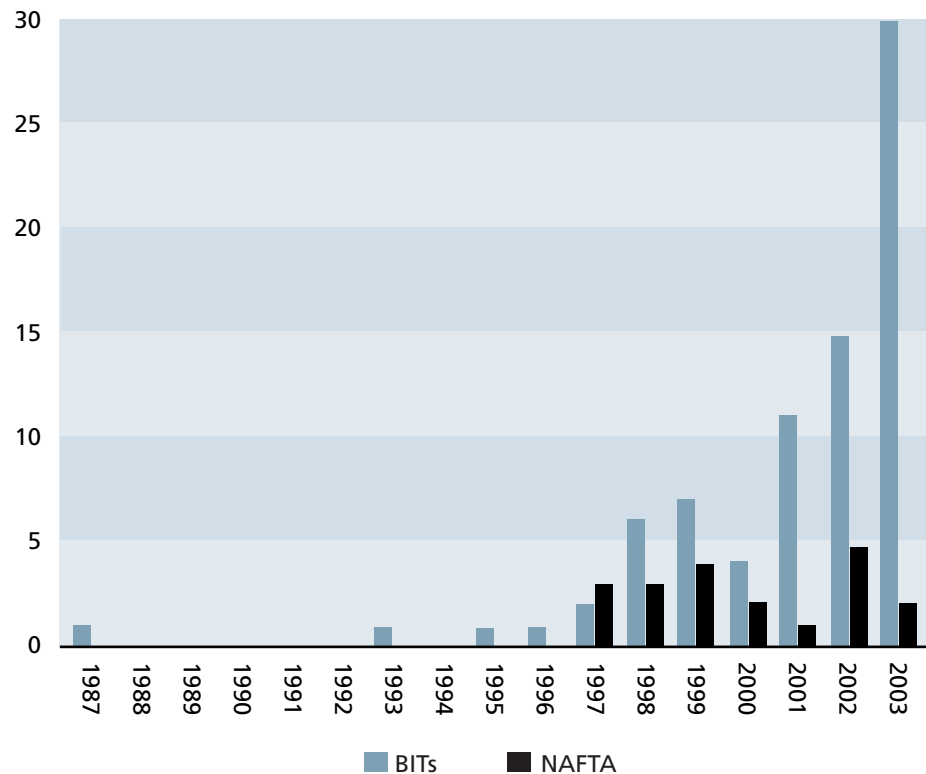
The difficulties encountered in developing a stable interpretation of such important concepts as expropriation shows once again how procedural inadequacies can result in substantive problems. The issue of expropriation is particularly sensitive because the concept of regulatory takings has been the subject of a dispute between U.S. scholars and policy-makers that has continued for three decades without coming to a clear result. It seems particularly hazardous to launch international investment agreements into such a set of issues when their dispute settlement mechanisms have none of the institutional safeguards that have kept more extreme interpretations from prevailing in the U.S. context. Moreover, countries' traditions differ widely with regard to compensation for regulatory actions. Tribunals in international investment disputes are left with little in the way of useful guidance on how to steer a path between these different traditions.

2.3 The increasing use of investment treaties

All evidence points to a significant increase in the use of BITs and other investment agreements since the late 1990s. In the NAFTA context this is not as evident; Figure 1 shows a more or less steady use of arbitration over the life of the Agreement. In the BITs context the picture seems different. It should be cautioned that the procedural shortcomings highlighted above render impossible an adequate accounting of investment treaty arbitration. Rather, we rely a great deal upon the public registry of cases filed at ICSID, along with a smattering of intelligence about other disputes that emerge through various alternative means. Nonetheless, it is clear from Figure 1 that BIT arbitration is on

the rise. To some extent, these figures are enhanced thanks to an unprecedented flurry of claims against a single country: the Argentine Republic. To date, more than a dozen claims—many of them relating to that country’s financial crisis—have been mounted.

Figure 1: The Growth in ICSID BITs and NAFTA Chapter 11 Arbitrations⁶⁴



However, even putting aside the claims against Argentina, and keeping in mind the inadequacy of the visible record, it is apparent that investors are turning to investment treaty arbitration with greater frequency. At the same time, the types of claims which are being brought to arbitration have evolved considerably since the earliest BIT cases were brought against Sri Lanka and the Democratic Republic of Congo (then Zaire) in the mid-1980s. These early claims had been for compensation arising out of clear-cut and egregious destructions of property thanks to the actions (or omissions) of state security forces in the host territories. More recent BIT claims, as well as those brought under NAFTA’s Chapter 11, target a wide range of regulatory and administrative treatment which may have allegedly diminished the value of an investment. Research by IISD has revealed that emerging BIT disputes include claims related to environmental regulation, land-planning and government oversight of essential public services such as water and sanitation.⁶⁵

This increase in use is hardly surprising and can likely be attributed to a number of factors. Among them is surely a growing realization on the part of investors and their legal counsel that the tool is available and, as shown by recent rulings, useful. As well, as detailed above, there is a proliferation of classes of possible investor litigants (investments, major investors, minority investors), and of types of measures covered. There is also the possibility of multiple proceedings, and the potential for “forum shopping”—searching for a home state that offers the protection of a BIT.

These conclusions are neither new nor original.⁶⁶ Host states must now anticipate that BIT-based litigation is likely, and may even become commonplace, as it has this past year in Argentina.

Endnotes

- 4 UNCTAD, “Developing Countries Further Liberalize their FDI Regime in 2001,” Press Release, August 20, 2002, (http://r0.unctad.org/en/subsites/dite/bit_dtt.htm).
- 5 See for example, FTAs between Singapore and Australia; Thailand and Australia; or between the U.S. and each of Chile, Singapore, Morocco and, as a single unit, the five Central American states.
- 6 See Howard Mann and Konrad von Moltke, “NAFTA’s Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment.” Winnipeg: IISD, 1999 (<http://www.iisd.org/publications/publication.asp?pno=409>).
- 7 See references to the ICC rules in the U.K.’s BITs with Cuba and St. Lucia.
- 8 The *amicus curiae* brief is a legal instrument used in a number of legal systems that allows a non-party to contribute legal arguments for the consideration of the court. It has been extensively used in the U.S. as a tool for bringing public interest arguments to cases where these would otherwise not be heard.
- 9 This point was recently underscored by an ICSID Tribunal in the ongoing case of *Aguas Del Tunari v. Bolivia*, see the Tribunal’s letter to prospective interveners at: http://www.law.berkeley.edu/faculty/ddcaron/Documents/ICSID%20Arbitrations/ARB-02-3_NGO_Petition_ICSID_Response_2003.pdf.
- 10 Yves Dezalay and Bryant G. Garth, *Dealing In Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order*, University of Chicago Press, 1996, p. 53.
- 11 The willingness of states to use commercial arbitration rules for investment disputes shows a high degree of pragmatism and a resistance to the creation of new institutions. However it runs the risk of misappropriating rules for purposes for which they were never designed and are not suited. See Konrad von Moltke and Howard Mann, “Misappropriation of Institutions: Some Lessons from the Environmental Dimension of the NAFTA Investor-State Dispute Settlement Process,” *International Environmental Agreements*, Vol. 1, No. 1 (January 2001), pp. 103–123.
- 12 The sites in question—Canada at (<http://www.dfait-maeci.gc.ca/tna-nac/nafta-en.asp>); Mexico at (www.economia-snci.gob.mx/sic_php/ls23al.php?s=18&p=1&l=1) and the United States at (www.state.gov/s/l/c3439.htm)—vary in the degree of information they provide.
- 13 See <http://www.dfait-maeci.gc.ca/nafta-alena/Nondisputing-en.pdf>. For an analysis of what the October 2004 statements contain, and their implications, see Howard Mann, “The Free Trade Commission Statements of October 7, 2003, on NAFTA’s Chapter 11: Never-Never Land or Real Progress?” Winnipeg: IISD, 2003 (<http://www.iisd.org/publications/publication.asp?pno=578>).
- 14 This is the *Methanex v. the United States of America* dispute. For more details, see http://www.iisd.org/pdf/2003/trade_methanex_background.pdf.
- 15 See <http://www.dfait-maeci.gc.ca/nafta-alena/open-hearing-en.asp> and <http://www.ustr.gov/regions/whemisphere/nafta2003/statement-openhearings.pdf>.
- 16 Neither would it be a problem in the NAFTA context if the Agreement could be easily reopened and amended. But such a prospect would also open the Agreement to renegotiation on a slew of other areas with which the various governments are unhappy, and is therefore not likely to occur any time soon.
- 17 The draft model BIT can be found at <http://www.state.gov/e/eb/rls/prsrl/2004/28923.htm>.
- 18 Doak Bishop and Lucy Reed, “Practical Guidelines for Interviewing, Selecting and Challenging Party-Appointed Arbitrators in International Commercial Arbitration,” June 2001, available online at Web site of King & Spalding Attorneys: <http://www.kslaw.com/library/pdf/bishop4.pdf>.
- 19 M. Sornarajah, “The Clash of Globalizations and the International Law on Foreign Investment,” the Simon Reisman Lecture in International Trade Policy, in 10 *Canadian Foreign Policy*, No. 2 (Winter 2003), 2–10.
- 20 See “The Rise and Rise of ICSID,” Sophie Nappert, Legalease Special Report Disputes 2001, referring to *Amco Asia v. Republic of Indonesia Decision on Annulment*, May 16, 1986, ICSID Reports 1, 509, 521; and also Philippe Pinsolle, “The Annulment of ICSID Arbitral Awards,” *Journal of World Investment*, July 2000, Vol.1, No.1, at 243–4.
- 21 Jeswald Salacuse, “BIT by BIT” The Growth of Bilateral Investment Treaties and their Impact on Foreign Investment in Developing Countries,” 24 *International Law*, 675, 1990.
- 22 This is based upon interviews with lawyers involved in the case, see: “US oil company won damages in 1999 investment treaty claim against Kazakhstan,” by Luke Eric Peterson, *INVEST-SD News Bulletin*, October 11, 2003.
- 23 *Ronald S. Lauder v. the Czech Republic*, UNCITRAL Arbitration Proceedings Final Award, and *CME Czech Republic B.V. (The Netherlands) v. The Czech Republic*, UNCITRAL Arbitration Proceedings Partial Award. Available online at http://www.mfcr.cz/index_en.php.
- 24 Luke Eric Peterson, “Research Note on Emerging BITs Disputes,” April 2003, available at: http://www.iisd.org/pdf/2003/investment_investsd_note_2003.pdf.
- 25 M. Sornarajah, “The Clash of Globalizations and the International Law on Foreign Investment,” the Simon Reisman Lecture in International Trade Policy, in 10 *Canadian Foreign Policy*, No. 2 (Winter 2003), 2–10.
- 26 This has happened in the case of the otherwise opaque UNCITRAL process, where a BIT arbitration between a Swedish investor, Swembalt, and Latvia came to light after an award was handed down, because the Latvian government attempted to challenge the award in the courts.

- 27 This is a classic reading of the common standard for review, but it is under some stress today for greater flexibility by reviewing courts.
- 28 In the NAFTA context, see the proposal for a Permanent North American Court on Trade and Investment in Robert Pastor, "Toward a New North American Community," Institute for International Economics, 2001.
- 29 See, however, S. M. Schwebel, "The Creation of an International Court of Arbitral Awards, in *The Internationalization of International Arbitration*, M. Hunter, A. Mariott, V.V. Veeder (eds.), 1995, p. 115.
- 30 "In the Matter of an Arbitration under Chapter 11 of the North American Free Trade Agreement and the UNCITRAL Arbitration Rules between Methanex Corporation and the United States of America: Decision of the Tribunal on Petitions from Third Persons to Intervene as 'Amici Curiae,'" January 2001, para. 49 (http://www.iisd.org/pdf/methanex_tribunal_first_amicus_decision.pdf).
- 31 *Crompton Corp. v. Canada*, Amended Notice of Intent to Submit a Claim to Arbitration, September 2002. The case concerns the use of lindane, a suspected carcinogen, in pesticides. Although the actual arbitration has not been fully commenced as of April 2004, Crompton continues to have discussions with the Canadian government under threat of the arbitration.
- 32 This section draws heavily on Howard Mann, "Review of Investment Disputes Arising from NAFTA and BITs: A Preliminary Assessment of the Implications for Developing Countries," paper prepared for the United Nations Conference on Trade and Development, 2003.
- 33 Provisions on performance requirements are found in relatively few older BITs, but they are part of the new standard agreement being pursued by the U.S., Japan and Canada.
- 34 The Tribunal in the end ruled, however, that this "investment" had not suffered enough of an impact that the measure in question could be held to be expropriation. See *Pope & Talbot v. Canada*, paras. 97–98.
- 35 UNCTAD, "Admission and Establishment," 1999, pp. 26–28.
- 36 *S.D. Myers Inc. v. Canada*, Partial Award (on merits), November 13, 2000; *Marvin Feldman v. United States of Mexico*, Final Award, December 16, 2002.
- 37 Note that not all IIAs include the NAFTA language on "in like circumstances." Nonetheless, even in such treaties a panel will be faced with the task of deciding in some fashion whether it is legitimate to compare the treatment received by two different investors.
- 38 *ADF v. United States of America*, para. 157. Note that this breach itself would have been saved by the fact that the Tribunal found the Virginia contract to be "government procurement" as defined in the NAFTA, and therefore not subject to Chapter 11's non-discrimination obligations (as per Article 1108(7)).
- 39 ICSID Case No. ARB/97/17, 25 January 2000; 40 ILM 1129 (2001).
- 40 See *ADF v. United States of America*, "Post-Hearing Submission of the Claimant ADF Group Inc. on NAFTA Article 1105(1) and the Damages Award in *Pope & Talbot v. Canada*," paras. 59–62 (<http://www.state.gov/documents/organization/12001.pdf>); and *Pope & Talbot v. Canada*, "Response of the Investor to the Tribunal's Letter of August 14, 2001," dated September 10, 2001, p. 7 (<http://www.dfait-maeci.gc.ca/tna-nac/documents/D-3.pdf>).
- 41 *Técnicas Medioambientales Tecmed v. United Mexican States*, Case No ARB(AF)/00/2, Award, May 29, 2003, para. 69. This is applied in practice in *ADF v. United States of America*, Final Award, January 9, 2003.
- 42 The original of the "egregious and shocking" test is in the landmark *U.S.A. (L.F. Neer) v. United States of Mexico*, (1926), p. 62.
- 43 The most rigorous discussion, and eventual rejection, of the Neer test is in the BIT case of *Técnicas Medioambientales Tecmed v. United Mexican States*, Case No. ARB(AF)/00/2 Award, May 29, 2003; and the NAFTA cases of *Pope & Talbot v. Canada*, Award on damages, May 31, 2002, para. 57 *et seq*; *ADF v. United States of America*, Final Award, January 9, 2003, paras. 179–180; *Mondev International Inc v. United States of America*, Final Award, October 11, 2002, paras.114–116.
- 44 *R. Loewen and Loewen Corp. v. United States of America*, Final Award, June 26, 2003, para. 132.
- 45 *Mondev International Inc v. United States of America*, Final Award, October 11, 2002, para. 123.
- 46 *Ibid*, para. 120.
- 47 *Ibid*, para. 116.
- 48 *Técnicas Medioambientales Tecmed v. United Mexican States*, Case No. ARB(AF)/00/2, Award, May 29, 2003, para. 154 *et seq*.
- 49 *Alex Genin, Eastern Credit Limited, Inc v. Republic of Estonia*, (Case No. Arb/99/2). Award, June 25, 2001, para. 367, 371. See also *Eudoro Armando Olguin v. Republic of Paraguay* (ICSID Case No. ARB/98/5); Award, July 26, 2001.
- 50 *Técnicas Medioambientales Tecmed v. United Mexican States*, Case No. ARB(AF)/00/2, Award, May 29, 2003.
- 51 *Pope & Talbot v. Canada*, Final Award on Merits, April 10, 2001; Award on Damages, May 31, 2002
- 52 *Emilio Agustín Maffezini v. The Kingdom of Spain* (Case No. ARB/97/17), Decision of the Tribunal on Objections to Jurisdiction, January 25, 2000; Award, November 13, 2000; Rectification of the Award, January 31, 2001. As this determination actually rejected the transfer as an act of fraud or theft, its inclusion here is significant in seeing a lower applicable standard than historically used.

- 53 *Técnicas Medioambientales Tecmed v. United Mexican States*, Case No. ARB(AF)/00/2, Award, May 29, 2003; where the issue lay more in implied contracts than actual written terms; *Wena Hotels Ltd v. Arab Republic of Egypt*, ICSID Case No. 98/4; Decision published in 41 ILM 896 (2002); Annulment decision of January 28, 2002, 41 ILM 933 (2002); *Marvin Feldman v. Mexico*, Final Award, December 16, 2002.
- 54 See Howard Mann and Julie Soloway, “Untangling the Expropriation and Regulation Relationship: Is there a way forward?” A Report to the Ad Hoc Expert Group on Investment Rules and the Department of Foreign Affairs and International Trade (Canada), March 31, 2002 (<http://www.dfait-maeci.gc.ca/tna-nac/regulation-en.asp>).
- 55 The language in the draft model BIT reads in part as follows: “Except in rare circumstances, 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.” (Annex B (4)B).
- 56 See *Metalclad Corp. v. Mexico*, Final Award, September 2, 2000, Case No. ARB(AF)/97/1, para. 111.
- 57 See *Pope & Talbot v. Canada*, Interim Award on Merits, June 26, 2000, para. 102.
- 58 *S.D. Meyers Inc. v. Canada*, Partial Award (on merits), November 13, 2000, para. 282.
- 59 *Marvin Feldman v. Mexico*, Final Award, 16 December 2002, paras. 152–153.
- 60 USA, American Law Institute Publishers, Vol. 1, 1987, Section 712, comment g (cited in *Feldman*, para. 99).
- 61 *Técnicas Medioambientales Tecmed v. United Mexican States*, Case No. ARB(AF)/00/2, Award, May 29, 2003.
- 62 *Ibid.*, para. 116.
- 63 This view is echoed by prominent arbitrator L. Yves Fortier, “Caveat Investor: The Meaning of “Expropriation” And The Protection Afforded Investors Under NAFTA,” *NEWS From ICSID*, Vol. 20, No. 1, Summer 2003.
- 64 Source: Howard Mann, *supra* at 32, p. 9.
- 65 Luke Eric Peterson, “Emerging Bilateral Investment Treaty Arbitration and Sustainable Development,” Research Note, International Institute for Sustainable Development, 2003, available at: http://www.iisd.org/pdf/2003/investment_investsd_note_2003.pdf.
- 66 Senior arbitrators have made the same point recently, as has at least one respected international lawyer. See, e.g., William Rogers, “The Emergence of the International Centre for the Settlement of Investment Disputes ICSID as the Most Significant Forum for the Submission of Bilateral Investment Treaty Disputes,” Presentation to the Inter-American Development Bank Conference, October 26–27, 2000; Barton Legum, “Trends and Challenges in Investor-State Arbitration,” *Arbitration International*, 2003, at <http://www.kluwerarbitration.com/arbitration/arb/home/ipn/default.asp?ipn=25008>.

**Investment and
Sustainable
Development**

A Guide to the
Use and Potential
of International
Investment
Agreements

20

3. Multilateral Investment Agreements

The desire to address foreign investment at the multilateral and global levels first arose through its relationship to trade. The links between trade and investment are obvious. Much foreign investment is designed to replace trade, or is dependent on trade opportunities. Thus a multilateral agreement on investment was seen as an obvious extension of the trade regime, so much so that its purpose was never the subject of much discussion. Yet investment is unlike many other WTO Agreements, most of which involve issues that constitute potential barriers to trade or seek to limit the risk of hidden protectionism.⁶⁷ That aspect is at best marginal in investment agreements, which have thus far involved the acquisition of rights by investors.

During the Uruguay Round of trade negotiations a number of countries, in particular European countries, pressed for an agreement on investment as part of the WTO. Their concern, most strongly articulated by smaller countries with large foreign investments, was the desire to protect their investors by means of a multilateral agreement, which was perceived as more effective than the BITs that had been concluded. Faced with resistance on the part of some developing countries, the final agreement was strictly limited to *trade-related* investment measures, but the issue remained on the agenda of the WTO. One of the paradoxes of the language of trade agreements is that the use of “trade-related” is an indication that the fuller issue being addressed is primarily not trade related. The preceding discussion of the BITs obligations and their scope of impact provides ample evidence of this truth.

Foreign direct investment has long been of concern to developing countries, most of which have a severe shortage of capital. In this constrained environment, some large foreign investments can be overwhelming, leaving the public authorities few options in terms of ensuring appropriate behaviour by the foreign investors. The issue of an international investment regime has, therefore, been viewed in a dynamic of competing needs: the desire to protect foreign investors, the desire to attract investment to supplement the domestic capital stock, and smaller countries’ needs for international assistance in dealing with large foreign investors.

3.1 Early attempts at multilateral investment rules

One of the first attempts to agree to multilateral rules on investment was the investment provisions of the 1948 Havana Charter—the post-war agreement that aimed to establish the International Trade Organization. The ITO was to serve as the third pillar in the Bretton Woods triad, along with the IMF and the World Bank. The Charter contained provisions on investment, as well as on restrictive business practices, full employment policies, labour standards and trade rules. Only the last of these survived in any form, as the General Agreement on Trade and Tariffs, as the U.S. Senate would not ratify the Charter. The investment provisions played a significant role in preventing U.S. approval of the Charter (and thus preventing the ITO from becoming a reality). There is general agreement that the “investment provisions of the Charter were, by far, the most controversial.”⁶⁸ They provided significant leeway for the host country to set its own priorities when it came to investment.

In the 1970s, the United Nations Conference on Trade and Development (UNCTAD), which had been established to address the particular needs of development in the framework of the international economic order, through its United Nations Centre for Transnational Corporations (UNCTNC) sought to develop a binding Code of Conduct on Transnational Corporations.⁶⁹ This effort attracted vehement opposition from some corporations that were likely to be affected, creating severe difficulties for UNCTAD and ultimately leading to the closure of UNCTNC. Given that the role of multinational corporations continues to increase, and given the extreme rarity of closing down an international institution, this step must be viewed as dramatic indeed.

In retrospect, it appears that any attempt to agree on a binding set of detailed rules governing the behaviour of private international investors was bound to fail. The diversity of needs, the variety of domestic practices in host countries, the range of governance requirements in home countries all render the prospect of international consensus unlikely. Indeed, these are many of the issues that continue to burden attempts to negotiate multilateral agreements on investment.

The Organisation for Economic Cooperation and Development (OECD) worked on these issues in parallel and in competition to UNCTNC. It has maintained an OECD Code of Liberalisation of

Capital Movements since 1961 that has been updated regularly (260 times by March 2003).⁷⁰ The Code is based not on multilateral negotiation but on “unilateral liberalization and peer pressure.”⁷¹ It focuses on the actual movement of capital rather than on the rights (or obligations) of investors, but its principles are largely modelled on those of the trade regime: non-discrimination and transparency.

The OECD also developed Guidelines for Multinational Corporations that were first adopted in a 1976 OECD Declaration and were significantly amended in a lengthy process leading to the adoption of revised Guidelines in 2000.⁷² Apart from being non-binding, the principal difference between the OECD Guidelines and the UNCTNC Code was that the former were negotiated among countries that exported capital and were home to most large multinational corporations, whereas countries importing capital were at the centre of the UNCTNC draft. This entire fraught process, involving governments and private interests over a period of more than 30 years, is an indication of the difficulties that are liable to be encountered in comprehensive investment negotiations—and of the importance attached to these negotiations by all parties concerned.

3.2 The OECD’s Multilateral Agreement on Investment

Almost immediately following the conclusion of the WTO’s Uruguay Round in 1995, the OECD economics ministers launched negotiations for a Multilateral Agreement on Investment (MAI) among OECD countries.⁷³ The OECD has traditionally been the forum in which developed countries could articulate an agenda for trade negotiations and explore agreements and disagreements before taking the issue to the wider forum of the GATT. There is little doubt that the MAI was intended to become the basis of an investment agreement in the WTO. Although this goal has not been publicly acknowledged, there are several indications to that effect in the text of the draft MAI itself. For one thing, there is no provision for an organizational framework for the agreement, clearly anticipating that this will ultimately be the WTO. Moreover, the OECD engaged in consultations on the MAI with governments of the “dynamic economies of Asia and Latin America.” In essence, this was a form of lobbying of governments by other governments, seeking to create a favourable basis for action on an international regime.

The initial draft mirrored many of the investor rights and obligations surveyed above and, by the time of the last draft, no significant new ideas had been put forward.⁷⁴ The MAI negotiators moved within a consensus that they viewed as so well established as not to require much discussion. The purpose of such an agreement was so self-evident to them that it was never explicitly articulated in the draft, nor does there appear to have been any serious discussion of the ultimate goal the negotiators were seeking to achieve. A multilateral agreement on investment was viewed as the logical next step in the process of liberalization and the applicable principles and rules appeared to be well known. Indeed, the MAI negotiations took the various elements that were in place—bilateral investment agreements, regional agreements such as NAFTA Chapter 11, and certain parts of the WTO Agreements—to create what they saw as a more coherent and unitary structure. From this narrow perspective, the entire exercise could be viewed as a technical exercise rather than as a striking innovation.

The MAI negotiations resulted in a failure more dramatic than that of UNCTNC. In March 1998, after an unprecedented international campaign, triggered by environmental interests but ultimately supported by a wide range of groups, the MAI negotiations were put on a slower track with no deadline. In October 1998, the process was abandoned after France withdrew, mainly because the United States would not accept provisions that shielded French cultural industries from MAI rules. The newly installed German government also decided to press for “social and ecological compatibility,” which could not have been accommodated in the technical draft under consideration. The result was a lengthy, much-bracketed text that meant the issue of an investment agreement in the WTO would need to be raised without prior agreement within the OECD, and with the burden of public concern that necessarily attached to such an undertaking at the WTO.

3.3 Investment in the WTO: TRIMS and GATS

Following the establishment of the WTO, the issue of an investment agreement was raised promptly at the first Ministerial Meeting in Singapore (1997). It became one of four “Singapore Issues” that were viewed by some as a natural extension of the WTO and by others as one step too far.⁷⁵ They

occupied a middle ground between the environment, which was accepted onto the negotiating agenda, albeit with some resistance from developing countries, and labour, which was rejected on the grounds that labour issues were matters for the International Labour Office (ILO).

The two WTO Agreements that currently address investment are the TRIMS Agreement and the General Agreement on Trade in Services (GATS). The GATS incorporates rules on investment, but only in so far as it is necessary for services that are provided by on-site investments, through a local presence (referred to as a “commercial presence” in the legal texts) in the foreign country. The TRIMS agreement, on the other hand, was intended by its proponents as a first step towards a much more comprehensive agreement on investment.

This difference of approaches adopted in the GATS and TRIMS Agreements reflects differences in the relationship between investment rules and trade in services on the one hand, and trade in goods on the other. As trade in services often involves some form of investment (as when a foreign bank establishes offices in a host country), the investment rules of the GATS are there because they are needed. The relationship between investment and trade in goods, however, is much more tenuous. Clearly, foreign direct investment (FDI) and trade in goods are related: much FDI is undertaken to facilitate trade, or to replace trade. Yet, the fact that they are related does not lead to any clear conclusions: it means neither that trade and investment should be treated in essentially the same manner nor that investment negotiations must necessarily be conducted in the trade regime. Indeed, a simple assumption on either of these points would ignore the vastly different types of linkages to the local environment and ecosystem, labour, human welfare and human rights, and political, legal and administrative institutions that an investment into a community and country have, as compared to trade in a product.

The word “investment” occurs but twice in the GATS, both times in Article XVI (on Market Access).⁷⁶ This is because the investment provisions that are part of the GATS are subsidiary to its service-trade liberalizing provisions, and are designed to avoid hidden protectionism and to protect investments that are an integral part of services such as banking and transport. As such, it should be noted, these investment provisions are subject to Article XII (Restrictions to Safeguard the Balance of Payments) and Article XIV (General Exceptions), which have no equivalent in most investment agreements.⁷⁷

The investment implications of the GATS are largely derived from the key definition of Article I.2, which identifies the “modes” by which services can be supplied. Several of these imply a significant presence in the country where the service is provided, and provide the basic protections of the GATS to the investments that are an integral part of this presence. Consequently, the investment provisions of GATS bear little or no resemblance to the provisions that are typically found in investment agreements and in the TRIMS agreement in particular.

In one respect, though, the GATS rules under negotiation resemble investment rules: they have aroused public concerns over their potential limiting effect on domestic “policy space” for regulation in the public interest. Specifically, the language on domestic regulation sets up a sort of necessity test on any regulations affecting services (“not more burdensome than necessary”) that has raised red flags with a number of non-governmental critics.⁷⁸

The TRIMS Agreement is a fairly constrained document, resulting from the desire of some countries to go much further in the direction of a multilateral agreement on investment and the resistance of other countries to any agreement on investment within the framework of the WTO. Its operative provisions are contained in a single sentence of Art 2.1: “Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.” These are, respectively, the provisions obliging states to provide national treatment for trade in goods, and the provisions prohibiting quantitative restrictions on imports or exports. The Agreement is notable for its lack of any reference to most-favoured nation treatment, and for the lack of a specific definition of either “investment” or “trade-related investment measure.” Rather, an Annex provides an illustrative list of TRIMS that are inconsistent with Article III or Article XI of the GATT. In the terminology of international investment agreements, the measures that are listed in the Annex are “performance requirements,” such as requirements that investors purchase inputs from domestic suppliers.

Based on these provisions, it has been argued that investment is already in the WTO and that the proposal to negotiate further on investment does not represent a major departure. However, if the proposed negotiations are to follow a more traditional model of investment agreements, as seen in the MAI negotiations and as described above in the context of bilateral and regional agreements, this argument is impossible to sustain. Indeed, the limited investment provisions in the current WTO Agreements address practically none of the numerous issues that have proven controversial in other investment agreements.

3.4 Investment in the WTO post-Singapore

The Singapore Ministerial established a Working Group on Investment that initiated a process of expanded, more broadly based WTO work on the relationship between trade and investment. At the time of the Singapore Ministerial, it proved impossible to go further on investment. Most developing countries were unready or unwilling to negotiate on new issues after the 1994 Marrakech Agreement, pending proper implementation of existing agreements.

The scope of the Working Group's study was decided on the basis of its recommendation to the WTO General Council in 1998. The agenda included the investment-trade relationship; implications for development and growth; various aspects of the economic relationship between investment and trade; a stocktaking and analysis of existing agreements regarding trade and investment (bilateral, regional, WTO provisions); and a set of miscellaneous issues that included analysis of the advantages and disadvantages of entering into bilateral, regional and multilateral rules on investment, including from a development perspective. The failure of the MAI was still recent at that point, and the approach chosen was to avoid, rather than confront, those issues that had led to the failure.

The 2001 Report of the Working Group on the fulfillment of this mandate shows little by way of solid results.⁷⁹ There was ample discussion, but little of it was directed at consensus building or at finding common approaches to issues raised. A key reason for this is obvious: serious disagreement remained as to how far the WTO should approach investment issues, making a forward-looking report on individual issues difficult.

The Singapore issues became a central part of the compromises that formed the Doha Ministerial Declaration. The European Union in particular hoped to obtain agreement to negotiate the Singapore issues in exchange for increased willingness to consider cuts in export subsidies for agricultural products.

There are two critical questions: Did the Doha Ministerial contain a mandate to negotiate an investment agreement? If so, what was its intended scope?

The short answer to the first question is that Doha itself contains a *conditional* mandate to negotiate on investment, with the condition being agreement "by explicit consensus" on the modalities of the negotiation at the 2003 Cancun Ministerial meeting. The term "explicit consensus" has no precedent in GATT or WTO practice, so its meaning remains unclear.⁸⁰ All parties agreed on one of the most salient modalities issues: the inclusion of pre-establishment rights only on a positive list basis. This was already set out in paragraph 22 of Doha, which also specifies that the objective is "long-term cross-border investment," presumably a phrase designed to exclude short-term portfolio investment. In the absence of final agreement on modalities, the likely scope of WTO negotiations on investment remains uncertain. But some guidance does arise from the range of issues addressed expressly in Doha and in the subsequent investment discussions in the Working Group.

What is most fundamental is that the negotiations, if they take place, will not be limited to trade-related issues as in the TRIMS Agreement. They will, rather, address a broader range of issues that are specific to investment, as do the bilateral and regional investment agreements. This is set out in Doha Paragraph 20: "Recognizing the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment, particularly foreign direct investment, that will contribute to the expansion of trade..." It is also implied by paragraph 22, which sets out several specific elements for inclusion in the negotiations, by way of reference to further work by the Working Group until the next Ministerial meeting. These include several classic elements of any IIA:

- non-discrimination;
- modalities for pre-establishment commitments based on a positive list approach;
- exceptions and balance of payments safeguards; and
- consultations and dispute settlement between members.

However, paragraph 22 also adds elements not seen in most recent bilateral and regional agreements. This includes development provisions as a specified element, and a broader requirement that the results “reflect in a balanced manner the interests of home and host countries, and take due account of the development policies and objectives of host governments as well as their right to regulate in the public interest.” Special considerations for least developed countries are also called for. Thus, paragraph 22 calls for a broader agenda than a traditional IIA.

The status of paragraphs 20–22 of the Doha Declaration remains unclear following the fifth WTO Ministerial meeting, held in Cancun in September 2003. Failure to reach agreement on the four Singapore issues was the proximate cause of the breakdown of negotiations, although the thorny question of agriculture had not yet been fully explored. At a late stage in the process, the European Union, the principal advocate for the Singapore issues, indicated a willingness to entertain different approaches to the four Singapore issues but this did not suffice to keep negotiations going. Resistance among major developing countries to negotiations on investment had increased in the months leading up to the Cancun Ministerial, fuelled by the growing critique of existing IIAs and the lack of any evidence that they had provided developing countries with tangible benefits.⁸¹

Following Cancun, trade negotiators are seeking a new balance within the Doha agenda. While the Doha Declaration remains the formal framework, in practice it is all but inconceivable that negotiations on investment will go forward as part of the “single undertaking” that binds all the parts of the Doha Declaration together. The European Union now seeks “plurilateral” negotiations that are outside the single undertaking and involving only countries that wish to participate. In practice, however, any plurilateral agreement is bound to become the object of pressure to become a full part of the WTO structure, so many developing countries are likely to resist this approach.⁸²

The Doha Declaration set out a negotiating mandate that now appears to have been too ambitious. Reducing its scope may prove to be an essential step towards successful negotiations on the other issues that are on the agenda, agriculture in particular. Should that prove to be the case, failure in Cancun may, in retrospect, appear more like a successful restructuring of the negotiating agenda. Yet the fact remains that, for a third time, an attempt to negotiate multilateral investment rules has ended in failure. At the very least, this suggests that countries still have not managed to fashion an agenda that is appropriate and promises significant benefits for all participants.

Endnotes

67 The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) is an obvious exception.

68 Daniel Drache, “The Short but Significant Life of the International Trade Organization: Lessons for Our Time,” Centre for the Study of Globalization and Regionalism Working Paper No. 62/00, University of Warwick, 2000, p. 20 (<http://www.warwick.ac.uk/fac/soc/CSGR/wpapers/WP6200a.pdf>). See also Americo Beviglia Zampetti and Torbjörn Fredriksson, “The Development Dimension of Investment Negotiations in the WTO: Challenges and Opportunities,” *Journal of World Investment*, Vol. 4, No. 3, 2003, p. 399: “... the investment provisions of the Havana Charter proved to be among the most controversial, contributing to the downfall of the ITO project ...”

69 See UNCTAD, *International Investment Instruments: A Compendium*, Vol. 1: Multilateral Instruments. New York: United Nations, 1996, pp. 161–180.

70 Available at http://www.oecd.org/document/14/0,2340,en_2649_34887_2030158_1_1_1_37467,00.html.

71 OECD, “OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations: Users Guide,” Paris: OECD 2003. Available at: http://www.oecd.org/document/6/0,2340,en_2649_37467_1838086_1_1_1_37467,00.html.

72 Basic texts available at [http://www.ois.oecd.org/olis/2000doc.nsf/LinkTo/daffe-ime\(2000\)20](http://www.ois.oecd.org/olis/2000doc.nsf/LinkTo/daffe-ime(2000)20).

73 The negotiations were launched by a decision of the Council of the OECD. These decisions are not, however, readily available to the public. The OECD Web site has no link to the Council decisions, nor does a search using document numbers result in success. While not strictly speaking a secret, the decision to launch the negotiations was only available through government officials.

74 The final draft is currently (March 2004) available at: <http://multinationalmonitor.org/mai/contents.html>.

- 75 The other issues were competition, trade facilitation and government procurement.
- 76 Investment is mentioned first in a provision prohibiting quantitative restrictions on the participation of foreign capital (in sectors where market-access commitments are undertaken); and again in an annex on financial services.
- 77 The OECD Codes of Liberalisation have “classic” exceptions for public order or the protection of public health, morals and safety, essential security interests, and the fulfillment of obligations relating to international peace and security. The draft MAI had much more restrictive exceptions, pertaining to security and disarmament, though the Chair of the negotiations had proposed highly conditioned environmental exceptions modeled on Article XX of the GATT. NAFTA’s Chapter 11 is subject to the NAFTA’s general national security exceptions, but has no environmental exceptions. Most BITs have no such exceptions.
- 78 GATS Art. VI(4)b. For a good overview of these concerns, and other criticisms from a development perspective, see the section on services in UNDP, 2003. *Making Global Trade Work for People*. London: Earthscan.
- 79 Report of the Working Group on the Relationship between Trade and Investment to the General Council, WT/WGTI/5, October 8, 2001.
- 80 The Ministerial Chairman stated: “Let me say that with respect to the reference to an ‘explicit consensus’ being needed, in these paragraphs, for a decision to be taken at the Fifth Session of the Ministerial Conference, my understanding is that, at that session, a decision would indeed need to be taken by explicit consensus, before negotiations on trade and investment and trade and competition policy, transparency in government procurement, and trade facilitation could proceed.” The full text is found at http://www.wto.org/english/thewto_e/minist_e/min01_e/min01_chair_speaking_e.htm.
- 81 See Hallward-Driemeier, Mary, 2003. “Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit... and They Could Bite.” World Bank Policy Research Working Paper 3121, Washington, D.C.: World Bank; and UNCTAD, 1998. *Bilateral Investment Treaties in the Mid-1990s*. New York: United Nations.
- 82 For a strong statement of this position, see Bhagirath Lal Das (2001) “Pitfalls in Plurilateral Path on Investment Talks,” *SUNS News Service*, November 9. (<http://www.twinside.org.sg/title/pitfalls.htm>).

4. Going Further: Prospects for Creating a Positive Agenda for Investment Law

Our analysis suggests a compelling need to reconsider the underlying purposes, substantive content and processes associated with IIAs. In this section, we will first consider some of the legal and political challenges that are posed to creating a new form of IIA. We then turn, in order, to specific areas where positive agendas for change can be identified: the objectives of IIAs, the structure and scope of IIAs, the dispute settlement procedures, and the institutions of governance.

4.1 Obstacles to reform

While one may posit that a single sustainable-development-oriented multilateral agreement on investment might represent a preferable alternative to the current, almost anarchical, world of BITs and regional agreements, there are a number of political and legal obstacles to moving in that direction. Understanding these obstacles gives a good picture of the effort that will be needed to develop an alternative approach to the ongoing development of the international investment regime.

4.1.1 Political obstacles

Perhaps the most critical obstacle is the political one: there are few signs that the countries that have championed BITs and regional treaties over the past two or three decades have any desire to decommission them. Rather, to the extent that countries have acknowledged problems with the treaties, reforms have tended to be incremental and have involved improving subsequent treaties, rather than amending earlier ones.⁸³ This places a broader reform effort in a precarious position.

In fact, the U.S. and other OECD business interests have sought to *shore up* commitments to existing BITs. In particular, U.S. officials had signalled prior to the WTO Ministerial meeting in Cancun that they would seek to carve out protection for its existing BIT program in the event that any multilateral agreement did not obtain the same levels of investor protection.⁸⁴ This direction will present political obstacles to overcome if the broader international investment regime is to be successfully reconstructed.

4.1.2 Legal obstacles

In addition to opposition from business and political constituencies, efforts to promote reform of existing investment treaties may confront several potential legal complications. The first of these is that it is common for investment treaties to contain provisions that allow one party to terminate the agreement—usually after a minimum period—but to stipulate that the rights and protections will be enjoyed by established investors for some further period. For instance, the 1999 BIT between Australia and India, provides that either party may terminate the agreement with one year's notice, after the agreement has been in effect for at least a decade. However, the treaty further provides that “the agreement shall continue to be effective for a further period of fifteen years from the date of termination in respect of investments made or acquired before the state of termination of this agreement.” In effect, the rights are held to “live on” for some length of time, despite the demise of the agreement. This type of provision is especially encumbering when one party to a BIT wishes to terminate it.

Where *both* parties wish to alter or terminate a BIT it would seem to be a prerogative of sovereign nations to do so at any time. What is unclear is whether the rights of foreign investors would continue if so provided in the original treaty text, or whether they could be terminated or altered with immediate effect by agreement of the parties. While the 1969 Vienna Convention on the Law of Treaties allows the parties to amend or alter their treaty obligations, a strong argument could also be made that the rights vested in third parties survive independently of such an agreement, given the nature of investor reliance on such rights.

A further complication which treaty parties may face if they seek to reform BIT provisions on a piecemeal basis is that most BITs promise investors most-favoured nation treatment. As previously discussed, the MFN clause was successfully used by an Argentine investor seeking to access more favourable rights offered by the Spanish government under its treaties with non-Argentine parties. Following this ruling, it is unclear whether the MFN clause might be used by investors to thwart states that act to narrow the scope of provisions in some BITs, but leave standing more extensive versions of the same rights in other existing treaties.

Existing cases give little guidance on how far this approach might be applied in practice. At the very least, governments would be advised to proceed carefully as they begin to contemplate reforms and modifications to these treaties as lessons begin to emerge about the concrete meaning and implications of the BITs. When contemplating changes to substantive provisions of the treaties they might need to include efforts to circumscribe the reach of the MFN clause, so that it does not allow investors to detour around changes in a given BIT.

States might consider the more challenging task of negotiating all changes to BIT provisions simultaneously with its various treaty partners, so as to not allow some treaties to remain as anachronisms. They might even contemplate renouncing all of their BITs in favour of a single multilateral agreement. Clearly these are more ambitious options.

A third option is to have a broader multilateral negotiation that revises equally the rules in most, if not all, BITs simultaneously. Whatever the scope of a multilateral negotiation, it will certainly have to consider the legal relationship between its results and the universe of existing IIAs.

These legal and political factors highlight just some of the difficulties an investment agreement negotiation at the WTO or in another forum would have to face. While they are important, one might also note that the increased reach and use of these instruments also makes them an important part of the current and future global economic regime, for the reasons already discussed. Hence, ongoing research and efforts to improve upon existing models remains a critical necessity.

4.1.3 Movement to date

The governments of the United States and Canada appear to have moved the furthest in recognizing certain shortcomings of the IIAs. Having been chastened by the emergence of unanticipated types of NAFTA Chapter 11 claims, the U.S. has made and Canada is openly considering changes to the template of future agreements. But neither appears ready (with one recent and limited exception, discussed below) to amend prior BITs.

The U.S. Congress has laid out a series of procedural and substantive requirements which must be incorporated into any investment rules included in new trade agreements concluded by the U.S. government. These changes were part of a parcel of concessions that the administration of George W. Bush agreed to, in order to obtain so-called fast-track negotiating authority in 2002.⁸⁵ They included, for example, the requirement that any IIA not give foreign investors substantively greater rights than accorded to domestic investors under U.S. law. As well, as described below, the U.S. has made changes to its model BIT (changes that are reflected in all its recent FTA investment provisions) to increase transparency and openness, and to limit the scope of obligations on expropriation and minimum international standard of treatment. Canada is also debating changes to its template which would apply to all investment rules, whether in BITs or in broader FTAs.⁸⁶

The Trade Ministers of Canada, the U.S. and Mexico (acting as the NAFTA's Free Trade Commission [FTC]) have on two separate occasions issued statements that seek to alter the way the NAFTA is interpreted, and to open up the process of arbitration.⁸⁷ The 2001 FTC Statement had two parts: first, an interpretation of Article 1105 (minimum international standards of treatment); and second, a clarification and commitment on the issue of transparency.⁸⁸ On the latter, the FTC statement asserted that NAFTA's drafters, when promising treatment in accordance with international law, in fact meant *customary* international law—a much weaker standard of protection. Several NAFTA panels had used this article to “import” obligations from non-Chapter 11 parts of the NAFTA, and from other trade agreements—a prospect the three governments found unappealing. As noted below, this weaker standard is now part of the amended U.S. model BIT, and is found in the U.S. FTAs with Chile, Singapore and the five Central American states.

The 2001 statement also addressed process issues, pledging that the Parties to a Chapter 11 dispute will “make available to the public in a timely manner all documents submitted to, or issued by, a Chapter Eleven tribunal.” This pledge is subject to three possible exceptions, one of which is vitally important: except for “information which the Party must withhold pursuant to the relevant arbitral rules, as applied.” This could render the pledge close to meaningless, since the relevant rules are set at the beginning of each case by the tribunals, over which the FTC has no jurisdiction. The tribunals, as noted above, are guided by the rules of the ICSID, the ICSID Additional Facility or UNCITRAL. However, the statement did send an important signal with both legal and political commitments. Indeed, since that time the three governments have routinely posted NAFTA case documents to their respective Web sites.⁸⁹

The next set of statements to come out of the FTC (discussed in depth in Section 2.1.1.) was in 2003.⁹⁰ This time the Ministers focused entirely on the dispute settlement process. The statements included a joint statement of suggested guidelines for tribunals considering petitions for *amicus curiae* status.⁹¹ As noted above, the FTC has no jurisdiction to dictate how the tribunals conduct their arbitration, but this statement does go some way toward legitimizing such petitions, and imposing order on the process.

Another outcome of the 2003 meeting was a pair of statements from Canada and the U.S. (Mexico apparently resisted) indicating that they will push for public hearings in all Chapter 11 cases. Again, this is not a legally-binding decision, and the investor’s opinion on this question is important, but it does mean that in every case against them the two governments are now committed to push for such openness. And, as already noted, two cases have been made open to the public to date.

Outside the NAFTA context, the investment chapters of the recent trade agreements concluded by the U.S. with Singapore, Chile and the five Central American states (and the reformed U.S. model BIT) also give hope that some changes are possible in IIAs.⁹² The procedural changes included in these agreements include making dispute settlement proceedings open to the public and providing procedures for potential *amicus curiae* to make submissions to tribunals. As well, the treaties follow the NAFTA’s lead in providing a procedure by which related claims may be subsumed under the jurisdiction of a single tribunal, thus helping prevent the kind of situation that the Czech Republic found itself in when it faced separate arbitrations by a firm and its major shareholder. This represents an improvement from standard BITs which do not address the potential need for the consolidation of similar claims.

These Agreements also include language designed to limit the substantive reach of their investment provisions. Most notably, the agreements include language intended to reduce the risk that regulatory measures designed to protect the public welfare will be found to constitute “indirect” expropriation. And they replicate the language of the 2001 FTC interpretative statement limiting the scope of obligations on minimum international standards of treatment.

Despite the efforts catalogued above, it is important to note that no country is known to be pursuing alterations or amendments to its *existing* BITs. The one exception to this rule is a U.S.-European Union agreement for the U.S. to amend its BITS with the newly acceding countries to the European Union.⁹³ This agreement was necessary to allay concerns that provisions in the BITS would conflict with the European Union’s policies. Even under these circumstances, the fight to achieve amendment was long and difficult, and this very specific set of circumstances does not signal a broader inclination to amend existing BITS to address the types of concerns analyzed in this paper.

4.2 Refashioning the objectives of IIAs

At the core of the movement to rethink existing IIAs is the need to fully consider their objectives. The argument was made above that investment agreements alone fail to achieve one of their key ostensible objectives—generating increases in FDI. This leaves only the protection of foreign investors as a justification for maintaining the current structures of IIAs. Taken in and of itself, such protection might be desirable. But, given the problems associated with this narrow focus, as reviewed in the preceding section, it seems that new objectives are needed for IIAs to adequately reflect a proper international public policy purpose.

IISD believes that the appropriate goal of an international investment regime should be the promotion of sustainable development through foreign direct investment.⁹⁴ It may be noted here that not all FDI is desirable from a sustainable development—or even a narrower economic—perspective. In

some cases, FDI simply crowds out domestic investment, offering no net gain in investment overall, or it may erode the domestic economy’s ability to innovate or engage in R&D.⁹⁵ In other cases, FDI’s impacts on the environment and human health may leave long-term costs that are higher than the short-term economic benefits. And it is possible that the wealth generated by FDI in the host country will intensify income inequality. Thus, an IIA should promote investment that addresses the economic requirements of sustained growth and development, and the environmental requirements that ensure the protection and inter-generational viability of resource bases. The idea of *quality* investment may be useful as a shorthand here, as long as it is understood to include both the development and sustainability halves of the sustainable development paradigm.

In addition, the idea of quality investment incorporates other indicators often associated with a broad concept of sustainable development, such as the promotion of higher labour standards and the protection of human rights. Of course, one must be careful not to load any given legal instrument or branch of international law with every issue and cause. This caveat, however, does not mean that an international investment regime should not fully address the critical issues associated with FDI.

To summarize, investment agreements today need not be only about liberalizing capital flows: these are largely, and increasingly, unconstrained. They should be about ensuring fair and equitable treatment of investors, and the proper balancing of private rights and public goods in a world of increasingly liberalized capital flows. And they should be about building domestic institutions capable of supporting this goal.

4.3 The structure and scope of IIAs⁹⁶

4.3.1 A balance of rights and obligations

If one adopts a different objective for IIAs, then a different scope and structure becomes a logical next step. Where existing agreements have a one-dimensional focus on investor rights, a broader objective would yield a broader set of actors, rights and responsibilities. As set out in Table 1, rights and responsibilities for foreign investors, of host states and of home states can be articulated in two time periods: pre-establishment—or before an investment is actually made and operational—and post-establishment, or after the investment is made or is operational. If such a structure is adopted, then the nature and scope of these rights and obligations can then be considered in detail. In addition, the linkages among these various rights and responsibilities can be clearly set out, allowing a balancing of private and public interests through an explicit interplay between them.

Table 1: Basic Elements of a Balanced IIA

	Pre-establishment	Post-establishment
Foreign investor	■ rights	■ rights
	■ obligations	■ obligations
Host state	■ rights	■ rights
	■ obligations	■ obligations
Home state	■ rights	■ rights
	■ obligations	■ obligations

4.3.2. Investor rights and obligations

Foreign investment cannot be compelled: it can only be attracted by sound strategies that ensure a fair return on the invested capital. Aid can supplement but cannot fully replace the economic and social attributes of quality foreign investment, so investment is still necessary to achieving the goal of sustainable development.

Despite the absence of any empirical evidence linking IIAs with flows of FDI, part of the process for achieving those flows may continue to rest with the articulation of specific international rights like national treatment and minimum international standards of treatment. In other words, even in an

agreement focused on achieving sustainable development, many of the elements of traditional IIAs, such as rights of foreign investors, will still be present.

At the same time, it should be recognized that investors do become economic citizens of the host state. They acquire extensive rights through private contracts, host state legislation and international investment agreements. The first and most obvious obligation that they also acquire is to respect the laws and regulations of the host state. But beyond this most basic obligation, a common floor of pre- and post-establishment obligations or duties can also be foreseen, as laid out in Table 2. Areas of minimum standards could include environmental impact assessments of proposed investments, anti-corruption obligations, and full investor disclosure requirements. All of these tools exist and are applied in various forms today.

The idea of obligations on foreign investors goes back some 30 years, as already seen. As noted in Section 3.2., voluntary responsibilities were foreseen in the MAI negotiations, which proposed the adoption of the OECD Code of Conduct for Multinational Corporations as a non-binding annex to the Agreement. Many observers are concerned, understandably, with the provision of legal rights but only voluntary obligations. This is one element that requires further exploration both from a conceptual international law basis and from an enforceability basis. To suggest that further exploration is needed is not to imply, however, that either the conceptual or practical issues are insurmountable. For example, if access to the investor-state dispute settlement process were conditioned on certain obligations being met, a means of self enforcement could be generated.

Introducing the idea of common minimum standards in certain areas does not mean that the IIA itself must create each of these standards. In this respect, the IIA could emulate the example of trade law, which references outside standard setting bodies in critical areas of technical and sanitary and phyto-sanitary standards. Thus, it is possible to envisage a well-structured IIA setting out minimum standards for performance in areas such as environmental assessments pre-establishment, environmental management post-establishment, human and labour rights, and anti-corruption standards for foreign investors by reference to other, existing instruments. An additional element that may be appropriate is a stronger recognition of liability of the investor for decision-making associated with the conduct of its investment. Liability within the home state is a particular issue for further study in this regard.

Table 2: Potential Foreign Investor Rights and Obligations

Foreign Investor	Pre-establishment	Post-establishment
Rights	<ul style="list-style-type: none"> ■ Scope of right of establishment ■ National treatment ■ MFN ■ Minimum standards of treatment/transparency ■ Performance requirements 	<ul style="list-style-type: none"> ■ National Treatment ■ MFN ■ Minimum standards of treatment/transparency ■ Performance requirements ■ Expropriation ■ Repatriation, staffing
Obligations	<ul style="list-style-type: none"> ■ Minimum standards in: <ul style="list-style-type: none"> ● Environmental impact assessment ● Anti-corruption ● Full disclosure of purposes, history 	<ul style="list-style-type: none"> ■ Minimum standards in: <ul style="list-style-type: none"> ● Environmental management ● International environmental standards ● Anti-corruption ● Corporate accountability ● Compliance with national laws ● Basic human rights ● Core labour standards ■ Liability of the investor and investment
-common minimum floor		

It can be argued that host states already have the right to enact requirements of the type spelled out above. For example, many states already require an environmental impact assessment of new investments, foreign or domestic. What value, then, does an IIA bring by incorporating these investor obligations? The answer can be illustrated by reference to an example: the extensive restrictions placed on the conduct of tobacco companies (amounting essentially to new obligations) by the WHO Framework Convention on Tobacco Control. All the obligations contained in the Framework Convention could have been effectively implemented on a state-by-state basis—there is no obvious free-rider problem here compelling international, as opposed to domestic, action—so what is the point of this hard-fought agreement?

The point is the power imbalance between the companies involved and many of the smaller economies looking to regulate their behaviour. As long as there is no recognized international standard, any individual state will face a pitched battle in implementing the controls that it, granted, has a clear legal right to put in place. Some states are better equipped to fight such battles than others, and it was the less-well equipped states—the clear majority of the signatories—that needed the backing of international agreement.

Investor obligations spelled out in an IIA would serve the same purposes. They would give states—particularly the less developed among them—the backing they need in imposing obligations on investors. They would also remove the power of investor threats to locate in other, less regulated, jurisdictions.⁹⁷

4.3.3 Host state rights and obligations

IAs have generally shied away from articulating host state rights in the text of the agreements. It can be argued that this reluctance is not necessary. Indeed, the articulation of such rights would act as an interpretational balance to investor rights, without denying them.

The setting out of certain rights of host states does not mean that each host state will act on them in the same way. Indeed, the intent would be to provide a legal platform to make decisions most conducive to national development and sustainability strategies, recognizing the diversity of local and national conditions. For example, clearly articulating the right of a host state to enact *bona fide* regulations in the public interest does not require any particular type or scope of regulation to be enacted. It simply preserves the legal and policy space for host states to make appropriate decisions.

Table 3: Potential Host State Rights and Obligations

Host State	Pre-establishment	Post-establishment
Rights	■ Maintain development priorities	■ Maintain development priorities as agreed, under law
	■ Performance requirements (market disciplines)	■ Right to regulate in public interest (public welfare, environment, etc.)
	■ To establish high environmental/human health standards	
Obligations	■ Establish transparent legal and administrative processes	■ Not to reduce standards to maintain investment
	■ Anti-corruption	■ Non-discrimination, pay for expropriated property, due process, etc.
	■ Not to reduce environmental standards to attract investment	■ Prevent subversion of MEAs, international labour standards
	■ Prevent subversion of MEAs, international labour standards	

An IIA might also reiterate a host state’s right to undertake basic screening of investments to ensure that they accord with national, host state, priorities. Again, the exercise of this right, where it occurred, would reflect a combination of host state goals and available tools on the one hand, and the market for international investments on the other.

Host state rights can be balanced against a set of obligations as well. Indeed, many potential obligations correspond to the scope of potential foreign investor rights and responsibilities. For example, an obligation not to reduce standards to attract investment fits with the general corporate social responsibility requirements of foreign investors. Thus, building on the hortatory language in NAFTA,⁹⁸ IIAs might incorporate host state obligations against the reduction of environmental standards for the purpose of attracting investments. As well, both host states and home states should share the obligation to prevent corruption in a foreign investment context. These examples suggest a variety of opportunities for the proper balancing of rights and obligations of the three different actors. A possible list of host state rights and obligations is set out in Table 3.

A key responsibility of host states should be to establish and maintain institutions of good governance: that is, institutions capable of balancing private rights and public goods in a legitimate, transparent and accountable manner, such as a working judiciary. This may be a longer-term objective for many developing countries, especially least developed countries. At the same time, articulating such a vision allows greater opportunities for international support for this aspect of development.

4.3.4 Home state rights and obligations

Few investment agreements today include any recognition of an appropriate role for home states within an international investment regime, let alone actually articulating provisions for home state obligations. Arguably, however, all states—home states and host states alike—have an obligation to ensure that investors and investments respect the essential norms of sustainable development.

To this end, home states could support the development of the requisite institutions in developing countries by articulating minimum standards of conduct for their capital exporters. Some straightforward examples (as laid out in Table 4) could include standards for accounting and corporate reporting, anti-corruption laws, and environmental impact assessment rules (especially where government funds are involved).

Regulating corporate and individual conduct abroad is not new in national or international law systems. We already have examples such as the punishment of adults travelling to engage in the child sex trade. However, developing countries may rightly fear the investment constraining impacts of such an approach in the investment field. One answer to this concern is to work toward these types of standards at the international level, which would restrict opportunities for constraints harmful to promoting foreign investment and hence to development goals, while helping ensure that minimum standards of conduct are enforceable.

Table 4: Potential Home State Rights and Obligations

Home state	Pre-establishment	Post-establishment
Rights	■ Promote agreed terms	■ Assist investors ■ Subrogation of rights ■ State-state disputes
Obligations	■ Respect for basic norms of sustainable development ■ Anti-corruption obligations ■ Assist host states in institutional development	■ Respect for basic norms of sustainable development ■ Ensure impediments to liability of investor are removed ■ Anti-corruption obligations

A key practical difficulty in this area is defining the home state. Under current definitions, a firm from country A could incorporate in country B to then take advantage of a BIT between country B and country C. In effect, the firm adopts a new home state. This new twist on the flag of convenience phenomenon may make it desirable for firms to adopt home states that do not recognize or enforce home state responsibilities, but which are signatory to a large number of BITS.

4.4 Dispute settlement procedures

Section 2.1 argued strongly that, from a public welfare perspective, the current dispute settlement model displays shortcomings of transparency, legitimacy and accountability.

Both the BITS and the NAFTA include state-state dispute settlement processes in the investment field, using traditional inter-state consultation, arbitration or adjudication processes. One proposed solution to the shortcomings outlined above is the use of the WTO state-state model, with its appellate process in particular. This could be one useful approach, provided other transparency and public participation issues could also be addressed.

However, state-state dispute settlement is unlikely to prove sufficient in the context of investment disputes. Indeed, the absence of an investor-state reference in the Doha Ministerial statement was apparently one of the reasons leading business groups have sought to shore up the BITS against possible erosion by the WTO negotiations on investment.

The main reason for this is that disputes are not usually between a home state and a host state but rather between an *investor* and a host state. In most instances, the specific circumstances of the investment are central to the dispute, as opposed to a more systemic legal barrier to investment.⁹⁹ As well, history shows that state-to-state mechanisms are more easily distorted by politics and influence, according better treatment to large players than to small and medium-sized enterprises, and ever subject to the political dynamics of the moment. In other words, there are important arguments in favour of the investor-state dispute settlement mechanism, but irrefutable arguments against using existing models.

To go back to a previous statement, “investment agreements need not be only about liberalizing capital flows; these are largely, and increasingly, unconstrained. They should be about ensuring fair and equitable treatment of investors, and the proper balancing of private rights and public goods in a world of increasingly liberalized capital flows. And they should be about building domestic institutions capable of supporting this goal.”

In keeping with the goal of domestic institution building, a first recommendation is that the exhaustion of local remedies (that is, the requirement to first exhaust all domestic avenues for justice) should be reconsidered as a pre-requisite to investor-state arbitrations, returning to previous approaches in this area. This seems especially appropriate for countries where worries about corruption in the judicial system are absent—a goal that should be held out for all countries participating in IIAs. If the historic concern of corrupted judicial systems simply supporting government positions is increasingly less applicable, and the investor-state arbitration process is actually increasingly under challenge from within due to its loss of speed, finality and efficiency,¹⁰⁰ what rationale is ultimately left for the investor-state process as a tool of first resort?

Further, when the investor-state dispute settlement mechanism *is* called into play, it should meet basic standards of legitimacy, accountability and transparency throughout the dispute settlement process, from initiation of a complaint to publication of all decisions. Many open judicial models of this type exist in international law, in particular the European Court of Justice, the International Court of Justice, the International Criminal Court, the European Court of Human Rights and the Law of the Sea Tribunal.

While the United States has thus far not been willing to participate in the creation of any new global institutional framework, it has hinted at a more court-like approach to investor-state dispute resolution in its two most recent free trade agreements. As already noted, the Chile and Singapore Free Trade Agreements with the United States both include greater requirements for transparency in the procedures, though they maintain the current appointment process for arbitrators.¹⁰¹ However, both Agreements allow for a possible appellate mechanism to be introduced at some time, suggest-

ing more thinking on this is to come from the U.S. and their interlocutors. Thus, it is possible to foresee a multilateral tribunal and/or an appellate process geared specifically to issues of foreign investment agreements and customary international law standards.

IISD believes that the minimum requirements today for an investor-state process that meets basic tenets of transparency, legitimacy and accountability would include:

- a requirement for the exhaustion of local remedies, which implies stronger support for domestic institutions and institution building; and
- an investor-state process that respects basic democratic judicial principles of transparency, accountability and legitimacy:
 - has a standing body of panelists who are not encumbered by systemic or other potential conflicts of interest;
 - has proceedings that are open to the public;
 - has provisions for granting *amicus curiae* status to non-states;
 - has public access to all documents and claims; and
 - is subject to a sound appeal process.

While the above should be a hallmark of all future agreements, it should be noted that even existing agreements could in theory be relatively easily fixed to reflect these same principles. That is because, as far as the investor-state process goes, most agreements reference the ICSID and UNCITRAL arbitration rules. Should a process to amend these rules be undertaken to reflect these principles, almost all existing agreements would then, in practice, be amended as well. At the procedural level, therefore, fixing the existing flawed mechanisms is an inherently doable task.¹⁰²

Of course, however much the dispute settlement system might be improved, it is only as legitimate as the substantive law that it must apply; the types of reforms envisioned here are complementary to the substantive reforms proposed in the preceding section.

4.5 International investment institutions

Much attention has been focused over the past two years on the WTO as a forum for investment negotiations. With this likelihood now significantly diminished, the question arises, in its starkest terms, if not the WTO, then where?

While many observers believe that a multilateral investment agreement is not desirable, IISD has taken the view that the right kind of agreement is very desirable, and may even be an essential element in a global economic regime that takes sustainability seriously. If this view is correct, the next question is what should the institutional home for such a regime be? Should it be the WTO in Geneva? The World Bank perhaps, where the dispute settlement process through ICSID is already housed? The UN, perhaps as a related agency to UNCTAD? In reality, none of these options is especially satisfactory, as none of these institutions is really geared to housing the development and implementation of a global investment regime that is much broader and more complex than trade, more policy focused than a dispute settlement system, and must be less politicized in its operations than a UN agency.

The likely result is that a new agency, or at least a combined role for existing agencies, may be needed. Here, it is wise to refrain from a specific recommendation. IISD believes that the form should follow the function, rather than the other way around. It is only when the full scope of an agreement begins to materialize that the right home (or group of homes) can be assessed. But within this lies the key issue: no forum that cannot deliver a full, balanced, transparent and accountable regime should be chosen simply because it might be able to do part of the job. The building of the international investment regime to date has as its hallmark a fragmented, rudderless institutional base. Augmenting this with simply the most temporarily convenient institution will compound rather than fix the current problems.

Endnotes

- 83 Note the U.S. willingness to reform its model BIT, and the investment provisions of the recent FTAs, with respect to openness of the investor-state dispute settlement mechanism, and the limits put on the substantive obligations on expropriation and minimum international standards of treatment. This stands in contrast to the NAFTA context, where the Parties have only addressed the latter point, and have made limited attempts to address transparency in dispute settlement. It stands in even sharper contrast to the U.S.'s complete failure to amend past BITs in any of these respects.
- 84 Luke Eric Peterson, "US Administration Warns WTO on Inviolability of its Bilateral Investment Treaties," *INVESTSD News Bulletin*, May 9, 2003.
- 85 For an overview of these changes, see John Audley, "Environment's New Role in US Trade Policy," *Carnegie Endowment for International Peace, Trade, Equity and Development Series*, Issue #3, 2002. Available at http://www.ceip.org/files/pdf/TED_3.pdf.
- 86 Communication with Canadian Department of Foreign Affairs and International Trade, June 4–5, 2003.
- 87 NAFTA's Article 1131(b) gives the FTC the power to interpret Article 11: "An interpretation by the Commission of a provision of [Chapter 11] shall be binding on a Tribunal established under this section."
- 88 The statement can be found at <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>. For an analysis of what this statement contains, and its implications, see Aaron Cosbey, "Note on NAFTA Commission's July 31, 2001, Initiative to Clarify Chapter 11 Investment Provisions," Winnipeg: IISD, 2001 (<http://www.iisd.org/publications/publication.asp?pno=375>).
- 89 See *supra* at 12.
- 90 See http://www.dfait-maeci.gc.ca/tna-nac/nafta_commission-en.asp. For an analysis of these statements, see Howard Mann, "The Free Trade Commission Statements of October 7, 2003, on NAFTA's Chapter 11: Never-Never Land or Real Progress?" Winnipeg, IISD, 2003, available at <http://www.iisd.org/publications/publication.asp?pno=578>
- 91 See <http://www.dfait-maeci.gc.ca/nafta-alena/Nondisputing-en.pdf>.
- 92 See Luke Eric Peterson, "US-Singapore FTA Text Released; Investment Provisions Reveal Many Changes," *INVESTSD News Bulletin*, March 14, 2003, available at: http://www.iisd.org/pdf/2003/investment_investsd_march_2003.pdf.
- 93 "Understanding Concerning Certain U.S. Bilateral Investment Treaties," September 22, 2003, available online at: <http://www.useu.be/Categories/US&EUEnlargement/Sept2203BITsUnderstanding.html>.
- 94 A number of others have previously made this same argument. See, for example, Zampetti and Fredriksson, *supra* at 68; and UNDP *supra* at 81.
- 95 See Manuel R. Agosin and Ricardo Mayer, "Foreign Investment in Developing Countries: Does it Crowd in Domestic Investment?" UNCTAD Discussion Paper 146, Geneva, 2000 (http://www.unctad.org/en/docs/dp_146.en.pdf); and Kevin P. Gallagher and Lyuba Zarsky, "Sustainable Industrial Development? The Performance of Mexico's FDI-led Integration Strategy," Global Development and Environment Institute, Tufts University, 2004 (<http://ase.tufts.edu/gdae/Pubs/rp/MEXICOFDIREPORT11-03.pdf>).
- 96 This section draws heavily on work first undertaken for the IISD collaboration with the Royal Institute of International Affairs: "Investment, Doha and the WTO," Background paper to the Chatham House meeting convened by IISD and RIIA: Trade and Sustainable Development Priorities Post-Doha, London, April 7–8, 2003. As well it draws on Konrad von Moltke, "A Model International Agreement for the Promotion of Sustainable Development," paper prepared for the Swiss Agency for Development Cooperation, Winnipeg: IISD, 2003.
- 97 This is the free-rider problem, evident in the case of FDI to an extent that it is not in the case of tobacco control.
- 98 NAFTA Article 1114(2) says in part: "The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from... such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor."
- 99 This broader type of dispute has in fact recently been litigated on a state-state basis under NAFTA. In the Matter of Cross-Border trucking Services, North American Free Trade Agreement, Arbitration Panel Pursuant to Chapter 20, Secretariat File No. USA-MEX 98-2008-01, Final Report of the Panel February 6, 2001.
- 100 E.g., Charles Brower, "A Crisis of Legitimacy," *National Law Journal*, October 7, 2002, p. 1.
- 101 See Singapore-United States Free Trade Agreement, <http://www.ustr.gov/new/fta/Singapore/final.htm>; Chile-United States Free Trade Agreement, <http://www.ustr.gov/new/fta/Chile/final/index.htm>.
- 102 As noted above, however, the UNCITRAL rules (unlike those of ICSID) are used almost exclusively for commercial arbitration—business to business. It is highly unlikely that these rules would be changed to reflect the difficulties encountered in the relatively few UNCITRAL cases that arise from IIAs.

5. Conclusions

Investment is of critical importance to sustainable development. Without the right kind of investment we will not replace current unsustainable economic structures with those that tread more lightly on the earth, and we will not manage to lift the mass of humanity out of the poverty in which it now exists. But, as this book has argued, the need is to focus on quality investment, and to do so in a manner that does not unduly restrict the ability of states to act and regulate in the public interest.

We noted that the thousands of existing IIAs for the most part share certain problems of process and substance that, taken together, threaten to limit the valuable policy space for actions in the interest of development and the environment. And we argued that fixing these problems may be difficult given the complexities involved in amending any given treaty, particularly in the politically-charged context that has seen the spectacular failure of a number of major attempts to multilateralize rules for investment.

In the end, it comes down to this: if we hope to have investment serve sustainable development we need a new breed of IIA, one that focuses on this objective as a starting point. We have begun here to speculate as to the shape of such an agreement, and have also highlighted the significant obstacles to be surmounted by any attempt to bring such agreements into force. These obstacles may be daunting in the short term. But a clear-headed look at the fundamentals—the reason we value investment in the first place, and what we hope it might accomplish—will necessarily lead us in this direction.

**Investment and
Sustainable
Development**

A Guide to the
Use and Potential
of International
Investment
Agreements

Investment and Sustainable Development

This book looks at the role international investment agreements have, and *might* have, in fostering sustainable development. Such an analysis is long overdue; it is becoming ever more widely accepted that the proper goal in attracting investment is *quality*, rather than *quantity*. In the end if investment does not increase well-being on a sustainable basis, it is not worth having, much less chasing.

How do the current agreements measure up in such a framework? Not well. There are currently over 2,000 bilateral investment treaties in force. There is also a growing number of investment agreements folded into broader trade agreements, NAFTA's Chapter 11 being the best known. All suffer from three critical faults.

First, the investor-state dispute settlement mechanisms found in these agreements are—to varying degrees—non-transparent, unaccountable and illegitimate. This is particularly worrying when the cases deal with matters of public policy, such as states' right to regulate and tax in the public interest. Second, the rules contained in the agreements are being argued and interpreted in ways that tip the balance toward investors' rights, and away from non-commercial policy objectives such as environment and public health. Third, the agreements do nothing to ensure the quality of the investment—a problem particularly in those states where the domestic institutions for doing so are weak.

Grounded in the International Institute for Sustainable Development's extensive body of work on investment and sustainable development, this book explores these problems, and explores the ways in which a new breed of agreements might address them.

